IS FRANCHISING ABANDONING ARBITRATION?
CURRENT TRENDS IN ARBITRATING FRanchise DISPUTES

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Introduction

Franchise lawyers love to debate issues, and one of their favorite debates seems to be whether arbitration is good or bad. Some might think this debate would always break into franchisor counsel (arbitration=good) versus franchisee counsel (arbitration=bad), but that is not the case. Discussion on the ABA Forum Listserv in recent years has shown a dichotomy of opinions, even within the ranks of franchisor counsel, as to whether arbitration is the way to go. There are plenty of points to debate on the topic. And the debate is not limited to franchise lawyers who struggle with arbitration issues—franchise lawyers have clients and clients have cases in courts. Courts, therefore, get involved too, as judges get called upon to express a much more official and meaningful opinion on the topic of whether arbitration is good or bad. Courts in recent years have been as active as ever in answering the arbitration-related questions that come to them.

Amidst all of the debate and judicial activity, it seems possible that arbitration is losing ground as a chosen method of dispute resolution in franchising. Using a recent empirical study as a backdrop, this paper will explore whether franchising is moving away from arbitration and what reasons may exist for an increased dislike of arbitration by franchisors, franchisees, or the courts. A description of pending legislation and new case law will follow. Next, the paper will describe and compare the many entities that provide administration services for parties that have cases to be arbitrated. We provide this information on the theory that it may not be the concept of arbitration itself that fuels dislike of the process, but rather the way the process is or was administrated in a particular case. Lastly, this paper provides ideas for improving arbitration for those who still think it has redeeming qualities and/or cannot avoid arbitration.

Discussion

1. IS THERE A “FLIGHT FROM ARBITRATION” GOING ON?

In a recent empirical research project, the authors examined whether companies did in fact flee from arbitration in the last decade. Drahozal & Wittrock, “Is There a Flight from Arbitration?”, 37 Hofstra L. Rev. 71 (Fall 2008). Franchise contracts were the basis for the research, thanks to their availability on file with state franchise examiners. The study sampled the agreements of seventy-five leading franchises in the years 1999 and 2007. The franchisors represented larger businesses from a cross-section of the franchise industry. In short, while noting several anecdotal reports of dissatisfaction with arbitration, the recent research demonstrated no appreciable shift away from arbitration in business franchise contracts. Whereas 45.1 percent of the franchise agreements in 1999 included arbitration clauses, 43.7 percent did so in 2007. The finding of this Hofstra Law Review project article thus differed from the message of an earlier, non-franchise article by Eisenberg and Miller entitled “The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies,” 56 DePaul L. Rev. 335 (2006).

Since franchisors draft the contracts, the Hofstra Law Review project studied the change in number of contracts with arbitration clauses to determine whether franchisors have fled from arbitration. The data show no material net change in the overall number of franchisors using an arbitration clause, although several franchisors did change from an arbitration clause to a forum selection clause, or vice versa. Thus while no significant net flight actually took place, the shift in dispute resolution practices of a few franchisors and the strong feelings of a few franchise lawyers may have given rise to the impression of a shift away from arbitration that has not materialized to date.
The Hofstra Law Review project also attempted to measure franchisee movement away from arbitration by examining the change in number of franchised units per franchisor with each type of dispute resolution clause. This assumes that franchisees could express their preference for dispute resolution forum in negotiation of the final contract, or by refusing to enter into the franchise agreement at all. The data show a 2.7 percentage point increase in the portion of franchised units operating under a franchise agreement that contains an arbitration clause, but an even larger increase (8.6 percentage points) in the share of franchise locations with exclusive forum selection clauses. Although the percentage of franchisees with arbitration clauses increased noticeably less than the increase in franchisees with forum selection clauses, the difference is not large enough to constitute a flight from arbitration.

Rather than fleeing arbitration altogether, the Hofstra Law Review project also considered the possibility that franchisors merely modified specific provisions in their arbitration clauses, resulting in a partial flight from arbitration. With regard to arbitration provider, the project found some shift away from the American Arbitration Association, and the data also show a move toward specifying use of a sole arbitrator. Class arbitration and the use of carve-outs to exempt some types of claims from arbitration both increased over the relevant time period. The use of time limits on claims and limitations on punitive damages also increased. On the other hand, provisions regarding discovery, judicial review of awards, location of the proceedings, and allocation of costs showed no change between 1999 and 2007.

Although the project revealed some movement away from certain parts of arbitration, the empirical research uncovered little evidence of a net flight from arbitration. The project did find individual franchisors and franchisees that changed the type of dispute resolution clause used, and the data show modifications in some aspects of arbitration. These changes, coupled with anecdotal information, may explain the perception of a flight from arbitration.

a. What People Like About Arbitration

There can be benefits to using arbitration as a method of dispute resolution. Arbitration is touted as a method for resolving disputes more efficiently than litigation, saving both money and time. In addition, arbitration provides the parties with the ability to control the process. The parties can draft an arbitration clause to predetermine the requirements for choosing an arbitrator as well as the procedure to be followed. A determination of the case after an arbitration hearing, with only a limited right of review, provides finality that does not exist in the trial stages of a litigation.

i. Cost Savings

Depending on the administrative organization used and the individual arbitrator or arbitrators, there may be a substantial cost savings by arbitrating disputes. Among other

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3 For sake of simplicity, reference in this paper to a single arbitrator is intended to also apply to a panel of arbitrators.
things, costs are reduced because discovery tends to be limited in arbitration proceedings.\(^4\) Attorney’s fees and costs associated with attorney time spent preparing and responding to written discovery demands are lower. Additionally, the often curtailed ability of the parties to take depositions reduces attorney’s fees associated with preparing for, taking, and defending multiple depositions. Avoiding motions saves arbitrator and attorney fees as well.

Moreover, arbitration often permits conferences between counsel and the arbitrator via telephone, and conferences and arbitration hearing dates are scheduled for certain dates based on the availability of the parties and their counsel. This process can dramatically reduce costs that may be incurred in litigation when counsel are required to prepare for and appear in court only to have the conference or trial adjourned. The franchisee may also save money because unlike in litigation and except in rare circumstances such as arbitrations occurring California,\(^5\) the franchisee will not have to hire local counsel if lead counsel is from out of state.\(^6\)

### ii. Time Savings

By arbitrating their disputes, the parties can save valuable time as well. As indicated above, arbitration generally limits discovery and motion practice. As a result, the hearing can be held relatively soon after the claims and responses are filed and an arbitrator is chosen. In litigation, it is not uncommon for a defendant to file pre-answer motions which can take a court months to decide. Thereafter, assuming the complaint survives the motion, the parties are likely to engage in extensive discovery that may take months or even years to complete. Once discovery is completed, either or both of the parties are likely to move for summary judgment and it can take months for the parties to submit motions and receive a decision. It is only after the completion of discovery and dispositive motion practice that a case can be set for trial and depending on the court’s docket, it can take months for the parties to get a trial date.

Conversely, in arbitration, there is often limited discovery and motion practice. Once the parties choose an arbitrator, a schedule is usually set and hearing dates are chosen. The hearing can therefore occur within months of the filing of an arbitration demand.

### iii. Greater Control of the Proceeding and Outcome

Another benefit to arbitration is the parties’ opportunity and ability to control the process. For instance, the parties are able to control who the arbitrator will be. An arbitration clause may be drafted to ensure that an arbitrator will have certain qualifications. The parties are also able to predetermine the procedures they will use in the arbitration.


\(^6\) See Michael Einbinder & Dean Fournaris, Litigation About Arbitration, American Bar Association Forum on Franchising (2008). Julie Lusthaus is a partner in the firm of Einbinder & Dunn, LLP in which Michael Einbinder is also a partner.
(1) Selection of the Arbitrator

When the parties have the ability to select the arbitrator or to require that he or she have certain experience, they are more likely to ensure that the dispute is heard by someone knowledgeable about franchising or the particular industry involved. In that case, the arbitrator may be better able to make educated and informed decisions. Alternatively, in litigation, parties cannot choose the trial judge, and the judge assigned may not be as knowledgeable about the franchise relationship.

(2) Procedure

A significant benefit to arbitration is the ability of the parties to determine the rules they are going to follow. For instance, they can choose to limit discovery and motion practice. They can choose to apply relaxed rules of evidence. They can choose to allow witness affidavits or telephonic appearances in lieu of in-person testimony. In court, the parties must follow not only the procedural rules of the jurisdiction, but also the judge’s local rules and strict rules of evidence. In addition, from a franchisor’s perspective, the ability to incorporate uniform arbitration procedures in its franchise agreements may result in a more streamlined, efficient method for its counsel to arbitrate disputes with franchisees. 7

iv. Finality of the Dispute

Once the arbitration hearing date is set, the parties can have some comfort in the knowledge that that they will have a final decision with a certain time frame. 8 With court cases that are heard by a judge (as opposed to a jury trial where the determination is made directly after the submission of all evidence) the parties may wait months to receive a decision. In addition, the Federal Arbitration Act ("FAA") only provides for limited judicial review of arbitration decisions. 9 The deference given to arbitration awards is "designed to prevent the arbitration process from being ‘transformed from a commercially useful alternative method of dispute resolution into a burdensome additional step on the march through the court system’." 10 As a result, there is more likely to be a finality to the dispute upon receipt of the arbitrator’s determination. With litigation, the parties can sometimes engage in multiple rounds of appeals before the matter is finally resolved.

b. What Franchisees Dislike about Arbitration

There are possible benefits to arbitration which would cause franchisees and their attorneys to want to arbitrate their disputes with franchisors. When conducted as intended, arbitration proceedings provide a method to resolve a dispute in a cost-efficient and time-

7 See Einbinder, supra note 4.


efficient manner. Unfortunately, franchisees and their counsel do not often have meaningful 
input in determining the arbitration procedures the parties will follow and franchisees are often 
unable to realize these goals. In addition, there are other reasons why franchisees may not want 
to arbitrate their franchise disputes, such as limits on class arbitration and fewer opportunities 
for settlement. Of course, where franchisees and their counsel have input in the drafting 
process, the arbitration is more likely to meet the franchisee’s goals and expectations.

i. Costs

Notwithstanding its initial intended consequence of low cost dispute resolution, 
arbitration can be quite costly, often more costly than litigation where a party is required to pay a 
minimal filing fee and is not required to pay the judge’s salary. Where an arbitration agreement 
requires use of an administrative agency, the party initiating the arbitration must pay fees to the 
agency before the arbitration can be commenced. For instance, the American Arbitration 
Association (“AAA”) requires fees to be paid at various stages in the proceeding. These fees 
range from $750 to more than $65,000, depending on the amount of the claim.11 On the lower 
end of the spectrum but still greater than most court filing fees, Franchise Arbitration and 
Mediation Services (“FAM”) currently charges $950 to commence a proceeding with a single 
arbitrator and $1,900 to commence a proceeding with multiple arbitrators.12 A franchisee who 
wants to pursue claims against the franchisor when arbitration is required, often must pay 
thousands of dollars in up-front fees. This factor alone can impact a franchisee’s ability to 
pursue its claims against the franchisor, which may have been the reason the franchisor 
cluded the arbitration provision.

