Class Action Prohibitions and the Effect of Contract Rules on the Collective Pursuit of Common Claims

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Disputes in the Quizno's submarine sandwich system have recently shed light on the relationship between franchising and the class action provisions of the Federal Rules of Civil Procedure. In August 2010, a federal district court in Chicago approved a class action settlement between Quizno's and its franchisees valued at $206 million.[1]

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The franchisee class achieved this result despite an earlier decision by a Colorado federal district court enforcing a class action prohibition contained in a Quizno's standard franchise agreement and denying class action certification to a group of Quizno's franchisees that had bought franchises but never opened stores.[2]

Adding even more drama and legal uncertainty to franchise law, only two months after Quizno's prevailed in Colorado, a Pennsylvania federal court issued a contrary ruling, holding the Quizno's class action prohibition unenforceable as an impermissible restriction on the court's right to manage efficiently its own caseload.[3] Before the Colorado and Pennsylvania decisions, courts had rarely addressed the enforceability of class action prohibitions in the franchise context.

These difficult-to-reconcile cases involving franchise agreements in the same system highlight the uncertainty franchisors face when they seek to prohibit class actions in their franchise documents. Franchisors obviously prefer to avoid class actions at all costs. Can they do so by including class action prohibitions in their franchise agreements? Their ability to enforce such prohibitions likely will resurface as an issue for courts to address in the years to come.

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This article uses the Quizno's class actions litigated by the authors as the focal point for an examination and analysis of the enforcement of contractual class action prohibitions in the context of franchise disputes. The authors review how courts have dealt with these prohibitions in other contexts, discuss the Quizno's cases in detail, and conclude by offering several potential analytical frameworks for evaluating the enforceability of class action prohibitions in franchise agreements.

FRANCHISING AND CLASS ACTIONS

Franchising "provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors rather than employees of a vast chain."[4] To achieve systemwide uniformity, franchisors typically rely on controls in the franchise agreement that apply to all franchisees. The purpose of such controls is "to achieve standardization, uniformity, and optimum public good will."[5] With uniform rules and uniform application of those rules, franchisees often have common interests and concerns.

The class action thus serves as a powerful tool to redress systemwide issues that are common to franchisees. The class action vehicle also provides the franchisor with the ability to achieve systemwide resolution of disputes with its franchisees. Congress found in its 2005 enactment of the Class Action Fairness Act (CAFA) that class actions "are an important and valuable part of the legal system when they permit the fair and efficient resolution of legitimate claims of numerous parties."[6] Class action litigation "allows for the resolution of many claims that might otherwise evade legal enforcement."[7] The procedure further offers assistance to regulators who seek to "control conduct that threatens to harm various markets."[8] Consumer class actions in particular serve the laudable purpose of enforcing "regulatory standards designed to deter fraudulent marketplace conduct that might otherwise escape regulation."[9]

Class actions often assist the vindication of rights that otherwise may not be pursued because without the ability to pool costs and resources in a class action, a given individual's losses caused by a particular violation of law may not be cost effective to pursue under the economic constraints of modern-day litigation.[10] Thus,

> [t]he policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting

> his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.[11]

Of course, the Federal Rules of Civil Procedure do "not exclude from certification cases in which individual damages run high."[12] Rather, they, and in particular Rule 23, specifically contemplate the right to obtain damages of whatever amount, as well as declaratory and injunctive relief.[13]

CLASS ACTIONS: THE BASICS

Rule 23 governs class action practice in federal court.[14] To qualify for class action treatment, a plaintiff must meet all four requirements of Rule 23(a) and at least one of the requirements of Rule 23(b). The four requirements of Rule 23(a) are simply stated but hotly litigated: (1) "the class [must] be so numerous that joinder of all members is impracticable" (i.e., numerosity); (2) there are "questions of law or fact common to the class" (i.e., commonality); (3) "the claims or defenses of the representative parties are typical" of those "of the class" (i.e., typicality); and (4) "the representative parties will fairly and adequately protect the interests of the class" (i.e., adequacy).[15]

A party need not show that joinder of all class members is impossible to satisfy the numerosity requirement of Rule 23(a), only that it is "impracticable:"[16]

> A number of factors are relevant in determining whether joinder is impracticable, including the class size, the geographic diversity of class members, the relative ease or difficulty in identifying members of the class for joinder, the financial resources of class members, and the ability of class members to institute individual lawsuits.[17]

In a typical franchise system, numerosity should not be a difficult requirement to overcome.

The same can be said for the commonality requirement of Rule 23(a)(2). Under the rule, common does not mean "factually identical."[18] It is enough that "the claim[s] arise from the same set of broad circumstances."[19] Differences in the facts supporting the claims of individual class members will not defeat commonality.[20] In fact, "[c]ommonality is not necessary on every issue raised in a class action. . . . 'Rule 23 is satisfied when the legal question linking the class members is substantially related to the resolution of the litigation.'"[21] Thus, the commonality hurdle is minimal; it "requires only a single issue common to the class."[22] With standard form franchise agreements often in play, establishing commonality in the franchise context generally should not be difficult.

Establishing typicality is often not a problem either. "The threshold for typicality is low and the claims asserted by the class representative need only be typical of, not identical to, those of other class members:[23]"

> So long as there is a nexus between the class representatives' claims or defenses and the common questions of fact or law which unite the class, the typicality requirement is satisfied. . . . A sufficient nexus is established if the claims or defenses of the class and the class representatives arise from the same event or pattern or practice and are based on the same legal theory.[24]

In the franchise context, it is not hard to see how typicality can be satisfied where uniform controls or restrictions are placed on franchisees in the system and similar legal theories are asserted under standard form franchise agreements.

