SHALL WE ARBITRATE?
THE PROS AND CONS OF ARBITRATING FRANCHISE DISPUTES

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I. INTRODUCTION

Every legitimate franchisor commences operations confident in its business model and hopeful of harmonious relations with franchisees. Sooner or later, however, virtually all franchisors must face an unfortunate fact of franchising life: some disputes with franchisees are simply unavoidable even in well-managed, thriving systems. Since the early 1990s, moreover, “many prominent franchisors have become enmeshed in contentious litigation of systemwide disputes with franchisees,”1 at great expense and occasional peril to the continuing viability of the franchisors and their systems. Whether a franchisor eventually confronts isolated claims or systemwide problems, how the universal questions of where, by whom, and under what procedural and substantive rules disputes with franchisees are resolved can sometimes tip the balance from successful risk management to disaster.

An informed assessment of dispute resolution options is therefore crucial. In conducting that assessment, when drafting its first franchise agreement and thereafter as the franchise system evolves, every franchisor should ask itself, “shall we arbitrate?” This is an important question for franchisees to ponder as well. All prospective franchisees should understand what they are accepting as a dispute resolution mechanism before they execute a franchise agreement that contains an arbitration clause. Franchisees may also be able to negotiate modification or elimination of an arbitration requirement, either before signing the franchise agreement or after a dispute arises. Faced with an actual dispute, moreover, franchisees subject to compulsory arbitration clauses should always make informed judgments about whether to try to challenge the arbitration requirement.

Arbitration engenders a wide range of strong opinions among experienced franchisor counsel (and their clients). Some swear by it. Others loathe it. And some have concluded, based on painful experience, that despite its significant shortcomings, arbitration still beats litigation as a tool for cabining risk and thereby facilitating pursuit of the franchisor’s business goals. Franchisees and their lawyers are also divided in their views of arbitration. Some believe that franchisees can only get a fair shake from a hometown judge and jury.2 Other franchisee advocates recognize that the informality, limited discovery and motion practice, and equitable orientation of most arbitrations can actually increase their chances of success.3

The authors of this article both litigate primarily on behalf of franchisors but disagree about the wisdom of arbitrating most franchise disputes. It will therefore come as no surprise that this paper and the accompanying program are not intended to eliminate the existing diversity of opinion among franchisors, franchisees, and the franchise bar. The object of the presentation, instead, is to outline a framework for disciplined consideration of whether to arbitrate, based upon a set of factors most likely to determine whether arbitration makes sense for a particular franchise system and with regard to specific disputes.

To that end, this paper will first provide a brief overview of recent trends in litigation and arbitration. It will next identify the features of litigation that explain why arbitration is, at a

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2 For one viewpoint on the ostensible drawbacks of arbitration for franchisees, see Jean R. Sternlight, *Protecting Franchisees from Abusive Arbitration Clauses*, 20 Franchise L.J. 45 (2000).

minimum, always worth considering as a dispute resolution alternative. The paper will then address nine specific characteristics of arbitration, as they compare to litigation: (1) speed and cost; (2) the quality of the decisionmakers; (3) evidentiary rules and governing law; (4) injunctive relief; (5) motion practice; (6) outcome patterns; (7) punitive damages; (8) class proceedings; and (9) appellate review.4

II. AN OVERVIEW OF RECENT TRENDS

Americans continue to sue each other with great frequency, but actual trials on the merits in litigation are increasingly rare phenomena. Federal court statistics show that, between 1999 and 2004, civil filings in U.S. District Courts rose from 307,997 to 358,983.5 During that same period, the number of civil trials per judge has decreased from an annual average of 23 to 19.6 According to Marc Galanter, a leading dispute resolution scholar, “[b]etween 1962 and 2002, civil dispositions in the federal district courts increased by a factor of five – from 50 to 258,000 cases, but the number of trials dropped by 20 percent. Therefore, the portions of dispositions that are by trial today (1.8 percent) is less than one sixth of what it was in 1962.”7

The mediation boom is probably the single biggest explanation for “the vanishing trial,”8 but increased resort to arbitration has also been a factor,9 especially in franchising. One study

4 Because this paper covers such a broad range of topics, there are many that we did not have room to tackle, including the arbitration of international franchise disputes.