Perhaps the most substantial added expense to arbitration is the arbitrator’s fees. 
Arbitrators are often attorneys or retired judges who charge hourly rates to serve as arbitrators. 
These rates run several hundred dollars per hour and there is often no review or control over 
these costs, though FAM caps arbitrator fees at $500 per hour.13 The fees charged by the 
arbitrator are usually shared by the parties, at least initially, and these fees are often required to 
be paid prior to the arbitration hearing. Where there are three arbitrators, the parties must pay 
three hourly rates. Arbitration hearings can take days to complete causing the parties to spend 
thousands of dollars (in addition to their counsel’s fees) just to have the dispute heard.

ii. Speed

Arbitration was also intended to be a more efficient method of dispute resolution. 
Hearings were to be conducted after very limited discovery and motion practice. These days, 
however, franchisors may draft arbitration clauses to include discovery similar to that provided 
by the Federal Rules of Civil Procedure and some administrative organizations actually provide 
for discovery where the parties’ arbitration agreement is silent on the issue.14 The result is that 
arbitration proceedings can take as long as litigation.

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11 See AAA Commercial Rules, at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).
13 Id.
14 See generally AAA Commercial Rules, at http://www.adr.org/sp.asp?id=22440 (June 1, 2009); JAMS 
Comprehensive Rules, at http://www.jamsadr.com/rules-comprehensive-arbitration (July 15, 2009); CPR Non-
Administered Arbitration Rules, at
iii. No Class / Group Arbitration

Arbitration agreements often limit a franchisee’s right to proceed on a class basis or in group arbitration. Indeed, franchisors often use an arbitration clause in an attempt to preclude class actions.\(^{15}\) Similar to the joinder of claims in a court action, group arbitration would permit multiple franchisees with similar claims against the franchisor, to join together to pool their resources in the fight against the franchisor. The franchisees would benefit greatly from sharing the expenses of the fight. In addition, the franchisees benefit by sharing strategy and information relating to their claims, the franchisor and the franchisor’s defenses to the claims. When arbitration agreements prevent group arbitration, franchisees are forced to incur the expenses and burdens on their own, such as the costs for each arbitrator, though they still have the benefit of sharing strategy and information.

iv. Limited Judicial Review

Another concern of franchisees is that judicial review of arbitrator awards is limited. While franchisees have been successful in arbitration, if a franchisee believes the arbitrator decides a matter incorrectly, the only recourse may be to challenge the determination based on the grounds that the award was procured by corruption, fraud or undue means.\(^{16}\) Overturning an arbitration decision requires meeting a difficult burden (See Section II.C.). As a result, and often due to the costs involved, franchisees may be unable to pursue judicial review of arbitrator decisions.

v. No Jury

Arbitration, by its nature, precludes jury trials which franchisees and their counsel historically prefer. Juries are often thought to be friendly to the “small franchisee” trying to make it in business. Most franchisees believe that a jury will be more sympathetic to their story and will potentially award higher amounts for damages than arbitrators. Further, many franchisees and their counsel expect that arbitrators, particularly those with big firm backgrounds, will relate more readily to franchisors.\(^{17}\)

vi. Fewer Opportunities for Settlement

Some franchisee counsel find that there are fewer opportunities for the parties to engage in meaningful settlement discussions before the arbitration hearing. Generally, there are stress points in litigation where parties may be more amenable to settlement. Cases may be more likely to settle when the parties (and their counsel) are required to spend time and money on the case or when they are facing an immediate risk of a bad decision. Thus, just prior to extensive discovery, such as lengthy depositions, the parties may be more inclined to discuss settlement to avoid the costs. Similarly, parties facing motions for summary judgment may be more open to engaging in settlement discussions.


\(^{15}\) Recently, however, these clauses are being challenged with increasing success. (See Section II.A.).

\(^{16}\) See 9 U.S.C.A. § 10 (West 2009).

\(^{17}\) See Einbinder, supra note 4.
With arbitration, where discovery and motion practice are often limited, there are fewer defined events during the arbitration that can affect the costs or outcome of the arbitration. As a result, the parties may be less likely to engage in meaningful settlement discussions during the process.

c. What Franchisors Dislike about Arbitration

Franchisors also point out a variety of reasons why they dislike arbitration, or at least why they prefer litigation for certain cases. These reasons can be grouped into at least four categories, as discussed below.

i. Disappointing Experiences

To the extent that companies have moved away from arbitration, they generally have done so in reaction to disappointing past experiences. For example, a franchisor may have found that arbitration involves higher costs and a lengthier process than initially expected. They may also experience disappointment with the results and may choose to blame the arbitration process. The areas of disappointment can be summarized as follows:

(1) Cost

While franchisors often expect cost savings from arbitration, many have not experienced those savings. As mentioned above, arbitration often requires large, up-front filing fees and advance payments to arbitrators. The fact-finding process can also lead to costs that are higher than expected. For example, when arbitrators allow extensive document production, especially searching in physical storage facilities or extensive electronic searching, costs increase in particular for the franchisor, as it generally is the party with the most documents to be produced. Depositions also raise the cost of arbitration. Franchisors may have also experienced larger-than-expected costs where arbitration leads to collateral litigation regarding enforcement of the arbitration clause, or where a dispute erupts from a court action to confirm the award.

(2) Speed

To the extent that the arbitration process works more like litigation, for example when significant fact-gathering or motion practice takes place, arbitration may not proceed much more quickly than litigation. Just as with franchisees, the length of the process may frustrate franchisors’ expectations.

(3) Results

Parties to any dispute resolution procedure will often be disappointed with the results. At the end of the case, even the more successful party may feel it did not win as much as it wanted or won at too high of a cost. Even more so in arbitration, particular aspects of the process may cause parties to feel they would have fared better in court. For example, the procedural limitations on discovery and motion practice may cause a party to feel it had only a partial hearing. Arbitration decisions also are more final than litigation due to general inability to appeal from an award. Lastly, parties hoping for a complete victory may find less satisfaction with the arbitration process, which results in smaller-than-claimed awards, partial victories, or split decisions more often than litigation. These factors may all lead to companies’ disappointment with the results in arbitration proceedings.
ii. Enforcement Battles

One of the obvious downsides of arbitration is that a franchisor often must fight extraneous, preliminary procedural battles in an attempt to enforce an arbitration provision. As discussed elsewhere in this paper, these collateral disputes can turn on whether the arbitration provision is unconscionable or unenforceable for some other reason. The cost and difficulty of this fight often leaves franchisors and their counsel wondering if the battle is worth the cost.

iii. Procedural Shortcomings

As a general rule, litigation may in fact provide benefits for franchisors that the arbitration process does not allow. These benefits may help explain reports of business dissatisfaction with the arbitration process and any perceived shift away from arbitration clauses in franchise contracts. Frequently-noted procedural attributes that are more prevalent in court proceedings include:

1. Injunctive Relief

Arbitration processes typically cannot provide emergency relief to parties, or at least, as a practical matter, cannot provide a clear and quick procedure for injunctive relief. This is true despite rules such as the AAA’s Optional Rules for Emergency Procedure. Also, many dispute resolution clauses in franchise agreements expressly exempt injunctive relief from the requirement to arbitrate. For these reasons, franchisors seeking emergency injunctions or restraining orders generally must rely on the court system. Even when arbitration bodies do have emergency panels to hear urgent cases, the procedures are not widely used and do not work as well as the courts.

2. Discovery

Typically, arbitration allows for only limited discovery. This might lead a franchisor to feel it was unable to uncover useful evidence and fully prepare for the hearing.

3. Summary Judgment

Some arbitrators do not allow or appear to give serious consideration to summary judgment. Many arbitration proceedings do not allow motions for summary judgment. Defense attorneys particularly like summary judgment since it can result in the dismissal of a claim without the need for a trial, or at least it forces a plaintiff to disclose some information about its case in response to the motion. Even if arbitrators allow motions for summary judgment, parties in arbitration tend to be much less successful on their motions. Some believe that one possible reason for this phenomenon is that arbitrators receive fees from each case and therefore might be reluctant to dismiss a case and cut off their source of payment.

4. Rules of Evidence

Since state and federal rules of evidence do not inherently apply in arbitration proceedings, lawyers may feel arbitration does not provide the same level of procedural protection as litigation. Of particular concern may be the inability to exclude certain types of evidence—such as prior bad acts or how other franchisees allegedly were treated—that may hurt the franchisor’s case.
(5) Post-trial Motions

Arbitration proceedings typically allow fewer post-hearing requests for relief along the lines of court motions for judgment notwithstanding a verdict or for a new trial. Hence, attorneys may feel they have less effective procedural tools at their disposal, and franchisors who are disappointed with the results of arbitration have fewer avenues for recourse.

(6) Appeals

At least half of all parties (i.e., those who consider themselves to have lost the case) likely also lament the inability to appeal from the decision in arbitration. The issues related to the appeal of arbitration decisions are discussed in Section II.C. of this paper.

(7) No Need to File Action to Confirm the Award

Some arbitration proceedings require (and allow) the parties to file an action with the court to confirm an award by the arbitrator. This step adds to the cost and the length of arbitration proceedings. It also removes another of the benefits of arbitration: not having to go through a public court to obtain a decision.

iv. Friction Caused in the System or Impact on Franchise Sales When Franchisor Requires Arbitration

Franchisors may also have concerns regarding franchisee perception of the use of arbitration clauses. Franchisee and consumer advocates cite a number of reasons for opposing arbitration, as discussed elsewhere in this paper. This negative perception of arbitration may lead franchisees to be wary of franchisors that require arbitration, which may, in turn, hurt franchisors’ ability to sell franchises. Franchisee perception that arbitration is unfair to franchisees also may contribute to friction between the parties to a the relationship.

d. Arbitration Fairness Act of 2009

Empirical data aside, pending legislation may hasten a flight from arbitration by franchisors. The Arbitration Fairness Act (“AFA”) is legislation that, if enacted into law, will invalidate pre-dispute arbitration agreements for employment, consumer, and franchise disputes. Additionally, the validity or enforceability of an agreement to arbitrate shall be determined by a court, under federal law, rather than an arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement. The AFA is intended to modify the Federal Arbitration Act based on the belief that mandatory arbitration is a poor system for protecting civil rights and consumer rights because it is not transparent. The AFA notes in its findings, “[w]hile the American civil justice system features publicly accountable decision makers

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16 See AAA Commercial Arbitration Rule R-48(c)(parties consent to court jurisdiction to enter judgment upon the award).
20 Id. at Section 4(c).
who generally issue written decisions that are widely available to the public, arbitration offers none of these features.\textsuperscript{21}

The definition of a “franchise” under the AFA does not mirror the Federal Trade Commission’s (“FTC”) definition. The definition of “franchise” used in the AFA differs in one important way from the definition propounded by the FTC. The FTC’s definition of a “franchise” requires the payment of $500 or more to the franchisor at any time before to within six months after the franchisee's business opens,\textsuperscript{22} while the AFA’s definition contains no minimum fee that must be paid to qualify as a franchisee.\textsuperscript{23} In addition, the AFA expressly recognizes the payment of indirect franchise fees as sufficient to meet the statutory definition,\textsuperscript{24} but does not define what constitutes an “indirect fee.”\textsuperscript{25} The differences between the FTC Rule and the AFA are likely to cause confusion unless Congress takes steps to address the inconsistencies before the AFA’s enactment.

Irrespective of the outcome of the vote on the AFA, a second bill moving through Congress this session could also implicate franchise relationships. The Consumer Fairness Act of 2009 (“CFA”) also would avoid pre-dispute arbitration agreements.\textsuperscript{26} The CFA deems such agreements to constitute unfair and deceptive trade practices, and would apply retroactively to contracts entered into before enactment, if a dispute under the contract arises after enactment.\textsuperscript{27} The CFA defines “consumer” very broadly and applies to “consumer transactions” defined as “the sale or rental of goods, services, or real property including an extension of credit, or the provision of any other financial product or service, to an individual in a transaction entered into primarily for personal, family, or household purposes.”\textsuperscript{28} While the CFA’s apparent limitation to transactions of a “personal, family, or household” purpose might seem to exempt franchise relationships, the widening net cast by Little FTC Acts over the years suggests that the CFA’s application might similarly expand. With the retrospective nature of the CFA, the passage of the Act and the AFA together would mark a significant turning point in the arbitration of franchise disputes. Sophisticated businesses, which were once able to limit disputes to arbitration, would be left with no option but to litigate disputes with their franchisees in open court.