The final requirement of Rule 23(a), adequacy, focuses on the ability of those purporting to represent the class fairly and adequately to do so. "[A] class representative must be part of the class and 'possess the same interest and suffer the same injury' as the class members."[25] This fundamental requirement dovetails into two questions that the court must resolve to determine if the class representative is adequate: "(1) do the named plaintiffs and their counsel have any conflicts of interest with other class members and (2) will the named plaintiffs and their counsel prosecute the action vigorously on behalf of the class?"[26] These case specific inquiries provide ample room for fact-intensive arguments for and against class certification.

A plaintiff that satisfies each requirement of Rule 23(a) must then establish the right to certification of the class by meeting at least one of the requirements of Rule 23(b). Certification under Rule 23(b)(1) requires the plaintiff to establish that the prosecution of separate individual actions would prejudice the defendant or putative class members either by (1) establishing incompatible standards of conduct for the party opposing the class or (2) adjudicating the interests of other putative class members or preventing them from protecting their interests.[27] It is relatively uncommon for certification to be pursued under this provision.

Under Rule 23(b)(2), certification is appropriate where "the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole."[28] Class action lawyers typically refer to cases invoking Rule 23(b)(2) as injunction class actions, where the representative plaintiffs seek injunctive relief on behalf of the entire class.

Rule 23(b)(3) enables a court to certify a class where "questions of law or fact common to class members predominate over any questions affecting only individual members, and [where] a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."[29] This path to certification, used in an effort to obtain monetary damages, requires a showing of predominance and superiority.

The test for predominance necessarily requires the court to determine whether "common questions represent a significant aspect of the case" such that "they can be resolved for all members of the class in a single adjudication."[30] In a predominance analysis, the court identifies "the relevant factual and legal issues, and the elements of the claims and defenses in the case. . . . [H]owever, mere identification of the issues and elements of the claims and defenses is not an evaluation of the merits of the case; nor should it be."[31]

Instead, the court "must look only so far as to determine whether, given the factual setting of the case, if the [plaintiff's] general allegations are true, common evidence could suffice to make out a prima facie case for the class."[32] Even when individualized damages proceedings are necessary, it is not uncommon for courts to grant class certification on issues of liability, causation, and defenses.

In analyzing the superiority requirement of Rule 23(b)(3), courts look to four specific factors identified in the rule. First, the plaintiff will be asked to establish if the members of the class are likely to have little interest in individually controlling the prosecution of separate actions.[33] Second, the court needs to determine if litigation concerning the controversy has already been commenced by or against members of the class.[34] Third, in reviewing whether the class procedure is superior to other forms of litigation, the court must determine the "desirability or undesirability of concentrating the litigation of the claims in a particular forum."[35] Finally, the court must determine whether there are "likely difficulties in managing a class action."[36] Significantly, the existence of individual issues (for example, varying amounts of damages owed to each class member) does not necessarily establish that management of the class will be difficult under Rule 23(b)(3)(D) because the court must still weigh the benefits of proceeding as a class against that concern.[37]

CLASS ACTIONS IN THE FRANCHISING CONTEXT

The basic rules of class certification have been applied in the franchise context. For example, in *Broussard v. Meineke Discount Muffler Shops, Inc.*, the U.S. Court of Appeals for the Fourth Circuit reviewed a district court's class certification decision certifying a class of "'all persons or entities throughout the United States that were Meineke franchisees operating at any time during or after May of 1986.'"[38] Although the Fourth Circuit ultimately reversed the class certification decision based on its conclusion that the district court decision did not "conform to the requirements of Federal Rule of Civil Procedure 23(a)," reversal occurred only after a lengthy trial, jury verdict, and entry of a judgment close to $600 million against the franchisor.[39]

In *Bird Hotel Corp. v. Super 8 Motels, Inc.*, a district court in South Dakota in 2007 certified a class of 226 former and current franchisees to satisfy the numerosity requirement of Rule 23(a).[40] In certifying the class, the *Bird Hotel* court specifically found that common issues predominated due to the "standard form franchise agreements" and fact that "proof of liability [would] be the same for every class member."[41] More recently, that same court granted summary judgment on liability issues in favor of the franchisee class, leaving only a trial on damages.[42]

CLASS ACTION PROHIBITIONS AND CONTRACTUAL WAIVERS

Nearly every litigant in state and federal court has the procedural right to pursue a class action. The Federal Rules of Civil Procedure, after all, are "construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding."[43] A rule, such as Rule 23, that promotes joinder of parties with similar claims, certainly seems consistent with the foregoing admonition.

Not all courts see it that way, however. On April 20, 2009, a district court in *Bonanno v. Quizno's Franchise Co., LLC* denied class certification to a putative class of approximately 3,300 Quizno's franchisees that had purchased a franchise but had not yet opened their restaurant.[44] In addition to defending against plaintiffs' motion for class certification brought pursuant to Rule 23, Quizno's relied in the first instance on language from its franchise agreement that purported to bar the parties from seeking class relief: "The parties agree that any proceeding will be conducted on an individual, not a class-wide basis, and that any proceeding between Franchisor and Franchisee or the Bound Parties may not be consolidated with another proceeding between Franchisor and any other entity or person."[45] In *Bonanno*, the Quizno's class action waiver insulated the franchisor from exposure to a mass claim involving over 3,000 franchisees.