6 Id.

7 Marc Galanter, The Vanishing Trial, 10 No. 4 DISP. RESOL. MAG. 3 (2004) (footnote omitted). Another scholar has noted that:

Alternative dispute resolution (“ADR”) procedures have not displaced traditional litigation; hundreds of thousands of lawsuits are filed annually in state and federal courts. But there are some reasons to believe that the ADR movement has had some success over the past twenty-five years in changing business and legal decision-makers’ views of how best to resolve legal disputes. Courts’ civil caseloads have declined significantly over the past decade in many jurisdictions. At the same time, there has been a dramatic decrease in the fraction of civil cases reaching trial. Federal courts are now required by law to offer some form of ADR, and many state courts require parties to attempt to resolve their cases through mediation before they can obtain a trial date. Outside the courts, the use of binding arbitration appears to be on the rise.


8 Galanter, supra note 7.

9 “The civil jury trial is fast disappearing from our legal landscape, and one important reason for its disappearance is the rapid growth of mandatory arbitration.” Jean R. Sternlight, The Rise and Spread of Mandatory Arbitration as a Substitute for the Jury Trial, 38 U.S.F. L. REV. 17 (2003).
concluded that in 1999 nearly half of all leading franchisors’ franchise agreements contained arbitration clauses.\(^{10}\)

There are signs, however, that the pendulum may now be swinging back the other way. Anecdotal evidence suggests that many franchisors are either abandoning arbitration altogether or using more “carve-out” provisions (exempting specific categories of disputes from the franchise agreement arbitration clause). And franchisee advocates have already succeeded in piercing at least one hole in the armor of the Federal Arbitration Act (“FAA”). By virtue of a 2002 amendment, motor vehicle dealer agreements are now outside the FAA’s scope.\(^{11}\) That this exemption is limited to motor vehicle franchise agreements may simply reflect that motor vehicle dealers have substantial political influence, but the arguments\(^{12}\) that won passage of this amendment could justify exempting all franchise agreements from the FAA.

III. GIVEN ALL ITS OBVIOUS FLAWS, WHY WOULD ANYONE CHOOSE TO ARBITRATE?

IV. ONE AUTHOR OF THIS PAPER HAS PREVIOUSLY ASSERTED THAT “FRANCHISORS AND OTHER SUPPLIERS SHOULD THINK LONG AND HARD BEFORE REQUIRING ARBITRATION OF ALL CONTRACTUAL DISPUTES (OR BEFORE AGREEING TO ARBITRATION ABSENT A CONTRACTUAL REQUIREMENT TO DO SO).”\(^{13}\) EVEN CERTAIN ADVOCATES OF ARBITRATION RECOGNIZE HOW DEEPLY DISSATISFYING IT CAN BE. AS THE OTHER AUTHOR OF THIS PAPER HAS OBSERVED:

[to anyone who has ever endured a protracted arbitration, conducted without regard to evidentiary rules or governing law, only to receive a mystifying (or infuriating) award that a reviewing court will simply rubber stamp, the flaws of the process are manifest.\(^{14}\)]

“Runaway juries” are a commonplace fear of corporate America, but franchisors should also be cognizant of the potential for a “runaway arbitrator.”\(^{15}\)

When trial court judges and/or juries make mistakes, appellate courts can and often do correct them. Since the arbitrator [has] no fear of being reversed on appeal, he [may feel] free to substitute his own personal judgments . . . for the written terms of the parties’ contracts. Free of real appellate review, the arbitrator [may] not hesitate to make his own subjective determinations about whether merger and integration clauses should be enforceable. Any sitting federal judge


\(^{12}\) See generally Chiappa & Stoelting supra note 11 at 220.


\(^{15}\) Lockerby, *supra* note 13.
would instead [be] required to defer to the determinations of state legislators and state supreme court justices on applicable state law.\textsuperscript{16}

Many franchisors and their counsel “regard arbitration with a heartfelt blend of disdain and horror.”\textsuperscript{17} The reasons include the absence of meaningful discovery; the lack of dispositive motions and evidentiary rules; arbitrators “doing equity” according to their own personal standards, without regard to governing law; arbitrators in effect imposing settlements through compromise awards; and the absence of meaningful appellate review.\textsuperscript{18} This is a compelling bill of particulars.\textsuperscript{19}

According to one study, however, “[r]oughly half of all leading franchisors’ franchise agreements require arbitration of disputes.”\textsuperscript{20} If arbitration is so badly flawed, why do so many franchise agreements contain compulsory arbitration clauses? The traditional brief for arbitration would argue, among other things, that it is faster and less expensive than litigation. But this is certainly not always true, as we discuss below. And even in the specific matters where it is true, a potentially less expensive and quicker route to an unpleasant compromise outcome with no chance of appellate escape or modification still does not sound very attractive.