2. THE COURTS’ INFLUENCE ON ARBITRATION

While the empirical data does not reveal a clear trend away from arbitration by franchisors, recent case law indicates that some courts may be chipping away at this method of dispute resolution. Among the most hotly contested arbitration cases before the courts over the past few years have involved the enforceability of class action waivers, unconscionability challenges, and the scope of judicial review. Arising at the commencement and the conclusion

\textsuperscript{21} Id. at Section 2(5).
\textsuperscript{22} 16 C.F.R. 436.2(a)(3).
\textsuperscript{23} H.R. 1020 111th Congress (2009) at Section 3(5).
\textsuperscript{24} Id.
\textsuperscript{25} Id.
\textsuperscript{26} H.R. 991 111th Congress (2009).
\textsuperscript{27} Id. at Section 1003(b).
\textsuperscript{28} Id. at Section 1002(2).
of a legal dispute, an adverse decision on an arbitration agreement’s enforceability in whole or in part, or a vacated or modified award can have tremendous implications for franchisors and franchisees alike. All three issues have been the subject of much recent judicial debate and outright disagreement.

a. Class Action Waivers

Two of the federal circuits, the Second and the Third, have weighed in this year on enforcement of class action waivers in arbitration agreements. Though the two courts’ analyses differed—the Second Circuit decision arose under the FAA while the Third Circuit’s decision arose under state unconscionability laws—both found grounds to strike the waivers.

The dispute in the case of *In re American Express Merchants’ Litigation* arose when merchants filed several class actions in California and New York against American Express claiming illegal tying arrangements under federal antitrust laws. The cases were later consolidated in the Southern District of New York. The merchants’ agreements with American Express included a mandatory arbitration provision that contained a waiver of class actions. American Express responded by moving to compel arbitration and uphold its agreements’ class action waivers. Ruling in favor of American Express on the issue of arbitrability, the district court held that the broad scope of arbitration provision governed the parties’ dispute. On the issue of the class action waiver specifically, the court observed that the Clayton Act’s remedies of treble damages, attorneys’ fees and costs would assist claimants in their recovery and thus would not prevent the merchants from proceeding individually. In dismissing their complaints, the court held that the arbitrator should determine the enforceability of the class action waiver, noting that “[i]ssues relating to the enforceability of the contract and its specific provisions are for the arbitrator, once arbitrability is established.”

On appeal, the Second Circuit Court of Appeals reversed the district court on the narrow issue of whether the class action waiver provision in the parties’ agreement should be enforced. The court noted that “Section 2 of the FAA, 9 U.S.C. § 2, ... provides that an agreement to arbitrate ‘shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.’” The FAA’s Section 2, the court observed, “create[s] a body of federal substantive law of arbitrability.” Applying federal substantive law, the court found that a valid ground existed to revoke the class action waiver because enforcing the waiver “would grant Amex de facto immunity from antitrust liability by removing the plaintiffs’ only reasonably feasible means of recovery.” A persuasive factor in reaching its decision was the affidavit of the merchants’ economist expert, who opined that pursuing claims individually would be cost prohibitive in that the costs associated with expert services and a report alone could exceed $1 million. In reversing the district court’s judgment, the appeals court did not rule on the severability of the waiver clause from the agreement since

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29 554 F. 3d 300 (2d Cir. 2009).
31 The Second Circuit emphasized that its ruling was limited to a statutory rights analysis, part of the federal substantive law of arbitrability, and did not involve an unconscionability analysis under state law.
32 *Id.*, at 312.
33 *Id.*
34 *Id.*, at 320.
the plaintiff class had declared themselves willing to arbitrate the dispute; however, it remanded the case to the district court to allow American Express the opportunity to withdraw its motion to compel arbitration.35

The application of state law, rather than federal substantive law, led the Third Circuit to strike down a class action arbitration waiver in *Homa v. American Express Company.*36 The *Homa* plaintiffs, a putative class of American Express cardholders, filed suit against American Express under the New Jersey Consumer Fraud Act for alleged misrepresentations of its “Blue Cash” cash back rewards program. The cardholder agreements contained a mandatory arbitration provision that required all claims to be arbitrated on an individual basis and barred class action arbitration. In addition, the choice of law clause stated that Utah law governed any disputes. American Express moved to compel arbitration and enforce the class action waiver under Utah law that expressly upholds such waivers. The cardholders resisted the application of Utah law claiming that it would violate New Jersey public policy to enforce the waiver. The district court dismissed the plaintiff class’s complaint with prejudice in favor of individual arbitration. The Third Circuit reversed. At the outset of its opinion, the Court tackled the threshold determination as to “whether the Federal Arbitration Act (‘FAA’), 9 U.S.C. §§ 1-16, precludes this Court from applying state law unconscionability principles to void a class-arbitration waiver. We conclude that it does not.”37 Applying the law of the forum state, the court held that “the class-arbitration waiver violates fundamental New Jersey public policy as applied to small-sum cases,” and remanded the case to the district court for further proceedings.38

While neither the Second or Third Circuits decisions sound the death knell for class action waivers in franchise agreements, they do suggest that franchisee counsel are likely to more strenuously resist their inclusion in their client’s agreements and to attack the waivers should litigation erupt. Franchisors and their counsel should be prepared to defend the propriety of class action waivers during the negotiating phase of the relationship and respond to legal challenges by focusing on the unique economic features of the franchise relationship that distinguish them from the standard consumer transactions at issue in recent cases striking down class action waivers.

b. Unconscionability

*Nagrampa v. MailCoups, Inc.*,39 continues to cast a long shadow over courts wrestling with the issue of unconscionability in arbitration agreements. The California Supreme Court in *Nagrampa* refused to the enforce the arbitration provision in a California franchisee’s agreement on the grounds of unconscionability. The Court based its ruling on the arbitration agreement’s clause permitting the franchisor to seek a provisional remedy in court which resulted in a lack of

35 Id., at 321.
36 558 F. 3d 225 (3d Cir. 2009).
37 Id., at *1, citing Doctor’s Associates, Inc. v. Casarotto, 517 U.S. 681, 687 (1996)(“generally applicable contract defenses, such as…unconscionability, may be applied to invalidate arbitration agreements without contravening §2.”).
38 Id., at *6. For purposes of the appeal, the appellate court accepted as true the class members’ contention that their individual claims were of low value, but Judge Weis’ concurring opinion noted that since the case below was decided on a Rule 12(b)(6) motion, “the question of unconscionability under New Jersey law remains open for consideration on remand.” Id., at 233.
39 469 F. 3d 1257 (9th Cir. 2006).
mutuality and another clause situating the venue for disputes in Boston. Noting that California courts have ruled that no “legitimate business justification” exists for denying one party the right to obtain judicial redress and because the “parties bargaining positions were unequal, resulting in an oppressive contract of adhesion containing a forum selection clause”, the court found the franchise’s arbitration agreement unenforceable.

One by-product of Nagrampa has been courts’ efforts to uphold arbitration agreements subject to modifying them to excise unconscionable terms. In IJL Dominicana S.A. v. It’s Just Lunch Int’l, LLC, a group of franchisees sued franchisor, It’s Just Lunch. The franchisor sought to compel arbitration and the franchisees responded that the franchise agreement’s arbitration provision was unenforceable under the Ninth Circuit’s decision in Nagrampa. In reviewing the clause first for procedural unconscionability, the court found that the clause withstood challenge because the clause was printed in the same manner as the contract’s other provisions, was identified in the agreement’s index and, in fact, had been read by the franchisee. Substantively, however, the court found the clause unconscionable because it barred awards for punitive and exemplary damages, as well as class and consolidated actions. Despite the presence of these terms, the court did not find the arbitration agreement to be so imbued with unconscionability as to be rendered unenforceable and instead severed the unconscionable terms and upheld the remainder of the arbitration agreement.

Efforts to avoid Nagrampa’s reach, such as by providing for a state’s law other than California’s to govern the parties’ franchisee agreement, have met with mixed results. In Bencharsky v. Cottman Transmission Systems, LLC, a California franchisee sued Cottman for a variety of tort and contract claims following the franchisor’s failure to renew the franchise agreement under the Cottman trade name. Cottman moved to stay and compel arbitration, but the franchisee resisted claiming that the franchise agreement’s arbitration provision was unconscionable. The franchise agreement contained a Pennsylvania choice of law provision. Nonetheless, the California district court refused to apply Pennsylvania law on the grounds that application of that state’s law would prohibit application of the California Franchise Investment Law (“CFIL”) and thereby violate fundamental state policy. Next, applying the “crux of the complaint” test applied in Nagrampa, the district court ruled that since the challenge was solely to the validity of the arbitration clause, the issue should be decided by the court, rather than the arbitrator. Although the district court ultimately upheld the arbitration provision, it did so only after severing the “substantively unconscionable” terms, including the franchisor’s right to seek

40 Id., at 1286-87 and 1290.
42 Id., at *2.
43 Id., at *3-4. Notably, the court did not consider the one-year statute of limitations restriction in its substantive unconscionability analysis since the clause was contained outside the arbitration provision, however, the court did consider the provision in determining whether the franchise agreement was so “permeated with unconscionability that severing certain portions would be inappropriate.” Id., at *4.
44 Id., at *5-6.
45 2008 WL 5411500 (N.D. Cal., Dec. 29, 2008).
46 Cottman had initially filed a demand for arbitration against the franchisee for failure to pay past due franchise fees. Id., at *2.
47 Id., at *3. Under Nagrampa’s holding, when the “crux of the complaint” is the invalidity of the arbitration clause itself, rather than the invalidity of the contract as a whole, the court—not the arbitrator—must decide whether the arbitration provision is invalid. See Nagrampa, 469 F. 3d at 1264.
equitable and injunctive relief in court, a shortened statute of limitations, and those barring the arbitrator from awarding exemplary and punitive damages. The franchisee also asserted procedural unconscionability due to the unequal bargaining power of the parties. While the court pointed out several mitigating factors, including that fact that the franchisee had consulted an attorney during the contract negotiations and that the arbitration clause was conspicuous, these factors did not sway the court from finding “minimal” procedural unconscionability.

While severing unconscionable terms is one tool courts have employed in enforcing arbitration agreements, not all courts elect to do so. In *Bridge Fund Capital Corp. v. Fastbucks Franchise Corp.*, the substantive unconscionability finding included an analysis of a franchise agreement’s choice of law and forum selection clauses. The franchisee, Bridge Fund, filed suit against the franchisor, Fastbucks, for breach of contract, fraud, misrepresentation and violation of the CFIL in the Eastern District of California. Texas-based Fastbucks moved to stay and compel arbitration in Texas as mandated by the parties’ agreement.