CLASS ACTION BARS IN THE COURTS

Many, but not all, of the decisions addressing enforceability of contractual class action prohibitions involve arbitration clauses and therefore implicate the strong federal policy favoring the enforcement of agreements to arbitrate. Although some courts assert that arbitration cases carry little precedential weight outside their original contexts,[46] as a practical matter, many of the challenges to arbitration clauses that bar class proceedings employ the very same legal standard of unconscionability involved outside the context of arbitration.[47]

As might be expected, challenges to contract provisions founded on unconscionability are fact-driven. It is consequently difficult to distill any universally applicable legal principles from the decisions, although there are exceptions. A Pennsylvania court has held that an agreement to arbitrate in a consumer contract of adhesion that waives the right to class-based relief is per se unconscionable and thus unenforceable.[48] More typical, however, is the situation of Florida's appellate courts, which have issued facially inconsistent decisions addressing the enforcement of class prohibitions in arbitration agreements for telephone service.[49] Perhaps the best summary of the state of the law comes from the Illinois Supreme Court in its review of twelve decisions striking down class action prohibitions and eight cases upholding them:

> If there is a pattern in these cases it is this: a class action waiver will not be found unconscionable if the plaintiff had a meaningful opportunity to reject the contract term or if the agreement containing the waiver is not burdened by other features limiting the ability of the plaintiff to obtain a remedy for the particular claim being asserted in a cost-effective manner.[50]

Unconscionability is not the only legal lens through which courts have evaluated the enforcement of prohibitions against class proceedings. In *Kristian v. Comcast Corp.*,[51] the First Circuit invalidated an arbitration clause forbidding class proceedings on the grounds that enforcement would have made it impossible for plaintiff to vindicate its statutory rights under the antitrust laws. This was so because individual damages were a few thousand dollars, but plaintiff's counsel would have been required to make an up-front investment well into six figures in both attorney time and expert fees.[52] "Then, factoring in the uncertainty of success, the appeal for an attorney to take on an individual plaintiff's antitrust claim shrinks even further."[53] In this case, defendant would effectively enjoy immunity from antitrust liability, negating plaintiffs' statutory rights and frustrating the social and economic goals furthered by the antitrust laws.

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Although a number of decisions apply the "vindication of statutory rights" analysis to evaluate prohibitions against class-based proceedings, the continued viability of those cases is questionable in light of the U.S. Supreme Court's April 2010 decision in *Stolt-Nielsen, S.A. v. AnimalFeeds International Corp.*,[54] which held that class-based arbitration may not be ordered when the arbitration agreement is silent on whether the class action procedure may be used.[55] The *Stolt-Nielsen* Court's focus on enforcing the parties' agreement as written may make it more difficult for parties to use the "vindication of statutory rights" principle of federal arbitration law to challenge arbitration clauses that forbid class actions.

QUIZNO'S LITIGATION

The recently settled dispute between Quizno's and its franchisees involved four putative class action lawsuits that implicated Rule 23.

Three of the four cases involved the rights of franchisees that had opened and operated at least one Quizno's restaurant. Brought in the federal courts of Wisconsin, Illinois, and Colorado, each case comprising the Franchise Operator Class Action Litigation asserted claims for violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), fraud in the inducement, breach of contract, breach of the implied covenant of good faith and fair dealing, economic duress, promissory fraud, breach of fiduciary duty, and declaratory judgment. Each of these cases also asserted various claims based on specific statutes of the forum state. The damages of each class member in the Franchise Operator Class Action Litigation varied by franchisee; in certain instances, they were significant.

The *Bonanno* case, in contrast, was brought by franchisees that had purchased franchises but had been unable to find a site for their stores and then were denied a refund of the franchise fee by Quizno's. These franchisees were called "SNOs," an acronym for "Sold But Not Opened." *Bonanno* involved claims for violation of the Colorado Consumer Protection Act (CCPA), fraudulent inducement, breach of contract, violations of the covenant of good faith and fair dealing, unjust enrichment, conspiracy, economic duress, and declaratory judgment. Plaintiffs sought a return of the franchise fee, typically $25,000, that they had paid.

Bonanno plaintiffs moved under Rule 23 for class certification, and Quizno's vigorously opposed the motion. After significant briefing, the district court heard oral argument and issued a written decision denying the motion for class certification on April 20, 2009. The district court never reached the substantive requirements of Rule 23. The sole basis for its decision was the class action prohibition contained in the Quizno's franchise agreement.

Representative plaintiffs in *Bonanno* asserted five arguments as to why the class prohibition should not be enforced. First, despite the existence of approximately 3,300 SNOs in the Quizno's system with rights similar to those of the representative plaintiffs, absent a class procedure to incentivize plaintiffs and their counsel, very few lawsuits would be brought to recoup the $25,000 franchise fees at issue. History showed that a minimal number of suits by SNOs had been asserted nationwide. Plaintiffs offered declarations from various attorneys who contended that they were interested in pursuing individual suits but could not justify the time and expense of doing so because the amount in controversy was so low. Second, plaintiffs argued that the class prohibition language was procedurally and substantively unconscionable, as a host of courts (described above) had concluded in relation to similar prohibitions in other cases. Third, the franchisees argued that the Federal Trade Commission (FTC) viewed franchisees as members of one of two classes: ordinary consumers and "sophisticated investors." Plaintiffs argued that the putative class members fell into the former camp and that such a sweeping prohibition on the ability to obtain class relief would undermine the consumer protection laws that plaintiffs sought to invoke. Fourth, *Bonanno* plaintiffs argued that the only meaningful way to level the imbalance of power between franchisor and franchisee was to ensure that the franchisees had the ability to pursue relief on behalf of thousands rather than as individuals. In short, only with the "big stick" of Rule 23 could the power imbalance typically associated with the franchising model be remedied. Finally, in the face of an argument that they knowingly signed a franchise agreement containing a class prohibition, plaintiffs asserted that they did not knowingly waive their right to invoke Rule 23.