The real case for arbitration boils down to this: litigation may be even worse.\textsuperscript{21} American litigation is untidy, expensive, time-consuming, wildly unpredictable, fraught with risk and conducted in a broad array of judicial systems involving disparate rules, judicial quality, and juror attitudes. Any franchisor contemplating nationwide expansion (or even units in multiple


\footnotesize{\textsuperscript{17} Dunham, supra note 3.}

\footnotesize{\textsuperscript{18} Id. at 104-05.}

\footnotesize{\textsuperscript{19} One of the common criticisms of arbitration is that arbitrators tend to “split the baby” no matter what the merits. One case in which one of the authors of this paper was involved arguably demonstrates this phenomenon. There, a franchisor had an agreement to purchase its Texas franchisee based upon a multiple of earnings. The purchase agreement contained detailed rules governing Generally Accepted Accounting Principles (“GAAP”). The purchase agreement also required arbitration by a major accounting firm in the event of any dispute regarding GAAP or the purchase price. In a later arbitration regarding various accounting disputes that had arisen in connection with the purchase price, the arbitrator ruled in favor of the franchisor on all the accounting issues. The arbitrator’s ruling resulted in an adjustment of the purchase price in excess of $1 million. But the arbitrator then offset that award, dollar for dollar, with an award of damages for “breach of warranty” that the franchisor claimed had never been submitted to arbitration in the first place. In that case, the lack of a transcript of the arbitration complicated the task of determining what was properly before the arbitrator. The district court characterized what the arbitrator had done as “trying to play King Solomon” but nevertheless affirmed the arbitration award. On appeal, two panels of the U.S. Court of Appeals for the Fifth Circuit heard oral argument before ultimately affirming the arbitration award in light of the deferential standard of judicial review of arbitration awards. Executone Info. Sys., Inc. v. Davis, 26 F.3d 1314 (5th Cir. 1994). Mr. Lockerby was lead counsel for the franchisor in the Fifth Circuit appeal. Another law firm handled the arbitration and district court proceeding.}

\footnotesize{\textsuperscript{20} Kevin M. Kennedy & Bethany Appleby, Green Tree Financial Corp. v. Bazzle: A New Day for Class Arbitrations?, 23 FRANCHISE L.J. 84 (2003) (citing Drahozal, supra note 10). Mr. Kennedy is Mr. Dunham’s partner and Ms. Appleby is his associate.}

\footnotesize{\textsuperscript{21} For an earlier discussion of why that may be so, see Edward Wood Dunham et al., Franchisor Attempts to Control the Dispute Resolution Forum: Why the Federal Arbitration Act Trumps the New Jersey Supreme Court’s Decision in Kubis, 29 RUTGERS L.J. 237, 270 (1998).}
states) should understand what litigation in these diverse judicial systems can actually entail before concluding that it would rather litigate than arbitrate.22

In our view, four fundamental characteristics of the American justice system are especially relevant to the question “shall we arbitrate?”: (1) the large number of elected judges; (2) the impossibility of uniformly enforcing franchise agreement alternatives to arbitration clauses, including judicial forum selection clauses, jury trial waivers, damage caps, and damage disclaimers; (3) likely juror attitudes toward business in general and franchising in particular; and (4) the limited success of motion practice and appeals in avoiding or reversing adverse outcomes in court.

A. **It Pays to Remember How Many American Judges Are Elected Officials**

If a franchisor could be sure that federal courts would decide all of its disputes with franchisees, arbitration would almost certainly be much less popular. The federal judicial system is hardly perfect, but for businesses confronting litigation, the merits of the federal courts are many. Those merits include judges appointed for life, and therefore largely immune to political pressure and any tendency toward “home cooking”; generally manageable caseloads, enabling judges to dedicate adequate attention to important legal and factual issues; an ample supply of smart law clerks to help judges get it right; sensible procedural and evidentiary rules, consistently applied; and meaningful review by appellate courts populated by many extraordinarily talented judges.