Although cognizant of Texas’ interest in the dispute, the court nonetheless found that transferring the action or applying Texas law would run afoul of California’s public policy codified in CFIL and result in a waiver of the rights afforded franchisees by the statute. In reaching its decision, the court distinguished another California district court’s decision, *Smith v. Paul Green School of Rock Music Franchising, LLC*, which enforced a Pennsylvania choice of law and forum selection clauses in a dispute between a Pennsylvania franchisor and its California franchisee for, among other reasons, the franchisor’s concession that in the Pennsylvania arbitration, the arbitrator would be required to apply CFIL under that state’s conflict of laws principles. In addition to the choice of law and forum requirements of the agreement, the court found substantive unconscionability in the agreement due to the lack of mutuality in the parties’ ability to seek injunctive relief, the limitation of awards to actual damages, the shortened statute of limitation periods and even the agreement’s class action waiver though the waiver was not implicated. Ruling the arbitration agreement to be “permeated with unconscionability,” the court refused to enforce it.

Before unconscionability can even be assessed, courts must often decide where that assessment should be made. The First Circuit’s decision in *Awuah v. Coverall North America, Inc.*, addressed whether a dispute over an arbitration agreement’s validity should be decided by a court or an arbitrator. The franchisee plaintiffs sued Coverall in the Massachusetts district court seeking damages for *inter alia*, fraud, breach of contract and wage/hours violations. Coverall filed a motion to stay the action pending arbitration as the franchise agreements of several of the named plaintiffs included a mandatory arbitration provision incorporating the

48 Id. at *8-10. Interestingly, the court held that after striking these provisions as unconscionable, the clause prohibiting the arbitrator from modifying or altering any provision of the franchise agreement did not unduly limit the arbitrator and would not have to be severed. *Id.*, at *9.

49 *Id.*, at *7-8.


51 *Id.*, at *5.


53 *Id.*, at *7-11.

54 *Id.*, at *11.

55 554 F. 3d 7 (1st Cir. 2009).
AAA’s then current commercial rules. Those franchisees countered that the provision was unconscionable and argued that the court, rather than the arbitrator, should decide the issue of unconscionability. Although conceding the parties’ incorporation of the AAA rules, the district court nonetheless concluded that the franchisee agreements in question did not “clearly and unmistakably” state that challenges to validity and unconscionability must be decided by an arbitrator and referred the franchisees’ unconscionability claims to the magistrate judge.56 Coverall took an interlocutory appeal to the First Circuit asserting error and claiming that the parties’ agreement to incorporate the AAA rules—including Rule 7(a) requiring challenges to the validity of the arbitration agreement be decided by the arbitrator—controlled.

On appeal the First Circuit noted that the Supreme Court had yet to rule on whether an arbitrator should decide the validity of an arbitration agreement where the parties have only incorporated by reference rules such as AAA Rule 7(a) which provide the arbitrator with the power to make such determinations.57 The circuit court nonetheless ruled that the parties’ agreement to incorporate such rules by reference was adequate to convey that power to the arbitrator. Despite the role played by the arbitrator under such agreements, the First Circuit stated that the courts should still examine whether “the arbitration regime is structured so as to prevent a litigant from having access to the arbitrator to resolve claims, including unconscionability defenses.”58 In particular, the court cautioned that if the arbitration agreement’s provisions unduly burdened the claimant as to expense and inconvenience to such a degree that the arbitration remedy was illusory, then the court should decide the case itself. The First Circuit therefore affirmed the district court’s judgment refusing to order arbitration, but remanded for the threshold determination whether, under the facts of the case, the arbitration agreement failed to provide the claimants with a remedy.59

Claims of unconscionability to contest arbitration agreements has been gaining traction in recent years, most decidedly in California. At a minimum, franchisors should review their arbitration provisions to determine whether modifying their agreements to allow for reciprocal rather than unilateral access to courts to obtain equitable relief is appropriate. Changes to choice of law and venue provisions may also merit examination, but are less likely to be made since franchisors view them as key provisions of their agreements. Franchisees, however, will continue to characterize these provisions as unconscionable and, in a favorable jurisdiction, may have succeed not just in having them severed, but having the entire arbitration agreement ruled unenforceable.

c. Judicial Review

Judicial review of arbitration awards, or the lack of it, makes the ideological tug of war between the United States Supreme Court and some lower courts at the federal and state level one of the most fascinating to follow. In a victory for limited review, the Supreme Court ruled last year in Hall Street Associates, L.L.C. v. Mattel, Inc.60 that the statutorily enumerated grounds for judicial review of arbitration awards in Sections 10 and 11 of the FAA cannot be

57 554 F. 3d at 10.
58 Id., at 13.
59 Id.
expanded by the parties’ arbitration agreement. The lessor-petitioner in Hall Street leased its commercial premises to Mattel which agreed to abide by environmental laws and indemnify the lessor for clean-up costs incurred by Mattel or its predecessors. After testing showed environmental contamination, Mattel terminated the lease and Hall Street sued for improper termination and indemnity. The Oregon district court found for Mattel on the issue of termination, but the parties agreed to arbitrate the lessor’s indemnity claim. Their arbitration agreement required the court to vacate, modify, or correct any award if the arbitrator’s conclusions of law were erroneous.

After the arbitrator found for Mattel, the lessor appealed the award to the district court which vacated the award for legal error as permitted under the agreement. Citing Ninth Circuit precedent which held that under the FAA parties may contract for an alternate review standard, the district court remanded to the arbitrator. On remand the arbitrator found for Mattel and the finding was upheld on appeal to the district court. In appealing to the Ninth Circuit, the lessor argued that the district court erred as later Ninth Circuit precedent held that FAA Sections 10 and 11 contain the exclusive grounds for vacating or modifying arbitration awards. The Ninth Circuit agreed and reversed the award in favor of Mattel finding that the lessor’s claim that the arbitrator’s purported “implausible interpretation” of the lease exceeded the arbitrator’s powers was error, as “implausibility” is not a valid basis to vacate or correct an award under FAA Sections 10 and 11.61

The Supreme Court granted certiorari on two issues: first, that judicial review may be expanded by contractual agreement; and, second, since arbitration is a creature of contract and Congress has expressed its desire to enforce such agreements in the FAA, whether the parties’ contractual agreement to review an award for legal error should prevail. In rejecting both of the lessor’s arguments, the Court first conducted a review of its prior holding in Wilko v. Swan,62 which states that “the interpretations of the law by the arbitrators in contrast to manifest disregard [of the law] are not subject, in the federal courts, to judicial review for error in interpretation.”63 While recognizing that this statement arguably supported the lessor’s position, the Court tartly observed “arguable is as far as it goes”64. The Court found the Wilko statement an express rejection of expanded review for an arbitrator’s general errors of law. The reference to “manifest disregard”, the Court opined, can be seen as referring to Section 10’s grounds for review collectively or as “shorthand” for Section 10’s authorization for vacatur of awards where arbitrators are “guilty of misconduct” or “exceeds their powers.”65 In dispensing with the lessor’s second argument, the Court noted that despite a general policy favoring arbitration, Section 9 of the FAA “carries no hint of flexibility in unequivocally telling courts that they ‘must’ confirm an arbitral award, ‘unless’ it is vacated or modified ‘as prescribed’ by §§10 and 11.”66 Reconciling this general policy with the text of Section 9, the Court viewed the national policy favoring arbitration within the confines of Sections 9’s limited and expedited judicial review. In vacating and remanding the case, the Court expressly cautioned that its holding was limited to judicial review under the FAA. Noting that state statutory and common law may provide for a different

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61 Id., at 1401, fn. 1.
63 Id., at 436–437 (emphasis added).
64 128 S. Ct. 1403.
65 Id., at 1404.
66 Id., at 1405.
scope of review, the Court said it was “deciding nothing about other possible avenues for judicial enforcement of arbitration awards.”67

Despite the Supreme Court’s view of the scope of judicial review of arbitral awards under the FAA, especially as its implicates the notion of “manifest disregard of the law”, courts at both the federal and state level have long reached differing conclusions about the application of “manifest disregard of the law” as a ground for setting aside an arbitrator’s award. At the federal level, decisions from the First and Fifth Circuits hold that “manifest disregard of the law” has no applicability, while the Second, Seventh and Ninth Circuits find it to be encompassed within Section 10 of the FAA.

The case of Comedy Club, Inc. v. Improv West Associates,68 illustrates how “manifest disregard of the law” maintains viability despite the directive of Hall Street. In Comedy Club, the trademark licensor, Improv West Associates (“Improv”) entered into an agreement with the licensee, Comedy Club, Inc. (“CCI”) to operate a number of comedy clubs. When CCI could not meet the requirements of its development schedule, Improv defaulted CCI and terminated only its rights to open new clubs under the Improv trade name and advised CCI that Improv would open its own clubs. CCI filed suit in the federal district court in California seeking to declare the Improv’s restrictive covenant unenforceable under California law and that its failure to meet the development schedule should not have resulted in revocation of its rights to open additional clubs. Improv, in turn, filed a demand in arbitration. The arbitrator entered an award in favor of Improv which the district court affirmed. CCI appealed to the Ninth Circuit which found, inter alia, that the arbitrator’s enforcement of the restrictive covenant was a manifest disregard of the law.69 The Supreme Court granted a petition for certiorari, vacated the appellate court’s opinion, and remanded to the court to reconsider its prior decision in light of Hall Street on the issue of manifest disregard of the law.70

On remand, the Ninth Circuit reaffirmed that it had previously “determined that the manifest disregard ground for vacatur is shorthand for a statutory ground under the FAA, specifically 9 U.S.C. § 10(a)(4), which states that the court may vacate ‘where the arbitrators exceeded their powers’”71. The court then characterized the Supreme Court in Hall Street as not having reached the question of whether the manifest disregard doctrine fits within §§ 10 or 11 of the FAA. Thus it concluded that it was bound by its prior precedent and ruled that manifest disregard, as part of § 10(a)(4) remains a viable basis for vacating arbitral awards.72

In addition to the circuits’ split of authority over whether “manifest disregard of the law” is a permissible ground to vacate an arbitration award under the FAA,73 one circuit views it as an

67 Id., at 1406.
68 553 F. 3d 1277 (9th Cir. 2009).
69 Comedy Club, Inc. v. Improv West Associates, 514 F. 3d 833 (9th Cir. 2008).
70 Hall Street, supra.
71 Id., at *1290, citing Kyocera Corp. v. Prudential-Bach T. Servs., 341 F. 3d 987, 997 (9th Cir. 2003).
72 Id., at *1290. As for the restrictive covenant, the court deemed the arbitrator’s grant of injunctive relief preventing CCI from opening any clubs outside counties where it currently operated an Improv club overbroad and remanded with directions to the district court to partially vacate the arbitration award.
73 Cf. Citigroup Global Markets, Inc. v. Bacon, 562 F.3d 349 (5th Cir. 2009)(“[t]o the extent that manifest disregard of the law constitutes a nonstatutory ground for vacatur, it is no longer a basis for vacating awards under the FAA.”) with Stolt-Nielsen SA v. AnimalFeed International Corp., 548 F.3d 85, 94-95 (2d Cir. 2008).
alternate common law basis for vacating an award. The Sixth Circuit’s decision in *WW, LLC v. The Coffee Beanery, Ltd.*, 74 looks beyond the FAA to federal common law, specifically, *Wilko v. Swan* 75 in order to sidestep the impact of the *Hall Street* decision.