Defendants in *Bonanno* argued vigorously against these positions. First, they invoked the contractual bar contained in the franchise agreement to assert that plaintiffs had knowingly waived their right to proceed as a class. Quizno's

asserted that the language involved no ambiguity and that the plain language of the contract barred class-based litigation. Second, Quizno's relied on its own precedents (discussed above) to assert that class action prohibitions are enforceable. Third, relying on Colorado's test to determine unconscionability, Quizno's argued, among other things, that the prohibition was not thrust upon representative plaintiffs; that it was accepted at arm's length after a full and fair opportunity to read and understand it; and that the prohibition served a valid commercial purpose, namely, to provide certainty in the Quizno's system and reduce costs in the resolution of franchisee disputes. Finally, Quizno's argued that the right to proceed as a class action is a procedural right (not a substantive right), and it thus could not be substantively unfair to deny plaintiffs the right to proceed in this manner.

The district court in *Bonanno* ruled squarely in favor of Quizno's. In its decision denying class certification, the court did not address any of the Rule 23 requirements and focused exclusively on the enforceability of the class prohibition.

First, the district court concluded that the right to proceed as a class action is a procedural right, drawn from the English common law and designed to "avoid multiplicative litigation."[56] Thus, relying on the Supreme Court's decision in *Ortiz v. Fibreboard Corp.*, the court found that "Rule 23 remains a procedural tool, not a substantive right."[57]

Second, the *Bonanno* court rejected the idea that the doctrine of waiver had any application to the enforcement of a procedural right, holding instead that stringent requirements for determining whether a waiver had occurred were appropriate only when substantive constitutional rights were implicated.[58]

Third, the district court refused to follow precedent from other circuits holding class action waivers unconscionable. In so doing, the court questioned the applicability of the precedent on the basis that the prior cases involved claims far more complex, such as antitrust, than the "simple fraud and consumer protection–type claims" at issue in *Bonanno*.[59] The district court found it compelling that much of the precedent throwing out class action prohibitions arose from cases in an arbitration context and involved factual and legal circumstances different than those of the SNO class action.[60]

Fourth, after analyzing Colorado's unconscionability standards, the court concluded that the "take it or leave it" class prohibition offered by Quizno's was not unconscionable.[61] Although the district court agreed that Quizno's offered a "standard form" agreement, it noted that plaintiffs did not have to sign the agreement, had ample opportunity to review it before doing so, and were not misled simply by the placement of the class action prohibition toward the end of the agreement.[62] Further, the court specifically found that the Quizno's class prohibition served a legitimate purpose by enabling Quizno's to ensure "predictability in decision-making, budgeting and planning."[63]

Finally, the district court rejected the notion that the amount in dispute would serve as a disincentive to bring suit and, as such, could not be found to be a basis for invalidating the prohibition.[64]

FUTURE OF CLASS ACTION PROHIBITIONS

The *Bonanno* decision presents another case to add to the line of decisions enforcing class action prohibitions in franchising. Unsurprisingly, since *Bonanno* came down, other courts have continued to weigh in on the opposing side of the issue. Like many other cases, the holding of *Bonanno* is sufficiently tied to specific facts that its precedential value will primarily be persuasive. What follows are the authors' suggestions for advocates and courts alike to consider when faced with litigation regarding class action prohibitions in the franchise context.

IMPERMISSIBLE RESTRICTION OF COURT'S OWN POWERS?

Near the conclusion of its decision, the *Bonanno* court raised an issue that had not been briefed by the parties: "whether [a class action prohibition] improperly intrudes upon the Court's ability to manage its cases pursuant to the Federal Rules of Civil Procedure."[65] The district court expressed a concern that "with respect to the many different waiver provisions being inserted into contractual arrangements, at some point parties are going to overstep their bounds and intrude into the province of the courts by waiving procedural matters that affect case management and judicial economy."[66]

Ultimately, the *Bonanno* court disregarded the docket management concern and concluded that the class action bar should be enforced for two reasons. First, courts lack the power to certify a class without a request from at least one of the parties, even if class treatment would be the most efficient and economical option.[67] Second, because Rule 23 is not compulsory, "there is nothing jurisdictional about [it]"; therefore, "by enforcing the class action bar at issue, the Court will not improperly alter other procedural mandates, as would be the case if, for example, the question before the Court was the enforceability of a contractual bar on compulsory counterclaims."[68]

Not quite two months after *Bonanno* was issued, a district court in Pennsylvania reached the opposite conclusion in addressing the very same class action prohibition in the Quizno's franchise agreement.[69] In *Martrano v. Quizno's Franchise Co., LLC*, the court began its analysis by referencing Supreme Court precedent governing the interpretation of contractual forum selection clauses, which prohibits courts from automatically enforcing such clauses but instead requires the clause to be considered as merely one of many factors under the federal venue transfer statute.[70] The court reasoned that party preferences as expressed in the contract were entitled to even less weight in the class action and consolidation contexts:

> Unlike the situation with venue/forum selection clauses, in which the parties' expressed preferences are accorded substantial weight in the governing statutory framework, the parties' preferences with respect to class certification or consolidation are not among the factors encompassed within the framework of Rule 23 or Rule 42. . . . Under both Rule 23

and Rule 42, the ultimate governing standard is furtherance of efficient judicial administration, which leaves no room for enforceability of private agreements to forego the efficiencies potentially afforded by consolidated or class adjudication.[71]

The *Martrano* court concluded its analysis by noting that enforcement of a class action prohibition "could potentially force this and other courts to hold separate trials of dozens, or hundreds, or even thousands of cases involving extensively overlapping issues," a result "flatly inconsistent" with the mandate in Federal Rule of Civil Procedure 1 to "secure the just, speedy and inexpensive determination of every proceeding."[72]

The decisions in both *Bonanno* and *Martrano* acknowledge that there is no controlling precedent from higher courts directly addressing whether contractual class action prohibitions can be squared with the fundamental docket management and judicial efficiency concerns of Rule 23. The authors similarly found no cases on point. Whether parties can use private agreements to restrict the array of docket management tools available to busy federal judges poses an important public policy question. At the very least, the empirical question of whether class action prohibitions are depriving a heavily burdened federal judicial system of needed efficiencies requires further study.