But franchisors cannot always guarantee federal jurisdiction. Most claims by franchisees involve no questions of federal law. And diversity jurisdiction may also be unavailable, either because the amount in controversy is too low, or because the franchisee is able to sue an in-state defendant along with the franchisor. For example, the plaintiff franchisee claiming encroachment may sue both the franchisor and the franchisee whose unit is allegedly too close.

There are over 5,000 state trial courts in the United States, and approximately 76% of state court judges are elected. An additional nine percent are subject to a popular retention vote at some point after their appointment. Of state appellate judges, 51% are elected, and another 29% are subject to popular retention votes during their tenures on the bench.23

22 In considering the desirability of arbitration as a dispute resolution alternative, franchisors should ask the obvious question: “alternative to what?” According to some sources, certain of the judicial alternatives to arbitration are grim indeed. For example, the American Tort Reform Association (“ATRA”) has identified a number of state courts as “Judicial Hellholes,” based on a number of factors, including:

- the prevalence of forum shopping, novel legal theories, and discovery abuse, as well as the certification of class action lawsuits, the proliferation of junk science, contributions to judges and the uneven application of evidentiary rules.

American Tort Reform Association, Judicial Hellholes 2004, http://www.atra.org/reports/hellholes (last visited Aug. 12, 2005). Although these designations are based on personal injury litigation, the same factors that “earn” a state court this unfortunate label ought to make a franchisor wary of litigation there. If judicial forum selection clauses were always enforceable, deciding whether to arbitrate might be easier. But enforcing these clauses is often problematic, and because franchise agreements are typically long term contracts, it may also be difficult if not impossible to predict in advance which jurisdictions are best avoided and whether a forum selection clause will be effective for that purpose.

of these elected judges are excellent jurists, on par with their federal counterparts, and fair, impartial justice is available to all comers in thousands of county and state courthouses throughout the country. In certain jurisdictions, however, judicial hostility to out-of-state — and sometimes even out-of-county — corporate defendants is palpable, and the prospects of fair pre-trial treatment, let alone a fair trial, are dim.  

Fortunate franchisors will never be sued in any such jurisdictions. Those less fortunate can experience a form of litigation that puts the manifold drawbacks of arbitration in a whole new perspective.

B. Franchisor Attempts to Control the Judicial Forum, Avoid Jurors and Limit Damages Can Never Be Completely Successful.

Franchisors often attempt to avoid the risks of litigation, without accepting the perceived problems of arbitration, by including a series of risk management clauses in their franchise agreements. Judicial forum selection clauses, jury trial waivers, damage caps and damage disclaimers can all be extraordinarily effective tools. Indeed, “[a]long with a forum selection clause and a damage cap, a jury trial waiver would seem to give the franchisor a virtually perfect risk management world – at least on paper.” In the real world, however, franchisors can never achieve uniform enforcement of these contract terms. The franchise relationship statutes at least eight states expressly prohibit enforcement of such contract clauses, and “elsewhere their fate will often depend,” either in state or federal court, on “an unpredictable, case-by-case analysis,” under multi-part tests that include a number of subjective factors. This paper is not the occasion for a comprehensive review of the case law in this area. Suffice it to say that


25 Dunham, supra note 1, at 96.


It appears that even more states have statutes invalidating forum selection clauses. Benjamin A. Levin and Richard S. Morrison, Kubis and the Changing Landscape of Forum Selection Clauses, 16 Franchise L.J. 97, 116 (1997) (“California, Connecticut, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, North Carolina, North Dakota, Rhode Island, and South Dakota all have statutes, rules, or policies which regulate where franchise related litigation and/or arbitration may occur.”).


27 Dunham, supra note 1, at 97.
courts regularly issue new decisions demonstrating that franchisors cannot depend on being able to control the judicial forum, avoid juries, or limit damages through the terms of their franchise agreements. As this paper went to press, for instance, the California Supreme Court held that under a California statute governing waiver of the right to trial by jury, through the use of pre-dispute contractual jury trial waivers, are unenforceable.