The dispute in *Coffee Beanery* arose when the franchisee, WW, LLC, and its two principals, Richard Welshans and Deborah Williams, filed a demand for mediation and arbitration with the AAA arising out of claims against the franchisor and seven of its officers, including Kevin Shaw, seeking damages based on tort, contract, and violations of Maryland and Michigan franchise laws. Subsequently abandoning arbitration on the grounds that their claims were broader than the franchise agreement’s arbitration clause, they next filed suit in the District Court of Maryland. The franchisor successfully moved to compel arbitration in Michigan. While these events were transpiring, the Maryland Securities Commissioner initiated an investigation into the franchisee’s allegations. The Maryland district court stayed its proceedings in deference to the administrative proceedings and the Michigan action. Before the arbitration could proceed, Coffee Beanery and Kevin Shaw entered into a consent order with the Commissioner which required extending a rescission offer to the franchisee. Instead of responding to rescission offer, the franchisee and its principals submitted their claims to arbitration in Michigan. Following an 11-day hearing, the arbitrator issued an award in favor of Coffee Beanery on all claims. After unsuccessfully moving to vacate the award in the Eastern District of Michigan, the franchisee and its principals appealed to the Sixth Circuit.

Although recognizing the FAA’s presumption favoring the confirmation of arbitration awards and the narrow scope of review of such awards afforded under Section 10(a)(1-4) of the FAA, the circuit court observed: “This Court’s ability to vacate an arbitration award is almost exclusively limited to these grounds, although it may also vacate an award found to be in manifest disregard of the law.” 76 Acknowledging that *Hall Street* “significantly reduced” the court’s ability to vacate arbitration awards, it did not find the decision to have foreclosed the federal court’s review for manifest disregard of the law stating that “[i]n light of the Supreme Court’s hesitation to reject the ‘manifest disregard’ doctrine in all circumstances, we believe it would be imprudent to cease employing such a universally recognized principle.”77

While the appellants raised four arguments in support of vacating the award, the court found one argument to be dispositive: the arbitrator had evinced a manifest disregard of the law when she ruled that the franchisor was not required to disclose Shaw’s prior felony conviction in the offering circular. 78 Coffee Beanery asserted that the crime was not the type of conviction subject to disclosure under the state’s franchise law, but the court found the Maryland Franchise Act mandated disclosure of the conviction. 79 Reversing the district court’s judgment and vacating the arbitrator’s award, the court ruled that ‘[b]ecause the Coffee Beanery failed to disclose Shaw’s felony conviction, WW need not resort to arbitration to vindicate its statutory rights but may instead seek appropriate relief in a court of law.”80 Coffee Beanery has

75 347 U.S. 427 (1953).
76 Id., at 418.
77 Id., at 418-19.
78 Id., at 419.
79 Id., at 420-21.
80 Id., at 421.
petitioned for certiorari to the United States Supreme Court, so the Court may have yet another the opportunity to end the debate on the scope of judicial review of arbitration awards for manifest disregard of the law.81

At the state court level, judicial review of arbitral awards retains its broad scope, especially in California. The dispute in Cable Connection, Inc. v. DirectTV, Inc.,82 arose when retail installers of the broadcaster’s satellite equipment claimed that the broadcaster had failed to pay them commissions and imposed improper charges. The parties’ contracts contained an arbitration agreement which stated, in pertinent part, “the arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error.”83 The contracts also provided for the application of California substantive law, but were silent as to whether disputes could or could not proceed on a class basis. After the retailers initiated a class action suit in state court, the broadcaster successfully moved to compel arbitration. Following the entry of an award for the retailers, the broadcaster appealed the award claiming it contained errors of law making it ripe for judicial review under the parties’ agreements, including the determination that the claimants could seek relief as a class. Although the trial court vacated the award, the court of appeals reversed and found the expanded judicial review provision in the parties’ arbitration agreement unenforceable.

Reversing the Court of Appeals, the California Supreme Court, citing the California Arbitration Act (“CAA”), noted that California will uphold arbitration agreements as “valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of any contract.”84 Judicial review of arbitration awards, is permitted only for specified grounds, such as an arbitrator’s fraud, corruption, misconduct or for an award that exceeds the arbitrator’s powers.85 Concluding that the parties’ arbitration agreement contained a limiting clause—limiting the arbitrator’s powers by prohibiting “errors of law or legal reasoning” the court held that the award could be reviewed under the CAA’s provision that permitted a merits review of an award that exceeded an arbitrator’s powers. The court observed that the experiences of sophisticated parties to high stakes arbitration where “expectations deviated from the parties’ expectations in startling ways,” led to parties to seek the protection offered by judicial review for legal error. In the court’s view, allowing such review would decease rather than increase pressure on the court’s crowded docket: “The judicial system reaps little benefit from forcing parties to choose between the risk of an erroneous arbitration award and the burden of litigating their dispute entirely in court.”86 In upholding expanded review of the arbitrators’ award, the court remanded the case to the trial court to vacate the award so that the arbitration panel could

81 The International Franchise Association has filed a friend of the court brief in support of the Coffee Beanery petition. The brief can be viewed at: http://www.franchise.org/uploadedFiles/Franchise_Industry/Government_Relations/Final%20Coffee%20Beanery%20Amicus.pdf.
82 44 Cal. 4th 1339 (2008).
83 Id., at 1341, fn. 3.
86 Id., at 1363.
reconsider the availability of class wide arbitration under the parties’ contract and the AAA rules.  

The Cable Connection decision was the logical progression after the California Supreme Court’s earlier ruling in Gueyffier v. Ann Summers, Ltd.  

Gueyffier involved a franchisee who opened a lingerie store in Beverly Hills. The opening was plagued with problems and the franchisee filed a petition in arbitration alleging breach of contract due to inadequate training and support. The franchise agreement’s arbitration provision restricted the arbitrator from “modifying or changing” any material term of the agreement.  

Among the material terms in dispute was the requirement for the franchisee to provide the franchisor with written notice of default and 60 days to cure. The arbitrator found that the notice would have been futile, excused the franchisee’s performance under the notice and cure provision and awarded the franchisee $478,030 in damages.  

Moving to vacate the award, the franchisor argued that in excusing the franchisee from performance of the notice provision, the arbitrator had modified or changed a material term of the contract and thereby exceeded his powers. The trial court affirmed the arbitrator’s award, but the appeals court reversed the ruling and vacated the award.

On appeal, the California Supreme Court, ruled that since the parties’ arbitration agreement did not expressly prohibit the arbitrator from excusing the performance of a material term, the arbitrator had not exceeded his powers: “The arbitrator was empowered to interpret and apply the parties’ agreement to the facts he found to exist; included therein was the power to decide when particular clauses of the contract applied. In concluding the notice-and-cure provision was inapplicable on the facts as he found them, the arbitrator did no more than exercise this power.”  

Ruling that the court of appeals should not have vacated the arbitration award, the case was remanded to that court for further proceedings.

The prospect of judicial review of arbitration rulings and awards has certainly lead some franchisors to ponder the merits of including arbitration provisions in their franchise agreements. Judicial review can be a costly and time consuming process. Rather than risk the chances of a second forum evaluating the correctness of a ruling or an award, some franchisors are opting to eliminate arbitration provisions from their agreements and litigate disputes in the courts in the first instance.

3. IF THE ADMINISTRATION OF THE ARBITRATION IS A PROBLEM

To at least some extent, franchise lawyers and their clients have struggled to find arbitration administration services that fit their needs for particular cases. Indeed, there are different administrative organizations to consider when franchisors draft an arbitration clause in a franchise agreement. Some organizations such as AAA and JAMS typically maintain ongoing involvement in the arbitration. These organizations provide assistance to the arbitrators and

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87 Id., at 1366.
88 43 Cal. 4th 1179 (2008).
89 Id., at 1183.
90 Id.
91 Id., at 1185.
92 Id., at 1188-89. It is worth noting that while arbitration proceedings may be viewed as “speedier” than court, proceedings, the California Supreme Court’s decision in Gueyffier was handed down seven years after the franchisee first filed her demand in arbitration.
parties. Initially, they provide assistance in locating arbitrators as well as procedural rules for use in the arbitration. Additional services may include acting as a liaison between the parties and the arbitrator; maintaining files; collecting fees and providing a location (at an additional cost) for the arbitration hearing. Other organizations such as the Center for Public Resources (CPR) generally only provide the parties with assistance in locating qualified arbitrators and by providing rules of procedure. And, at least one organization, FAM, focuses on mediating and arbitrating franchise disputes. Alternatively, some franchisors choose to arbitrate privately without the use of an arbitration organization. Franchisor counsel and their clients should consider their expectations and goals for arbitrating disputes with franchisees prior to choosing an administrative organization. Below is a description of each of the aforementioned organizations as well as a comparative analysis for use in determining which organization, if any, would better serve the parties facing a dispute.

a. Administration Providers are Available
i. AAA

The AAA was founded in 1926 following the enactment of the Federal Arbitration Act in 1925. It is a private, international not-for-profit provider of conflict management services and was created for the purpose of helping to implement arbitration as an out-of-court solution to resolving disputes. The AAA advertises that its official mission statement and vision statement are based on three core values: integrity, conflict management and service. The AAA states that it holds its “mediators and arbitrators to strict codes of ethics and model standards of conduct to ensure fairness and impartiality in conflict management.” The International Centre for Dispute Resolution (ICDR) is the international division of the AAA. It was established in 1996 to provide alternative dispute resolution services to individuals and organization worldwide. The ICDR currently has established cooperative agreements with 62 arbitral institutions in 43 countries. The ICDR claims to have case managers who are fluent in at least 13 languages and maintains a panel of more than 400 independent arbitrators and mediators.

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94 9 U.S.C. § 1 et. al. (West 2009).
96 Id.
97 Id.
98 See About the International Centre for Dispute Resolution, at http://www.adr.org/about_icdr (last visited June 29, 2009).
99 Id.
100 Id.
101 Id.
ii. JAMS

The mission of JAMS, as reported on its website is to be the “Resolution Experts, providing the highest quality dispute resolution services” to its clients. JAMS has been providing arbitration services for over twenty years, established in California as Judicial Arbitration and Mediation Services in 1979. It claims to “provide fair, timely expert decisions based on the facts and the laws.” Its arbitrators “include ADR’s most respected judges and highly experienced attorney adjudicators.” JAMS arbitrators practice ADR full-time and are “exclusive to JAMS.”

iii. FAM

FAM, established in 1988, is an arbitration and mediation referral service specializing in the resolution of disputes involving franchising issues and disputes between franchisors and franchisees. To be a member of FAM’s arbitration panel, an applicant must be an attorney in good standing with at least five years of practice concentrating on franchise law. Presumably, the benefits to using FAM for a franchise dispute will include an arbitrator with sufficient knowledge in franchising issues to fairly and knowledgeably hear and determine the dispute.

iv. CPR

CPR was founded in 1979 as the Center for Public Resources by a coalition of General Counsel “dedicated to identifying and applying appropriate alternative solutions to disputes thereby mitigating the extraordinary costs of lengthy trials.” CPR is located in New York City and is a nonprofit membership organization. CPR has over 700 panel members located throughout the world including more than 110 retired state and federal judges. CPR advertises specialized arbitrator panels including franchise. Generally, CPR will provide the parties with a list of qualified arbitrators to hear the dispute. CPR also provides the parties

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105 Id.
106 Id.
108 Id.
110 See About the CPR Institute, at http://www.cpradr.org/AboutCPR/tabid/69/Default.aspx (last visited July 1, 2009).
112 Id.
with a set of procedural rules for their use in the arbitration.\textsuperscript{114} CPR typically only provides limited administration once an arbitrator has been chosen.\textsuperscript{115} However, the parties can request additional services.\textsuperscript{116}

\textbf{v. Private Arbitration}

Although often conducted under the auspices of administrative organizations, arbitrations may be conducted privately upon agreement by the parties. In this situation, the parties must agree to a method for choosing an arbitrator. Sometimes, they will simply agree on an arbitrator. Alternatively, they may agree to each pick an individual who will then work together to pick the arbitrator. The contract provision requiring arbitration can identify an organization’s rules to be followed during the arbitration, such as those provided by the AAA or CPR. The parties can also agree to rules among themselves, or have the arbitrator determine the rules to be followed. One of the benefits to the parties using private (also referred to as ad-hoc) arbitration will be the cost savings as a result of not engaging the services of an administrative organization. The only costs incurred will be those paid to the arbitrator. However, for this method to work, the arbitration clause should indicate how the arbitrator will be chosen as well as provide for a mechanism in the event the parties are unable to agree on an arbitrator. In addition, the clause should identify the rules to be followed in the arbitration.