The principal battleground for attacking and defending class action prohibitions has been the doctrine of unconscionability under state contract law.

COUNTERVAILING POWER ANALYSIS

Although the *Bonanno* decision ultimately enforced the Quizno's class action prohibition, the district court did acknowledge that "Quizno's retains far greater power in the parties' relationship than any one franchisee," relying upon the opinion of the franchisees' expert Professor Bert Rosenbloom to support this conclusion.[73] The approach outlined in this section draws from Professor Rosenbloom's analytical framework for evaluating power relationships in distribution channels.[74]

That framework begins with the simple concept of power in the marketing channel, defined as "the capacity of a particular channel member to control or influence the behavior of another channel member."[75] When franchising is the means of distribution, the franchisor ordinarily dominates its franchisees in the distribution channel: "[C]hannels that are contractually linked, such as in a franchised system, provide the franchisor with a strong legal power base that derives from the contract."[76] When coercive power, i.e., the threat or reality of punishment, is used to achieve a channel member's goals, it may reduce the stability and viability of the channel "and is likely to increase the possibility that the coerced channel members will seek outside assistance (such as government action) to reduce the coercion."[77]

If there are no viable means for the less powerful channel members (the franchisees) to raise and obtain resolution of their grievances, some form of collective action, such as a class action suit, may be the only realistic way to obtain redress. Before reaching the conclusion that such collective action is the only viable option for countering franchisor power, Professor Rosenbloom's methodology reviews less drastic options for practically raising and resolving grievances. The first option that might provide relief is a formal grievance procedure that identifies the franchisor officers empowered to deal with grievances and explains the process that franchisees must follow to present and resolve a dispute. Another option is a franchisee advisory council, comprised of top management representatives from the franchisor and a representative sample of franchisees. Such a council, when taken seriously by the franchisor, provides channel members with recognition in the franchisor's eyes, furnishes a vehicle for discussing mutual needs and problems, and improves communications.[78]

The third and final option is individual franchisee lawsuits against the franchisor. This option provides an adequate avenue for airing and resolving grievances and countering franchisor powers only if it is cost-effective; a relatively small franchisee attempting to sue a much larger franchisor may be required to spend substantially more in legal fees than the likely damages awarded in the event of a court victory, rendering such a case economically infeasible.

Notably, judges, many of whom have limited private practice experience in trying commercial disputes, often assume that the threshold for taking a case is much lower than it is in the real world.[79] The basic point of Professor Rosenbloom's framework is that the lower the stakes, the less likely it is that individual suits will prove to be an effective source of countervailing power on the franchisees' side.

If these three options fail to provide an adequate source of countervailing power, Professor Rosenbloom's framework suggests that a class action, through which franchisees can assert their rights collectively, is the last remaining practical means to restore the imbalance of power in the franchisor–franchisee relationship. Accordingly, when such conditions exist, contractual prohibitions against the use of class actions should not be enforced.

On the one hand, it is questionable whether courts unaccustomed to detailed factual analyses of business realities would accept this argument against the enforcement of a contractual provision. On the other hand, the kind of pragmatic approach to business litigation called for by Professor Rosenbloom's framework may be a useful tool in analyzing the potential unconscionability of contractual waiver provisions.

UNCONSCIONABILITY REVISITED

The principal battleground for attacking and defending class action prohibitions has been the state law contract

doctrine of unconscionability, probably because that theory is a well-recognized legal ground under Federal Arbitration Act precedent to challenge an arbitration clause that forbids class proceedings.[80] This section discusses several trends that the authors have discerned in the case law regarding class action prohibitions.

First, the amount of money at stake in an individual dispute may be the most important element of the court's unconscionability analysis when a class action prohibition is challenged. This is essentially a recognition of the central truth that, in the words of the Seventh Circuit, when the plaintiff's financial stakes are low, "[t]he *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30."[81] Put another way, in the context of Professor Rosenbloom's analytical framework, is the potential payoff for franchisees and their lawyers, weighed against the likely fees and expenses of litigation in light of the likelihood of prevailing on the merits, sufficient to justify the cost of an individual lawsuit?

Although there are no bright-line rules, a judicial consensus appears to be developing that individual litigation will be cost-justified at a fairly low threshold, giving franchisee plaintiffs, whose initial franchise fee alone usually exceeds the threshold, a steep hill to climb to defeat class action prohibitions. The California experience is instructive. In the wake of the California Supreme Court's decision in *Discover Bank v. Superior Court*,[82] courts evaluating class action prohibitions must consider, among other things, whether "disputes between the contracting parties predictably involve small amounts of damages."[83] A federal district court called upon to apply *Discover Bank* concluded that "no court has found that the amount at issue here, more than $5,000, falls within that definition"[84] and accordingly rejected plaintiffs' challenge to an arbitration clause that barred class proceedings.