C. The Typical Jury Probably Won’t Like “Big Business,” and May Not Understand Franchising

In “The Jury Mystique: Winning Trials in Franchise Cases,” a paper and workshop at the 2001 American Bar Association Forum on Franchising, the authors (who included one of this paper’s authors) discussed the results of the 2000 Juror Outlook Survey by Decision Quest and the National Law Journal, a national poll with 1,000 respondents. This survey was conducted before the Enron, WorldCom, Martha Stewart and Tyco scandals, ensuing guilty pleas and convictions, and the attendant publicity about corporate wrongdoing. The survey results contained sobering news for any corporation, including any franchisor, that might be a defendant in a jury trial. Among other things:

- 75.6% of those polled agreed “strongly or somewhat” that “executives of big companies often try to cover up the harm they do.”

For jury trial waivers, many courts have adopted the test from National Equip. Rental, Ltd. v. Hendrix, 565 F.2d 255 (2d Cir. 1977), but a recent Maryland case is illustrative of the many departures from that test. See G & R Moojestic Treats, Inc. v. Maggiemoo's Int'l, LLC, Bus. Franchise Guide (CCH) ¶ 13,066 (invalidating a jury trial waiver clause due to the franchisor’s failure to list the waiver in a summary of risk factors at the end of the contract, and because the franchisee’s lawyer failed to mention the waiver when recommending changes to the document). The Georgia and California Supreme Courts have held that jury trial waivers are contrary to the state constitution and always unenforceable unless authorized by statute. See Bank S.N.A. v. Howard, 444 S.E.2d 799, 800 (Ga. 1994); Grafton Partners, L.P. v. Superior Court of Alameda County, No. S123344, 2005 WL 1831995 (Cal. Aug. 4, 2005).


In the case of damage-limiting clauses, similar multifactor tests determine the scope of their enforceability. See, e.g., Shree Ganesh, Inc. v. Days Inn Worldwide, Inc., 192 F. Supp. 2d 774, 786 (N.D. Ohio 2002) (holding that while “New Jersey law gives favorable treatment to liquidated damages clauses”, it must meet a reasonableness test to be enforceable).

This decision may be further evidence that, as two commentators have recently remarked, “it is almost axiomatic that California is a dangerous place for franchisors to do business.” W. Andrew Scott & R. Samuel Snider, California Populism, Contract Interpretation and Franchise Agreements, 24 FRANCHISE L.J. 248 (2005).

Michael E. Cobo et al., The Jury Mystique: Winning Jury Trials in Franchise Cases, A.B.A. FORUM ON FRANCHISING § L/B 4 (2001) (Mr. Dunham was one of the authors of this article.).

Id. at 18-19.
• 27% of the respondents “acknowledged that they would not be impartial if a case included a corporate executive as a party;”\textsuperscript{32}

• 45% agreed that jurors should feel free to disregard the judge’s instructions on the law if they believed that this would serve justice;\textsuperscript{33} and

• 30% of the respondents agreed that in order for a jury to send an effective message to a “big corporation, it needs to award damages in the billions of dollars.”\textsuperscript{34}

Decision Quest also conducted a survey of views on franchising, especially for the 2001 Forum presentation. The respondents were “chosen to reflect the composition of a typical jury, with a balance of sex, race, age, income, education, marital status, and employment,”\textsuperscript{35} and were also geographically diverse. Of the respondents, 70% were confident that they understood what a franchise is and could explain it to others.\textsuperscript{36} However, their opinions about franchising would give any sensible franchisor pause before putting its fate in their hands. For example, 63% agreed, either strongly or somewhat, that franchising does not require franchisees to “take a lot of risk;”\textsuperscript{37} 55% agreed that the franchisor takes most of the risks associated with a franchise;\textsuperscript{38} and 80% of the respondents “believe[d] that the main reason franchises fail has absolutely nothing to do with the franchisee’s own conduct.”\textsuperscript{39}

As the authors of the “Jury Mystique” paper concluded, notwithstanding the results of these two surveys, “no franchisor should conclude that it can never win a jury trial against a franchisee.”\textsuperscript{40} Franchisors can and do prevail in jury cases with franchisees. But no prudent franchisor developing a risk management strategy can ignore the likely attitudes of jurors toward franchising and business in general, or the potential that those attitudes will produce adverse outcomes.