\textbf{vi. Other}

There are many other administrative organizations available to the parties and a comprehensive review of all of them is not possible here. Other organizations that franchisors and their counsel may want to keep in mind include ADRC and net-Arb.com.

\textbf{(1) ADRC}

The American Dispute Resolution Center (ADRC) states that it acts as the exclusive administrator for arbitrations involving the Subway franchise system. ADRC would handle disputes involving other franchise systems but currently, its panel members are mostly located in New England. This organization, therefore, may not be a good choice if the franchisor wants to ensure that the arbitration hearing is held near its home office and does not want to pay travel costs for the arbitrator.

\textbf{(2) net-ARB.com}

One interesting arbitration organization which may be on the forefront of the future of arbitration is net-ARB. net-ARB was founded in 2005 to provide low-cost binding arbitration which it does strictly through email.\textsuperscript{117} Currently, net-ARB is not capable of handling complex

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{115} See Dispute Resolution Services, \textit{at} http://www.cpradr.org/AboutCPR/FAQs/tabid/284/Default.aspx (last visited July 1, 2009).
\item \textsuperscript{116} \textit{Id.}
\item \textsuperscript{117} See net-ARB Overcomes Barriers to the Courts, \textit{at} http://www.net-arb.com/court_system_barriers.php (last visited July 1, 2009).
\end{itemize}
\end{footnotesize}
arbitrations such as those which typically arise in franchise disputes. With net-ARB, parties can choose to have a single arbitrator or a panel of arbitrators to decide their dispute.\textsuperscript{118} The arbitrator is required to decide cases based solely on “what they believe is fair.”\textsuperscript{119} They are required to determine a “fair and reasonable outcome” based on the evidence presented and application of (a) general principles of equity and common law; (b) common sense analysis of circumstances and context; and (c) personal experience and expertise.\textsuperscript{120} With net-ARB, neither party has an extra burden of proof, regardless of which party files first.\textsuperscript{121} The arbitrators are lawyers as well as non-legal experts in many industries.\textsuperscript{122} Currently, net-ARB typically handles disputes arising from software engineering, web design and web-based applications.\textsuperscript{123}

b. Choosing the Right Administrator

Arbitration is a creature of contract. The arbitration clause will dictate the procedure to be followed in the event of a dispute between the contracting parties. Before determining which administrative organization (if any) to specify in the contract clause, counsel and their clients should consider the goals they are seeking to accomplish with arbitration. Only then can they choose an organization and draft an arbitration clause that is more likely to accomplish those goals. For instance, is the client most concerned with cost containment of the dispute? Is the client most concerned about streamlining the process? Will the qualifications of the arbitrator be particularly important? Is the client concerned with controlling the detail of the procedures to be followed during the arbitration or is the preference to rely on standard rules created by an administrative organization? Once these questions are answered, then counsel and their clients can determine which organization (if any) is the right one for that franchise system. Of course the parties should bear in mind that the procedural rules of an administrative organization are not stagnant and are often amended over time. Disputes in franchise relationships can arise years after the agreement is drafted and executed and counsel and their clients should consider this fact when drafting the arbitration clause.\textsuperscript{124}

i. Costs Associated with Arbitration

One of the most significant factors to consider when choosing an administrative organization are the organization’s costs. Some organizations charge fees based on the amount of the claim filed and others have flat rates. Of course, the rates for each organization may change over time, but the following are the current fees for the organizations:

\textsuperscript{118} See Equal and Affordable Justice For All, at http://www.net-arb.com/what_will_arbitration_cost.php (last visited July 1, 2009).
\textsuperscript{120} Id.
\textsuperscript{121} Id.
\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{124} To avoid problems arising from a change in the procedural rules chosen, the arbitration clause can be drafted to provide that the arbitration should be administered in accordance with the organization’s rules in effect as of the date of the agreement. While this will not operate to bind an administrative organization to charge the fees in effect on that date, it will provide certainty with respect to the rules the arbitrator will be required to follow.
• **AAA's** initial filing fee is $750-$10,000 depending on the amount of the claim, up to a claim of $10 million. If the claim is for $10 million or above, the filing fee is $12,500 plus .01% of the amount of the claim (capped at $65,000). The **AAA** also assesses a case service fee: $200 - $6,000 depending on the amount of the claim if the case proceeds to a hearing.125

• **JAMS's** initial filing fee is $400 payable in full by a filing party. **JAMS** also assesses a case management fee of $400 per party, per day (one day equating to 10 hours of arbitrator time) for the second and third day of hearings. Following the third day (or 30 hours of arbitrator time), the case management fee becomes equal to 10% of the arbitrator’s fees.126

• **CPR's** non-administered arbitration, neutral selection service fee is $3,000 per party for a single arbitrator. If the dispute is to be heard by a panel of three arbitrators, the fee is $4,000 per party. If there are more than two parties to the dispute, there is an additional surcharge of $500 for each additional party past two.127

• **FAM** assesses a one time fee of $950 for arbitrations involving a single arbitrator or a fee of $1,900 for arbitrations involving multiple arbitrators.128

• **Private Arbitration:** Where there is no administrative organization used to administer the arbitration, the parties to the dispute are spared the expense of administration costs.

In addition to fees for the administrative organization, the parties to an arbitration must pay arbitrator fees. Generally, arbitrators set their own rates and those rates are identified at the time of appointment for serving as an arbitrator.129 Of note, however, is **FAM**'s current rule which caps arbitrator’s rates at $500 per hour.130

ii. **Selection of the Arbitrator(s)**

One of the benefits to using an administrative organization is that it will assist the parties in locating an arbitrator. When considering which organization to use, counsel and their clients should consider how important it is that the arbitrator has certain qualifications. Will it be important to have an arbitrator with knowledge of franchise law? Is it more important to the

125 See AAA Commercial Rules, at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).
parties that the arbitrator has experience arbitrating disputes? Should the arbitrator be a retired judge? Each organization has its own procedural rules for the selection of the arbitrator as well as a panel from which the parties select the arbitrator.131

- The AAA maintains a National Roster of Commercial Arbitrators. The AAA requires their panelists to participate in ongoing training in arbitration process and updates in the law.132 Following submission of an answering statement, the AAA sends a list of 10 individuals chosen from the National Roster along with general information about the proposed arbitrators.133 The parties can agree to or strike an arbitrator and number the remaining candidates.134 The AAA then makes an appointment based on the objections and designated order of mutual preference.135 Unless the parties agree otherwise, when there are two or more claimants or two or more respondents, the AAA may appoint all the arbitrators.136

- JAMS’ arbitrators are full time ADR practitioners.137 JAMS will send a list of 5 arbitrator candidates in the case of a sole arbitrator (or 10 for a tripartite panel), with a brief description of the background and experience of each arbitrator candidate.138 The parties may strike two names (or 3 for a tripartite panel) and then rank the remaining candidates in order of preference.139 The arbitrator candidate with the highest composite ranking shall be appointed the arbitrator.140

- CPR submits to the parties a list, from the CPR Panels, of not less than 5 candidates if one arbitrator is to be selected, and of not less than seven candidates if two or three arbitrators are to be selected.141 Such list includes a brief statement of each candidate’s qualifications.142 Each party numbers the candidates in order of preference and notes any objection it may have to any


133 See AAA Commercial Rules, R-11(a), at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).

134 See AAA Commercial Rules, R-11(b), at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).

135 Id.

136 See AAA Commercial Rules, R-11(c), at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).


140 Id.


142 Id.
candidate.\textsuperscript{143} \textbf{CPR} then designates as the arbitrator the nominee(s) willing to
serve for whom the parties collectively have indicated the highest preference.\textsuperscript{144}

- \textbf{FAM} referred arbitrators are usually trial attorneys with litigation experience (at
least 5 years) in franchise issues.\textsuperscript{145} \textbf{FAM} will poll its panel of referral arbitrators
situated in the general vicinity of the designated venue of the arbitration for
potential conflicts.\textsuperscript{146} After this screening is complete, \textbf{FAM} forwards to the
attorneys for the disputants the names of eligible, prospective arbitrators
including brief resumes (three nominees for a single arbitrator proceeding or nine
nominees for a multiple arbitrator proceeding).\textsuperscript{147} Both parties rank the proposed
arbitrators in order of preference and return the list to \textbf{FAM}.\textsuperscript{148}

- \textbf{Private Arbitration} requires the parties to locate and agree on a particular
arbitrator or method for selection of an arbitrator.

iii. General Procedural Rules

In addition to providing the parties with arbitrators, the administrative organizations also
have rules that govern the arbitration. Generally, if the arbitration agreement provides for
administration by a particular organization and is otherwise silent on the rules to be followed, the
arbitration will be administered in accordance with the rules of the selected organization.
However, the parties are generally free, by agreement, to alter or supplement an organization’s
rules.\textsuperscript{149} In addition, if the arbitration agreement requires private arbitration, the parties can
agree (either in that contract clause or once the dispute arises) to use the rules of a particular
organization.

iv. Rules Regarding Discovery

Franchisors and their counsel often choose to include an arbitration provision in
franchise agreements because of the belief that arbitration is a more efficient method of dispute
resolution. This is often based on the presumption that with arbitration, discovery will be
curtailed. Thus, when choosing an administrative organization, counsel and their clients should
consider the organization’s rules regarding discovery.

- The \textbf{AAA} permits an arbitrator, in his or her discretion, to direct the production of
documents and other information and the identification of any witnesses to be
called.\textsuperscript{150} Further, the parties are required to exchange copies of all exhibits they

\textsuperscript{143} See CPR Non-Administered Arbitration Rules, R-6.4(b), at
1, 2007).

\textsuperscript{144} Id.


\textsuperscript{146} Id.

\textsuperscript{147} Id.

\textsuperscript{148} Id.

\textsuperscript{149} See Roth, supra note 57.