Similarly, courts faced with five-figure claims have consistently ruled that those claims were of sufficient magnitude to incentivize litigants to bring their own individual suits. *Bonanno* itself involved claims to recover an initial franchise fee of "typically" $25,000.[85] Another federal court ruled that a claim of approximately $40,000 warranted individual litigation,[86] and still another held that a $75,000 claim was too large to justify disregarding a class action prohibition.[87]

It is difficult to tell from the face of these decisions whether the courts got it right because the opinions generally do not discuss the specific costs and fees to be incurred in the prosecution of a five-figure claim weighed in light of the obstacles to recovery. Sometimes the decisions make clear that the cost-benefit analysis cannot be done because the plaintiff failed to present evidence sufficient to permit analysis.[88] Probably the most thorough discussion of the economic risks and rewards of individual versus class litigation is the Second Circuit's decision in *In re American Express Merchants' Litigation*, in which the court relied on extensive evidence from a Ph.D. economist retained by plaintiffs to conclude that because plaintiffs' likely out-of-pocket expenses would range between several hundred thousand and $1 million and the likely maximum damages (after trebling under the Clayton Act) of an average class member would be a little over $5,000, upholding the contractual class action prohibition would effectively negate defendant ever being held accountable, even if it was guilty of antitrust violations.[89] But too often, the courts fail to explain how and why they have concluded that the ceiling for so-called small damages is $5,000, or that stakes of $25,000 or even $75,000 provide sufficient incentive to litigate individually when weighed against the expenses of litigation and the potential for adverse results. These questions are amenable to empirical analysis, and there is extensive literature on risk aversion and risk tolerance[90] that courts can use to illustrate the facts that litigants present.

Another trend in some recent unconscionability decisions has been a focus on the process of contract formation. In particular, the presence or absence of coercive, high-pressure sales tactics has been the subject of judicial focus in evaluating whether a clause is procedurally unconscionable.[91] In this context, courts and litigators alike must be careful not to confuse this aspect of unconscionability with an argument that the entire contract was fraudulently induced. In addition, counsel should separately analyze sales tactics used to induce prospective franchisees to investigate opportunities and those employed to induce prospects to sign the agreements after the required ten-day review period. When a franchisor has strictly complied with the ten-day waiting period and refrained from high-pressure sales tactics at the actual time of signature, the authors believe that courts will be less likely to attribute any significance to the franchisor's behavior at earlier stages of the process.

A final trend regarding the decision of whether to enforce a class action prohibition is identifying the potential for retaliation against putative class members, as several California courts have done in the employment context.[92] In particular, the continuing relationship between the employer and the employee may discourage employees who fear retaliation from stepping forward to pursue individual claims.[93] The continuing relationship between the franchisor and the franchisee may warrant a similar analysis.

CONCLUSION

Although a class action might seem well suited to resolving many disputes that arise out of the standardized aspects of a franchise system, many franchise agreements contain clauses that prohibit franchisees from invoking the class action mechanism. The courts have upheld and rejected class action prohibitions, but case law in the franchise context is limited.

In evaluating whether to enforce contract provisions that bar class actions, courts have focused primarily on whether individual lawsuits make economic sense, although the decisions feature more speculation than application of actual facts. Recently, courts have raised the issue of whether class action prohibitions impermissibly intrude upon the power of the courts to control their own dockets. This inquiry will undoubtedly merit further consideration by courts in future cases regarding the enforceability of contractual class action waiver provisions.

ENDNOTES

1. Siemer v. Quizno's Franchise Co., LLC, No. 07-C-2170, 2010 WL 3238840 (N.D. Ill. Aug. 13, 2010).

2. Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744 (D. Colo. Apr. 20, 2009).

3. Martrano v. Quizno's Franchise Co., LLC, No. 08-0932, 2009 WL 1704469 (E.D. Pa. June 15, 2009).

4. GTE Sylvania, Inc. v. Cont'l T.V., Inc., 537 F.2d 980, 999 (9th Cir. 1976) (quoting Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962)).

5. Murphy v. Holiday Inns, Inc., 219 S.E. 2d 874, 877–78 (Va. 1975), *quoted in* Hunter v. Ramada Worldwide, Inc., No. 1:04CV00062ERW, 2005 WL 1490053, at *6 (E.D. Mo. June 23, 2005).

6. Pub. L. No. 109-2, 119 Stat. 4 (2005).

7. Barbara J. Rothstein & Thomas E. Willging, Managing Class Action Litigation: A Pocket Guide for Judges 1 (Fed. Judicial Ctr. 2d ed. 2009).

8. *Id.*

9. *Id.*

10. *In re* Am. Express Merchants' Litig., 554 F.3d 300, 312 (2d Cir. 2009), *vacated and remanded sub nom.*, Am. Express Co. v. Italian Colors Rest., 130 S. Ct. 2401 (2010).

11. Mace v. Van Ru Credit Corp., 109 F.3d 338, 344 (7th Cir. 1997).

12. Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997).

13. Fed. R. Civ. P. 23(b).

14. Most states provide a mechanism for class action treatment as well. Many of them mirror the procedure used in the Federal Rules of Civil Procedure, while others depart dramatically from it. Although state court class action practice is far from dead, the enactment of the CAFA markedly altered the landscape for state court class action practice, primarily by enabling defendants to more easily remove cases filed in state court. Because the model on which most class actions proceed is the one used in federal court, we focus our discussion in this article on Rule 23. Practitioners are advised to be cognizant of the differences between state and federal class action practice.