D. The Limited Utility of Motion Practice and Appeals

The availability of dispositive motions and meaningful appellate review are two of litigation’s principal attributes, in contrast to arbitration. As discussed more fully below, the parties to every arbitration agreement should recognize that two things are virtually certain in the vast majority of cases. First, absent a negotiated settlement, the dispute will be tried to

\textsuperscript{32} Id. at 19.
\textsuperscript{33} Id.
\textsuperscript{34} Id. at 20.
\textsuperscript{35} Id. at 29.
\textsuperscript{36} Id.
\textsuperscript{37} Id. at 33.
\textsuperscript{38} Id. at 33-34.
\textsuperscript{39} Id. at 34-35.
\textsuperscript{40} Id. at 38.
conclusion, because arbitrators rarely grant motions to dismiss or the arbitral equivalent of summary judgment. Second, the parties will be stuck with the arbitration award, because reviewing courts will reflexively confirm it.

It is also important to recognize, however, that lawyers and clients alike sometimes tend to overestimate the impact of dispositive motions and appeals on the outcome of litigation. Based on the available data, “in the civil justice system as a whole and in narrower case categories, winning either a dispositive motion or an appellate reversal of a plaintiff’s jury or bench trial is unlikely.” For example, in a 2002 summary of case outcomes reported in the UFOCs of thirty leading franchisors (including the ten that Franchise Times magazine ranked as largest in number of units), “only 16% of the concluded cases terminated by motion, and in state court actions the figure was just 12%.” As for appeals, a comprehensive recent study of federal civil trials and appeals decided between fiscal years 1988 and 1997 concluded that only 21% of trial outcomes were appealed, and only 21% of those appeals resulted in reversal. Although the reversal rates varied significantly, depending on the types of claims and whether the plaintiff or the defendant was the appellant, the study confirms that in federal court “any party trying to overturn a jury verdict or bench trial decision will always be traveling statistically uphill.” Comparable statistics on state court appeals are not readily available. Anecdotal information and the authors’ personal experience, however, would suggest no reason to assume that it is any easier to reverse an adverse trial outcome in state court – especially in jurisdictions with a pronounced populist bent.

V. LITIGATION V. ARBITRATION: SPECIFIC FACTORS TO CONSIDER

Regardless of when the decision is made — either before executing the franchise agreement or after a dispute has arisen — the decision whether to arbitrate or litigate should be made only after carefully weighing nine crucial, comparative factors: (1) speed and cost; (2) the quality of the decisionmakers; (3) evidentiary rules and governing law; (4) injunctive relief; (5) motion practice; (6) outcome patterns; (7) punitive damages; (8) class proceedings; and (9) appellate review.

These considerations are equally relevant to both franchisors and franchisees. A franchisor typically drafts the arbitration clause in its standard form franchise agreement without negotiating the provision with any franchisees, but negotiation sometimes occurs before contract execution. As discussed below, moreover, franchisors, franchisees and their counsel should also recognize that they may not have to live with the arbitration clause as drafted. Negotiation after a dispute arises can sometimes produce an arbitration process more efficient, economical, and likely to yield a prompt and fair result than the procedure contemplated by the franchise agreement. In addition, franchisees who signed franchise agreements with arbitration clauses should compare these characteristics of litigation and arbitration before deciding to


42 Id.


44 Dunham & Geronemus, supra note 41, at 25.
challenge the arbitration clause (a time-consuming and expensive process, with a low success rate).

A discussion of each of these nine factors follows.

A. Speed and Cost

The conventional wisdom holds that arbitration is faster and less expensive than litigation. But do the statistics support that conclusion? Unfortunately, reliable data about the speed of arbitration are difficult to obtain. In contrast, statistics about the speed of disposition of civil cases filed in the federal courts are a matter of public record. In 2004, the median time from filing to disposition of all federal civil cases was 8.5 months, compared to 10.3 months in 1999. Cases that actually go to trial, however, take far longer to resolve. In 2004, the median time across the federal court system from filing to trial was 22.6 months. That represents an increase from a median of 20.5 months in 1999. These data would suggest that the average time to trial in federal court is longer than the time from filing to award in the typical arbitration.

Among federal courts, however, the overall statistics mask a wide disparity in the average time to trial. Several district courts maintain “rocket dockets.” The speediest of all, by every measure, is the U.S. District Court for the Eastern District of Virginia. The median time from filing to disposition of all civil cases in Virginia’s Eastern District is only 5.7 months. For cases that actually go to trial, the median is 9.2 months. Nationwide, there are a number of other federal courts whose speed of disposition and trial may well compare favorably to arbitration. These are found at Table C-5 of the Federal Judicial Caseload Statistics published on the Internet.