\textsuperscript{150} See AAA Commercial Rules, R-21(a), at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).
intend to submit at the hearing at least five days before the hearing.\footnote{151} The AAA’s rules generally limit discovery. However, pursuant to the AAA’s rules for large, complex cases (where a party’s claim or counterclaim exceeds $500,000 exclusive of costs) the arbitrator is authorized to order depositions or interrogatories.\footnote{152}

- **JAMS** provides for more extensive discovery. It requires the parties to cooperate in good faith in the voluntary and informal exchange of documents and information relevant to the dispute or claim immediately after commencement of the arbitration.\footnote{153} The parties are required to exchange all relevant, non-privileged documents, including names of witnesses and experts, together with experts’ reports.\footnote{154} The parties are also permitted to take one deposition of an opposing party.\footnote{155}

- **CPR** has promulgated protocols providing “best practices” for arbitrators in directing discovery to alleviate the problems created by runaway discovery.\footnote{156} They provide for disclosure as to “those items that are relevant and materials for which a party has a substantial, demonstrable need.”\footnote{157} However, the rules further provide that the arbitration tribunal may require and facilitate such discovery as it determines is appropriate in the circumstances, taking into account the needs of the parties and the desirability of making discovery expeditious and cost-effective.\footnote{158} Depositions should be permitted only where the testimony is expected to be material to the outcome of the case and where one or more of the following exigent circumstances apply: witness statements are not being used, the parties agree to the taking of the deposition and/or the witness may not be available to testify before the tribunal.\footnote{159} The tribunal is encouraged to impose strict limits on the number and length of any depositions allowed.\footnote{160}

\footnote{151} See AAA Commercial Rules, R-21(b), at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).
\footnote{152} See AAA Commercial Rules, L-4(d), at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).
\footnote{153} JAMS Comprehensive Rules, R-17(a), at http://www.jamsadr.com/rules-comprehensive-arbitration (July 15, 2009).
\footnote{154} Id.
\footnote{155} JAMS Comprehensive Rules, R-17(b), at http://www.jamsadr.com/rules-comprehensive-arbitration (July 15, 2009).
\footnote{160} Id.
In addition, CPR has developed different “Modes of Disclosure” which the parties can agree to in the arbitration clause or otherwise which identify the extent of discovery to be permitted.\textsuperscript{161}

- **Mode A** – No disclosure other than documents each side will present in support of its case.

- **Mode B** – Mode A disclosure plus pre-hearing disclosure of documents essential to a matter of import in the proceeding for which a party has demonstrated a substantial need.

- **Mode C** – Mode B disclosure plus documents relating to issues in the case that are in the possession of persons who are noticed as witnesses by the party requested to provide disclosure.

- **Mode D** – Disclosure of documents regarding non-privileged matters that are relevant to any party’s claim or defense, subject to limitations of reasonableness, duplication and undue burden.

- **FAM** provides that if discovery is not specifically agreed to by the parties either in the franchise agreement or otherwise, neither party in dispute is entitled to conduct discovery.\textsuperscript{162}

- **Private Arbitration.** The parties must either agree to discovery methods or have the arbitrator(s) determine the extent of discovery permitted.

v. E-Discovery

Some administrative organizations have taken steps to address and regulate e-discovery in arbitration.\textsuperscript{163}

**AAA’s** international arm, **ICDR**, has issued guidelines for arbitrators concerning the exchange of information.\textsuperscript{164} These guidelines provide that electronic documents shall be produced in the form in which they are maintained, absent a showing of compelling need by the requesting party for production in a different form. Also, requests for e-documents “shall be narrowly focused and structured to make searching for them as economical as possible.”\textsuperscript{165}

**CPR’s** guidelines provide that discovery of electronic documents should follow the general principles of narrow focus and balancing cost, burden and accessibility with the need for disclosure. In that regard, “production of e-materials from a wide range of users or custodians, which is both costly and burdensome, should not be permitted without a showing of


\textsuperscript{163} See Chamberlin, supra note 81.

\textsuperscript{164} See Aldrich, supra note 80.

\textsuperscript{165} Id.
extraordinary need.” As with paper discovery, CPR’s guidelines provide several different models that can be selected by the parties as early as the drafting stage to designate the breadth of permitted e-discovery.

- **Mode A**, the narrowest scope, provides for no prehearing disclosure other than copies of printouts of e-documents to be presented in support of each party’s case.

- **Mode B** requires production of (1) electronic documents maintained by a limited number (agreed to by the parties) of custodians. (2) Provision only of e-documents created from the date of signing the arbitration agreement to the date of filing the request for arbitration. (3) Production is limited to e-documents from primary storage facilities (i.e. no documents from backup servers, backup tapes, cell phones, personal digital assistants, voicemails or information obtained through forensic methods).

- **Mode C** provides for Mode B production but for a larger number of specified custodians and a wider time period. It also provides that the parties may agree to permit upon a showing of special need and relevance, disclosure of deleted, fragmented or other information obtained through forensic methods.

- **Mode D** provides for disclosure of electronic information regarding non-privileged matters relevant to any party’s claim or defense, subject to limitations of reasonableness, duplicativeness and undue burden. It is a broad level of disclosure similar to that required or permitted under FRCP Rule 26.

Thus, counsel should consider what discovery is likely to be essential and useful in a franchise dispute when choosing an administrative organization and drafting the arbitration clause.

vi. Motion Practice

Another consideration by counsel and their clients when choosing to arbitrate disputes is whether the parties should be able to engage in motion practice. The AAA does not address motion practice in its rules—it is neither prohibited nor explicitly permitted. JAMS’ rules expressly provide that the arbitrator may permit any party to file a motion for summary disposition of a particular claim or issue. CPR provides the arbitrator with discretion to conduct the arbitration as she deems appropriate in light of the objective that arbitration be expeditious, economical, and less burdensome than litigation. However, the commentary to Rule 9.1 provides that where controversies hinge on one or two key issues of law, it may be desirable for the arbitrator to rule on such issues before the arbitration hearing commences.

166 See Chamberlin, supra note 81.


168 See Chamberlin, supra note 81.

guidelines are silent on the issue of motion practice, leaving it to the arbitrator to determine whether motions shall be permitted.

In addition, the AAA and CPR both provide for emergency measures of protection. The AAA’s rules state that parties can, by special agreement or in their arbitration clause, provide for application of the AAA’s Optional Rules for Emergency Measures of Protection.170 Under these rules, an emergency arbitrator will be appointed prior to the constitution of the arbitrator panel to hear an emergency application for relief. To obtain such relief, the party must demonstrate that immediate and irreparable loss or damage will result in the absence of such emergency relief and that the requesting party is entitled to such relief.171 Under CPR’s Rule 14, the tribunal (if appointed or if not yet appointed, a special arbitrator appointed for this limited purpose), may take such interim measures as she deems necessary, including measures for the preservation of assets, the conservation of goods or the sale of perishable goods.172 The tribunal or special arbitrator may require appropriate security as a condition of ordering such measures.173 Unlike the AAA’s rules, CPR does not require the parties to agree in advance to special rules regarding emergency applications for relief. Rather, so long as the parties have not agreed otherwise, CPR’s Rule 14 is deemed part of any arbitration clause or agreement entered on or after November 17, 2007, that provides for arbitration pursuant to CPR’s rules.174

c. Purposes

Each of the administrative organizations has certain distinct characteristics that can aid or hinder parties facing a dispute from achieving satisfaction with the arbitration process. Before choosing an organization, the parties should determine their primary goal (a cost-efficient arbitration, an expeditious one, having their claims heard by an arbitrator with particular experience, etc.) and evaluate the organizations with a view towards those specific attributes.

The AAA may be the right choice for parties who appreciate a comprehensive set of arbitration rules at their disposal to assist them with the arbitration; a large nationwide panel of potential arbitrators (making it easier to find a local arbitrator); and the ability to chose from the highest number of arbitrator candidates—10—to find the candidate with the experience (and hourly rates) best suited to hear their dispute. On the other hand, the AAA may not be the best option for those seeking to limit their fees as the AAA’s fees can be quite expensive, particularly when the claimant seeks substantial damages. In addition, the claimant is solely responsible for the up-front initial filing fee which may make it difficult to pursue a viable claim. Finally, with the AAA, there is no guaranty that an arbitrator with the appropriate experience, such as knowledge about franchising issues, will be available.

JAMS may be a good option for parties who are desirous of a skilled ADR professional or former judge to preside over their arbitration, and who wish to import some practices

170 See AAA Commercial Rules, O-1, at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).
171 See AAA Commercial Rules, O-4, at http://www.adr.org/sp.asp?id=22440 (June 1, 2009).
173 Id.
174 Id.
traditionally used only in litigation—such as depositions, dispositive motion practice and a comprehensive set of rules—into their arbitration procedure. **JAMS** may also be a good option for parties seeking some input into the final award determination. In addition to award options solely determined by the arbitrator, **JAMS** offers Bracketed Arbitration (where the parties may agree to a minimum and maximum amount of damages that can be awarded on each claim or aggregate of claims, and the arbitrator’s final award is raised or lowered to conform to these amounts)\(^\text{175}\) and Final Offer Arbitration (where the parties exchange and provide **JAMS** with written demand and/or offer proposals. The arbitrator thereafter renders an award by deciding which of the proposals she finds the most reasonable and appropriate).\(^\text{176}\) On the other hand, **JAMS** may not be appropriate for parties seeking an expeditious arbitration, as depositions and motion practice are commonly time consuming.

**CPR** may be a good choice if the parties agree on the administrative aspects of the arbitration and only require assistance with securing an arbitrator and determining issues which may arise in connection with the chosen arbitrator. Further, unlike **AAA**, **CPR**’s fee structure does not take into account the amount of the claim. Accordingly, **CPR** may be a good choice for parties with a substantial claim, who are not interested in paying proportionally higher administrative fees to proceed with the arbitration. However, **CPR** does not provide extensive administration assistance and the arbitrator is provided with substantial discretion to determine how the arbitration will proceed.

**FAM** may be the right option for parties particularly concerned about having their dispute heard by an arbitrator with knowledge of franchising and franchise law as all of **FAMs**’ arbitrators are litigators with backgrounds in franchise law. In addition, **FAM** may be cost-efficient as it only assesses a one-time fee and caps the rates of its arbitrators at $500 per hour. Finally arbitrations administered by **FAM** may be more time efficient as **FAM’s** rules limit discovery (unless the franchise agreement or parties agree otherwise). On the other hand, **FAM** might not be the right choice for parties who feel more comfortable proceeding under a comprehensive set of arbitration rules (as exist with **AAA** or **JAMS**).

**Private Arbitration** may be appropriate for parties and their counsel who will be able to locate an arbitrator and agree on the rules to be followed (even if those simply permit the arbitrator discretion to determine the procedure to be followed). The fees associated with private arbitration are limited to those charged by the arbitrator. However, it will require detailed drafting of the arbitration clause to ensure that the parties have a method for choosing an arbitrator and determining procedural rules for the administration of the arbitration.

### 4. HOW ARBITRATION CAN BE IMPROVED

The empirical research addressed in Section I of this paper suggests that in fact there has not been a flight from arbitration. However, anecdotal evidence seems to suggest that parties are often unhappy with the arbitration process. Regardless, the parties can seek to obtain greater satisfaction with the arbitration process by making informed choices when agreeing to arbitrate and when drafting the arbitration clause. Indeed, one of the biggest

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advantages to arbitration which is not always utilized is the parties' ability to design specific features of the process.\textsuperscript{177} Conversely, in court proceedings there is a permanent body of procedural law which determines the parties' rights and obligations within a traditional legal framework.\textsuperscript{178} Where the parties (or the drafting party such as the franchisor), consider all options prior to drafting the arbitration provision, the parties will have far greater control over the dispute resolution process which will presumably result in a more favorable method for resolution.

a. Drafting a Better Arbitration Clause

Of course, how one views the problems of arbitration will certainly dictate the possible methods to improve it. Nonetheless, if one views the problems of arbitration arising from the cost and inefficiency, then one can draft a provision to ensure that the arbitration process is streamlined. The Supreme Court has determined that the FAA allows the parties to tailor many features of arbitration by contract. For instance, the parties are permitted to determine necessary qualifications of arbitrators; the method for choosing arbitrators; what issues are arbitrable; procedure to be followed by the arbitrator and the choice of substantive law.\textsuperscript{179}

To avoid the downsides of arbitration, a company may choose to modify its arbitration clause rather than remove it altogether. A drafting response may limit, clarify, or provide more detail surrounding the rules used in arbitration proceedings. Examples of specific modifications will be discussed below.