15. Fed. R. Civ. P. 23(a).

16. Daigle v. Shell Oil Co., 133 F.R.D. 600, 603 (D. Colo. 1990).

17. Colo. Cross-Disability Coal. v. Taco Bell Corp., 184 F.R.D. 354, 357 (D. Colo. 1999).

18. Cook v. Rockwell Int'l Corp., 181 F.R.D. 473, 480 (D. Colo. 1998).

19. *Id.*

20. J.B. v. Valdez, 186 F.3d 1280, 1288 (10th Cir. 1999).

21. Realmonte v. Reeves, 169 F.3d 1280, 1285 (10th Cir. 1999) (quoting DeBoer v. Mellon Mortgage Co., 64 F.3d 1171, 1174 (8th Cir. 1995)).

22. *E.g.*, *J.B.*, 186 F.3d at 1288 (citing K.L. v. Valdez, 167 F.R.D. 688, 690 (D.N.M. 1996)); *see also In Re* Am. Med. Sys., Inc. 75 F.3d 1069, 1080 (6th Cir. 1996); Baby Neal v. Casey, 43 F.3d 48, 56 (3d Cir. 1994).

23. *E.g.*, *Cook*, 181 F.R.D. at 481.

24. Joseph v. Gen. Motors Corp., 109 F.R.D. 635, 637 (D. Colo. 1986) (quoting Kornberg v. Carnival Cruise Lines, Inc., 741 F.2d 1332, 1337 (11th Cir. 1984)).

25. *E.g.*, Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 625–26 (1997) (citing E. Tex. Motor Freight Sys., Inc. v. Rodriquez, 431 U.S. 395, 403 (1977)); *see also* Schlesinger v. Reservists Comm. to Stop War, 418 U.S. 208, 216 (1974).

26. Rutter & Wilbanks Corp. v. Shell Oil Co., 314 F.3d 1180, 1187–88 (10th Cir. 2002).

27. Fed. R. Civ. P. 23(b)(1).

28. Fed. R. Civ. P. 23(b)(2).

29. Fed. R. Civ. P. 23(b)(3).

30. *E.g.*, Joseph v. Gen. Motors Corp., 109 F.R.D. 635, 641 (D. Colo. 1986) (quoting 7A C. Wright & A. Miller, Federal Practice and Procedure § 1778, at 53).

31. *E.g.*, *id.* at 641.

32. Blades v. Monsanto Co., 400 F.3d 562, 566 (8th Cir. 2005).

33. Fed. R. Civ. P. 23(b)(3)(A).

34. Fed. R. Civ. P. 23(b)(3)(B).

35. Fed. R. Civ. P. 23(b)(3)(C).

36. Fed. R. Civ. P. 23(b)(3)(D).

37. *Joseph*, 109 F.R.D. at 642 ("The individual questions presented can be resolved in separate proceedings."); Cook v. Rockwell Int'l Corp., 181 F.R.D. 473, 481–82 (D. Colo. 1998) (Despite facts suggesting individual issues concerning liability and damages, "resolution of the common issues will materially advance the resolution of the case itself.").

38. 155 F.3d 331, 334 (4th Cir. 1998).

39. *Id.* at 333.

40. Bird Hotel Corp. v. Super 8 Motels, Inc., 246 F.R.D. 603, 608 (D.S.D. 2007).

41. *Id.* at 607–08.

42. Bird Hotel Corp. v. Super 8 Motels, Inc., No. CIV06-4073, 2010 WL 572741 (D.S.D. Feb. 16, 2010).

43. Fed. R. Civ. P. 1.

44. Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744, at *24 (D. Colo. Apr. 20, 2009).

45. *Id.* at *1.

46. Among them is the district court in *Bonanno*. 2009 WL 1068744, at *12.

47. Cicle v. Chase Bank USA, 583 F.3d 549, 554 (8th Cir. 2009).

48. Thibodeau v. Comcast Corp., 912 A.2d 874, 886 (Pa. Super. 2006).

49. An arbitration clause was struck down and a class action allowed to proceed in *Powertel, Inc. v. Bexley*, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999), while an arbitration clause prohibiting class proceedings was enforced in *Fonte v. AT&T Wireless Servs., Inc.*, 903 So. 2d 1019 (Fla. Dist. Ct. App. 2005). The decisions can be reconciled based on their reasoning; in *Powertel*, the clause was found procedurally unconscionable because it was imposed unilaterally by the service provider during the term of customers' agreements, thus giving customers the untenable choice between switching providers and being subjected to the arbitration provision. 743 So. 2d at 574–75. In contrast, the service provider in *Fonte* included the class prohibition in an arbitration clause in the original service agreement signed by plaintiff, thus affording her a meaningful opportunity to reject the provision at no cost to her. 903 So. 2d at 1026–27.

50. Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 274 (Ill. 2006). Several recent decisions enforce class arbitration prohibitions under the "meaningful opportunity to reject" analysis when

the terms of the agreements allowed plaintiffs to opt out of mandatory arbitration by providing notice within a certain period after the agreement went into effect. Fluke v. Cashcall, Inc., No. 08-5776, 2009 WL 1437593, at *7–8 (E.D. Pa., May 21, 2009); Honig v. Comcast of Ga. I, LLC, 537 F. Supp. 2d 1277, 1288–89 (N.D. Ga. 2008).

51. 446 F.3d 25 (1st Cir. 2006).

52. *Id*. at 58.

53. *Id*. at 59.

54. 130 S. Ct. 1758 (2010).

55. *Id*. at 1775–76.

56. *E.g.*, Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744, at *9 (D. Colo. Apr. 20, 2009).

57. *Id.* at *11 (citing Ortiz v. Fibreboard Corp., 527 U.S. 815, 846 (1999)).

58. *Id*.

59. *Id*. at *15.

60. *Id.* at *16.