Turning to costs, arbitration can sometimes prove an economical means of resolving a dispute, particularly because it is usually free of protracted and expensive pre-trial discovery. But arbitration also includes additional expenses absent from litigation, resulting from

- the ADR provider’s administrative fees;

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46 Judicial Caseload Profile, supra note 5.

47 Id.

48 Id.

49 Id.

50 Id.

51 Id.

52 Id.

• the need to pay the fees of one or more arbitrators; and

• the tendency of parties and their lawyers to turn arbitration into the procedural equivalent of litigation, without the judicial checks and balances and the well-defined rules that govern litigation.

Although clients may well blame lawyers for the latter phenomenon, the fact of the matter is that one of the alleged benefits of arbitration — the lack of discovery — may well be a detriment in many franchise disputes, at least from the franchisor’s perspective. Franchisees facing termination often claim that they will suffer irreparable harm without a preliminary injunction, but discovery can sometimes prove otherwise. Similarly, if the issue is whether the franchisee has been under-reporting gross sales in order to under-pay its royalties, an arbitration hearing is not the ideal time and place to be poring over complex financial records for the very first time.

When parties try to recreate in arbitration the discovery that they take for granted in litigation, however, they often find that a significant amount of time and money can be spent haggling over ground rules that would be well-established in litigation. Also, many attorneys have more confidence that adversaries who regularly appear before judges will be more fastidious in honoring their discovery obligations than they may be in arbitration.

There are, of course, ways to try to limit the costs of arbitration. These include contractual limits on the length of any arbitration hearing, agreements with opposing counsel, and the use of a single arbitrator rather than a three-arbitrator panel. Like so many of the factors that govern the wisdom of arbitrating a franchise dispute, the relative cost may well depend upon what the specific litigation alternative might be.

B. Quality of the Decisionmakers

The parties to a lawsuit do not get to choose the judge who will sit on their case. Of course, the parties do participate in jury selection. In the federal courts and many state judicial systems, however, jury selection is a rapid-fire process. It often provides scant information about prospective jurors and little opportunity to explore their backgrounds, attitudes and views. Thus, even with experienced trial counsel, aided by a high-priced jury consultant and detailed preparatory work with mock juries, picking the actual jury can still be a crapshoot.

One critical potential advantage of arbitration is the opportunity to participate, in a truly meaningful way, in deciding who will decide the case. It is crucially important for every party to an arbitration to take full advantage of that opportunity, since the quality of the arbitrator(s) is by far the most important factor in determining whether arbitration is a satisfactory forum. And the arbitrator-selection process actually begins with the specific terms of the arbitration clause. In drafting that clause, the franchisor can — and should — (1) designate the ADR provider; (2) specify the number of arbitrators; (3) determine whether each party will have the right to appoint its own arbitrator; (4) decide whether arbitrators will then function as neutrals; and (5) choose whether to require particular experience for the arbitrators, such as prior service as an arbitrator in a franchise dispute, franchise business experience, or experience as a judge.
1. **Drafting the Arbitration Clause**

   a. **The ADR Provider**

      Many franchisors simply incorporate into their agreements the standard American Arbitration Association ("AAA") arbitration clause. The AAA is a venerable organization, but its administrative fees can be high, and as a result of a recent consolidation of its offices, the quality of the administrative staff (including its knowledge of the skills and experience of potential arbitrators) can leave something to be desired.

      Most important, standard AAA arbitration pools vary widely in caliber. Many AAA arbitrators are outstanding. But the AAA lists also include some lawyers who have gravitated to service as arbitrators because their practices are slow. In addition, franchisors should carefully examine arbitrator lists for plaintiffs' lawyers whose views of corporate parties may track those of potential jurors. And franchisees must be wary of the selection as an arbitrator of the sort of defense lawyer who might always have difficulty finding for a claimant. To state the obvious, a hostile solo arbitrator with a schedule in need of filling or an arbitration panel with time to kill and even one antagonistic member each carries a substantial risk of a protracted, expensive proceeding with an undesirable outcome.