Parties may also draft contracts in response to court decisions, for example decisions finding certain arbitration practices unconscionable, by removing specific provisions from their arbitration clauses. Thus, concerns regarding the arbitration process and enforcement of arbitration provisions may be addressed through careful drafting of arbitration provisions.

Notwithstanding this opportunity to affect the arbitration procedure to be followed, when drafting franchise agreements, many franchisors and their counsel simply include a boilerplate arbitration clause calling for arbitration before the AAA or JAMS.\textsuperscript{180} Some drafters are not even familiar with the rules of the organization chosen. For example, how are the arbitrators qualified and trained? What default rules apply when particular topics are not addressed in arbitration provisions?

Instead, counsel and their clients should make informed decisions about the procedure to be followed.\textsuperscript{181} They should choose which arbitration organization to use (or even whether to use private organization) in their arbitration provisions. As indicated herein, there are many

\textsuperscript{177} Murray S. Levin, \textit{The Role of Substantive Law in Business Arbitration and the Importance of Volition}, 35 AM. BUS. L.J. 105, 106 (1997).

\textsuperscript{178} See Collins, 361 F. Supp. 2d 1085.


\textsuperscript{180} Drahozal & Wittrock, \textit{"Is There a Flight from Arbitration?"}, 37 Hofstra L. Rev. 71, 100-01 (2008).

\textsuperscript{181} See In Wayland Lum Const., Inc. v. Kaneshige, 90 Hawaii 417 (1999) where the parties did not limit the Arbitrator's general authority to conduct hearings and draft orders to any particular rules or procedures (like that of the AAA). Accordingly, the court held it was reasonable to conclude that the parties intended under the contract to give the Arbitrator the authority to establish a procedure he considered appropriate to carry out his responsibility to arbitrate the dispute.
alternative organizations and indeed, an administrative organization is not required. Rather, counsel and their clients should review and discuss the goals they are seeking to obtain from the use of arbitration and chose a method that will best help achieve those goals.

i. Cost and Streamlining the Process

Parties and their counsel often cite cost and delay as major reasons for their dislike of arbitration. Originally, arbitration was supposed to be more efficient and cost effective.\(^{182}\) In fact, it does not always achieve these goals. However, with forethought, the parties can lessen the impact of these concerns.

One immediate way to reduce costs and streamline the arbitration proceeding is to choose to arbitrate using a private or ad hoc procedure without the use of an administrative organization. The parties are still free to use the rules of a particular organization (the rules are often available on the organization’s website). However, in this event, the parties will be required to locate an arbitrator without the assistance of a pre-approved list of arbitrators from an administrative agency. If this is a concern, the parties can also choose to use CPR which (for a fee)\(^{183}\) will provide a choice of arbitrators to the parties for their use in the arbitration.

Another way to reduce costs is to provide for arbitration with one arbitrator rather than a panel of arbitrators. Although this may increase the risk of an aberrational award, the shared cost of the hourly fee for one arbitrator is obviously substantially less than the cost for three arbitrators. Cost containment may also be achieved by limiting discovery and motion practice. The parties are free to determine in advance (in the dispute resolution clause of their agreement or otherwise) what discovery and motion practice (if any) will be permitted. By drafting an arbitration clause that sets forth exactly the discovery to be had, such as exchange of exhibits, the extent of written discovery or whether depositions will be had, the parties can contain the costs associated with discovery including ensuring that costs will not be incurred arguing with an adversary about the limits of permissible discovery.

If the parties are concerned about the length of time an arbitration requires, in addition to limiting discovery and motion practice, they can set a strict timeline for filing demands and responses. The parties can set a deadline for the end of discovery and for when a hearing must be held. Or, the parties can provide the arbitrator with authority to impose sanctions or fees against a party who seeks more than a certain number of adjournments. The parties can also shorten the time it takes to get a decision by using one arbitrator and not requesting a reasoned opinion which will certainly take time to write, edit and rewrite.\(^{184}\)

ii. Selection

When drafting arbitration clauses, consideration should be given to how the arbitrator will be selected in the event of a dispute. Before selecting an administrative organization, the parties should consider how that organization approves and trains its arbitrators. Arbitrators should be

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182 See Burton v. Bush, 614 F.2d 389, 391 (4th Cir. 1980) (stating that the “policy underpinnings of arbitration [are] speed, efficiency, and reduction of litigation expenses”).


184 See Kathy A. Bryan & Helena Tavares Erickson, Business Arbitration Can and Should be Improved in the United States. 14 DISP. RESOL. MAG. 3 (Spring/Summer 2008).
encouraged through training and by the organizations in which they are panel members to make the tough decisions which will make the arbitral process more efficient. Additionally, parties and their counsel may want to identify in the arbitration clause certain qualifications required for the arbitrator. Of course, a more extreme though acceptable approach would be for the franchise agreement to go so far as to specify a particular arbitrator. However, this may not be useful in a franchise dispute where the dispute typically arises years after the clause is drafted.

iii. Enforceability of the Provision

In an effort to avoid litigating the arbitration provision and thereby reducing costs and time on the dispute, parties should consider recent court decisions when drafting the arbitration provision. Counsel and their clients can modify the clause so as to remove specific violative provisions from the arbitration clause. That way, concerns regarding the arbitration process and enforcement of arbitration provisions may be addressed through careful drafting of arbitration provisions.

iv. Carve Out Certain Claims

Some franchisors and their counsel are concerned about not being able to obtain immediate relief where, for instance, there are concerns about trademark violations or improper competition by franchisees. Similarly, franchisees may be concerned about obtaining immediate relief to stop a franchisor from proceeding with an improper termination. It is not uncommon for arbitration clauses to exempt certain claims to avoid these types of concerns. A party requiring immediate relief, can access the courts to address the particular issue while agreeing to arbitrate generally claims arising from the franchise relationship. It may also be useful for the parties to draft an arbitration clause that permits arbitration of certain discrete issues while still permitting access to the courts for the overall dispute. For example, an arbitrator with certain expertise may be more qualified than a judge or jury to decide issues relating to encroachment claims. An initial determination on the encroachment claim may provide for early settlement or expedited litigation. Arbitration, therefore, need not be an “all or nothing” method of dispute resolution.

v. Take Control of the Process

Franchisors and their counsel should remember that arbitration is a creature of contract. They can control the arbitration process as much as they choose to, subject to the issues raised in Section II. However, they must make that choice. Simply picking an administrative organization without regard to its costs, rules, and the qualifications of its arbitrators is likely to result in disappointment with the arbitration process. Rather, parties and their counsel should consider in advance what goals they are seeking to achieve with arbitration (rather than litigation). In addition, they should consider what issues may arise in the dispute and how they want those issues to be addressed. In fact, arbitration provides the parties with an opportunity for almost complete control the dispute resolution process. They should take advantage of this opportunity rather than leaving it to the administrative organization to determine the best method for resolving their disputes.

185 See Bryan, supra note 103.

186 A problem with this method arises if the arbitrator is not available at the time of the dispute. The parties should ensure that the arbitration clause contains a contingent approach in that event.
b. Having the Proper Attitude about Arbitration

For some, the best way to “improve” arbitration is to go into it with a better understanding of what it will and should entail. For franchisors and franchisees alike who start down the arbitration path thinking the process will definitely be fast and cheap, and that they will prevail in all cases, disappointment is likely to be the outcome. Similarly, if clients and their lawyers want arbitration to be “just like litigation” (i.e., with the perceived benefits of motions, discovery, impartial decision makers, and full appeals) but without delays and high costs, then they are ripe for disappointment, as well.

Some of these misunderstandings can be avoided by careful drafting, as discussed above. But another way to improve the arbitration experience is to appreciate the ways arbitration is meant to be different from litigation and to have the attitude that one can accept the imperfections inherent in arbitration. The attitude could be that arbitration is not going to involve the exercise of every possible procedural right—indeed, certain rights can and should be waived by the very nature of arbitration. Not just the right to a jury is waived when arbitration is done correctly. We think the proper way to think about arbitration is that it will not involve as much discovery, it will not provide as many separate procedural opportunities to win, and it will be more, well, “arbitrary.” Arbitration by definition is meant to be decisive, quick, inexpensive, and final. While losing lawyers and clients never will like the results, the proper attitude about arbitration going in should be that the process may not have all of the benefits of litigation, but it will not have all of the drawbacks either. If a party understands the way arbitration was “meant to be” and thinks it can live with the imperfections and possible outcomes, then and only then should the party go down the arbitration path.

Conclusion

To answer the question: no, franchising is not abandoning arbitration. Not yet. The current trend in arbitrating franchise disputes is to make incremental changes and modifications to existing practices. This paper has described the positions of franchisors, franchisees, and the courts in adopting, accepting, or forcing those changes and modifications. If the administration of the arbitration has been a problem, the analysis above has surveyed the alternatives. Lastly, we have provided suggestions for ways to improve arbitration for situations in which the process is deemed the best way to resolve a dispute.
Biographies

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Julianne Lusthaus is a member of Einbinder & Dunn, LLP and has been practicing law since 1996. Julie represents franchise and other business clients in trials, arbitration and mediation. She also counsels franchisee clients including franchisee associations in connection with the acquisition of franchises, the negotiation of franchise agreements, including renewal agreements, and negotiations concerning disputes with franchisors. Julie is an active member of the American Bar Association Forum on Franchising; the New York State Bar Association Committee on Franchise, Distribution and Licensing Law; the International Franchise Association; the American Bar Association Law Practice Management Section; the Westchester Women’s Bar Association; the Brooklyn Women’s Bar Association; Flex-Time Lawyers, LLC and Second Shift. Julie has spoken at legal and industry events on franchising and has authored papers on franchising issues.
Mary Leslie Smith is a partner with Foley & Lardner LLP, a member of the firm’s Distribution & Franchise Practice Group. She is chair of the firm’s Miami, Florida litigation department. Ms. Smith litigates a range of commercial matters at both the trial and appellate levels in both federal and state courts. Her franchising and distribution practice provides clients with counseling and litigation services, from initial negotiations through resolution, including mediation, arbitration and trial. She has represented franchisors in a variety of commercial disputes involving trademarks, trade secrets, covenants not to compete and vicarious liability claims. Ms. Smith has been recognized as one of Franchise Times Legal Eagles 2009, is listed in 2009 edition of The International Who’s Who of Franchise Lawyers. She currently serve as a member of the American Bar Association’s Forum on Franchising Governing Committee. Ms. Smith is also the co-author of Annual Franchise and Distribution Law Developments 2004 published by the American Bar Association. Ms. Smith earned her J.D., with honors (1988), from the University of Florida, an M.A. (1981) from the London School of Economics, and a B.A., cum laude (1979), from Southern Methodist University. She is admitted to practice in Florida, the U.S. District Courts for the Southern, Middle and Northern Districts of Florida, and the U.S. Court of Appeals for the Eleventh Circuit.
Quentin Wittrock is a principal at Gray Plant Mooty, where he practices in the area of business litigation and arbitration, with a special emphasis on cases between competitors. He joined the firm in 1987. Quentin is a trial attorney who represents businesses in preventing or resolving disputes involving antitrust and distribution issues, as well as many other types of disputes. He has coordinated and tried franchise, distribution, noncompete, and employment cases throughout the United States. Recently, Quentin has been defending franchisors, product manufacturers, and other companies against fundamental challenges to their businesses in courts and in arbitration proceedings. This has included representation of two franchisors in defending a class action antitrust challenge and arbitrations involving the franchisors’ product supply practices, along with representing another major franchisor in defending its right to require franchisees to install new computer systems. Quentin writes and speaks frequently on arbitration, antitrust, and related issues.