61. *Id*. at *18.

62. *Id*. at *19.

63. *Id*. at *20.

64. *Id*. at *21.

65. *Id.* at *23.

66. *Id*.

67. *Id*.

68. *Id.*

69. *E.g.*, Martrano v. Quizno's Franchise Co., LLC, No. 08-0932, 2009 WL 1704469, at *21 (E.D. Pa. June 15, 2009).

70. *Id*. at *20 (citing Stewart Org. v. Ricoh Corp., 487 U.S. 22 (1988)).

71. *Id*.

72. *Id*.

73. *E.g*., *Bonanno*, 2009 WL 1068744, at *22.

74. Professor Rosenbloom's central notion of countervailing power is itself derived from the work of John Kenneth Galbraith. *See, e.g.*, John Kenneth Galbraith, American Capitalism (1956).

75. Bert Rosenbloom, Marketing Channels: A Management View 127 (7th ed. 2004).

76. *Id*. at 133–34.

77. *Id*. at 137.

78. *Id*. at 279.

79. Compare discussion of small damages, *infra* notes 80–88 and accompanying text.

80. Under the rule of *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996), "generally applicable" state law contract defenses may be used to defeat arbitration provisions, while state law specifically targeting the enforcement of arbitration clauses cannot be given effect without violating the Federal Arbitration Act. Unconscionability is well established as one of the generally applicable defenses that can prevent enforcement of an arbitration clause containing a class action waiver or prohibition. Ting v. AT&T, 319 F.3d 1126, 1150 n.15 (9th Cir. 2003); Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 261–62 (Ill. 2006).

81. Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004) (emphasis in original).

82. 113 P.3d 1100 (Cal. 2005).

83. *Id*. at 1110.

84. Smith v. Americredit Fin. Servs., Inc., No. 09cv1076 DMS (BLM), 2009 WL 4895280, at *7 (S.D. Cal. Dec. 11, 2009).

85. *E.g.*, Bonanno v. Quizno's Franchise Co., LLC, No. 06-cv-02358-CMA-KLM, 2009 WL 1068744, at *15 (D. Colo. Apr. 20, 2009).

86. Banus v. Citigroup Global Markets, Inc., No. 09 Civ. 7128 (LAK), 2010 WL 1643780, at *10 (S.D.N.Y. Apr. 23, 2010).

87. Schultz v. AT&T Wireless Servs., Inc., 376 F. Supp. 2d 685, 690–91 (N.D. W. Va. 2005).

88. Reid v. Supershuttle Int'l, Inc., No. 08-cv-4854 (JG) (WP), 2010 WL 1049613, at *3–4 (E.D.N.Y. Mar. 22, 2010).

89. *E.g.*, *In re* Am. Express Merchants' Litig., 554 F.3d 300, 318–20 (2d Cir. 2009). In May 2010, the Supreme Court granted certiorari and summarily vacated the court's decision, remanding for further consideration in light of *Stolt-Nielsen*. Am. Express Co. v. Italian Colors Rest., 130 S. Ct. 2401 (2010). The one-paragraph summary remand does not specify why the appellate decision was vacated; the Supreme Court held in *Stolt-Nielsen* that under Federal Arbitration Act principles, when an arbitration agreement is allowed, it is impermissible for an arbitration panel to impose class-based arbitration. Stolt-Nielsen, S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1775–76 (2010). Because the Second Circuit based its decision on "the federal substantive law of arbitrability" rather than unconscionability principles, 554 F.3d at 312, it appears that the Supreme Court believes the Second Circuit's approach resulting in the invalidation of the bar to class arbitration is inconsistent with the reasoning of *Stolt-Nielsen*. The Supreme Court has now expressed interest in reviewing courts' efforts to allow class actions to proceed in the face of arbitration agreements that prohibit class proceedings. In *AT&T Mobility LLC v. Concepcion*, 2010 WL 303962 (U.S. May 24, 2010), the Court accepted certiorari to determine whether the FAA preempts the State of California from conditioning enforcement of an arbitration clause on the availability of classwide arbitration. The Ninth Circuit did exactly that in *Laster v. AT&T Mobility*, 584 F.3d 849 (9th Cir. 2009), and the holding from *Laster* is now under attack.

90. Particularly significant in this context is the so-called endowment effect first explored by Kahneman and Tversky, in which a prospective loss of *X* amount is given substantially more weight by an individual than a prospective gain of equal magnitude. D. Kahneman & A. Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 Econometrica 263 (1979); William Poundstone, Priceless 98–101 (2010). There is extensive literature concerning the economics of contingent fee litigation, much of which would seem to be relevant to whether the stakes of victory for plaintiffs and their counsel will warrant individual lawsuits, e.g., Richard Posner, Economic Analysis of Law § 21.9, at 624–32 (5th ed. 1998), but this literature is rarely cited by courts analyzing the enforcement of class action prohibitions.

91. *E.g*., Cicle v. Chase Bank USA, 583 F.3d 549, 555 (8th Cir. 2009) (no unconscionability where plaintiff presented no evidence of high-pressure sales tactics); Fonte v. AT&T Wireless Servs., Inc., 903 So. 2d 1019, 1026 (Fla. Dist. Ct. App. 2005).

92. *See, e.g.*, Gentry v. Superior Court, 165 P.3d 556, 568 (Cal. 2007); Franco v. Athens Disposal Co., Inc., 171 Cal. App. 4th 1277, 1296 (Cal. Ct. App. 2009). Notably, both *Gentry* and *Franco* involved nonwaivable statutory claims relating to employee wages.

93. *E.g.*, *Franco*, 171 Cal. App. 4th at 1296.