      This does not mean that all AAA arbitrations are unsatisfactory, or that no franchisor should ever employ an AAA arbitration clause. But there are now many reputable ADR provider options. Franchisors should carefully explore them — for fee structure, administrative ease, procedural rules and quality of arbitrator pools — before contractually committing to any ADR provider. When an actual dispute arises, moreover, franchisees and their counsel should never be reluctant to propose alternatives to the contractually-designated ADR provider.

   b. **How Many Arbitrators**

      Whether to require one arbitrator or a three-arbitrator panel can be a close question. With a single arbitrator, it is easier to schedule hearings and the hearings are often shorter. When three arbitrators are questioning witnesses and counsel, conversing on the record, and requesting additional evidence or briefing, the proceedings have a natural tendency to enlarge. Longer hearings, at the hourly or daily rates of three arbitrators, obviously cost more than shorter hearings with a single arbitrator.

      A crisp hearing before a skilled, single arbitrator can capture all the substantive, procedural and economic advantages of arbitration, with none of the drawbacks. But what if, as things turn out, the arbitrator is not so skilled, or has predilections that were unknown during the selection process? Given the absence of meaningful appellate review, a biased, unintelligent, or ineffectual solo arbitrator can inflict substantial harm. A three-arbitrator panel may reduce that risk, and thereby limit the possibility of a "runaway arbitration," especially when each party has the unilateral right to choose one arbitrator.

      In the authors’ experience, a single arbitrator chosen (after careful due diligence) through an ADR provider with a high quality roster of candidates generally strikes the best balance of efficiency, expense, and limiting the possibility that a poor arbitrator will render an unfair or irrational award divorced from the merits of the case.
c. **Party-Appointed Arbitrators**

Certain arbitration clauses provide for party-appointed arbitrators, who often really serve as an extension of the appointing party and its counsel — acting not only as one of the “judges” of the case, but also as an extra advocate of the appointing party’s cause. The benefit of this system is that each party participates in selecting two of the three arbitrators. This process can lead to better qualified panels than selecting from a list circulated by the ADR provider. The risk of this approach is that the neutral arbitrator will regard each of his colleagues as a “shill” and tune them both out, leaving the parties with the added time and expense of a panel, but the outcome still decided as a practical matter by a single arbitrator.

There is, however, a different approach to party-appointed arbitrators, which can reduce the chances of inadvertently selecting a poor arbitrator, enhance the quality of the entire proceeding, and produce an award that benefits from the contributions of each panelist. Under this alternative, once selected, the party-appointed arbitrators each function as neutrals. The arbitrators cannot have any *ex parte* communications with the appointing party or counsel and are expressly obligated to decide the case based solely on the evidence and the law. In the authors’ experience, this has resulted in higher quality panels, more efficient proceedings (in part because the party-appointed arbitrators are not posturing on the record in order to lobby the neutral chair), and better-reasoned (and unanimous) outcomes.

d. **Requiring Particular Experience**

Some experienced franchise lawyers regard prior experience with franchise cases as a crucial requirement for any arbitrator. In the view of others, while that experience can be beneficial, it is not essential, as long as the arbitrator is a smart, fair and disciplined decisionmaker. Moreover, too much prior experience, in cases that may not be as similar to the pending matter as the arbitrator assumes, can actually get in the way. On balance, it probably makes sense to specify in the arbitration clause that the arbitrator must have had at least some experience with franchise or distribution matters. If, in connection with an actual dispute, an attractive candidate emerges who lacks that experience, the parties can always decide to waive this requirement.

2. **Negotiating the Terms of the Arbitration, Once a Dispute Arises**

Even if the franchise agreement contains no arbitration clause, nothing prevents either the franchisor or the franchisee from proposing arbitration of a particular dispute, pursuant to a process that the parties can negotiate at the time. If a franchisor wants to preserve arbitration as an option, however, that would not be the most prudent course to take. Instead, the franchisor should include an arbitration clause in its franchise agreements, and then decide whether to invoke that clause as actual disputes arise. It is important to remember as well that there will always be an opportunity to propose modifications to the arbitration clause, to tailor the process to the particular circumstances of the case. Especially if opposing counsel are able to communicate reasonably with one another, it may be possible to agree upon a different geographic location than the contract designates, choose a specific arbitrator without working through an ADR provider, select procedural and evidentiary rules, and even agree on how long each side will take to present its case.
C. **Evidentiary Rules and Governing Law**

Arbitration is intended to be an informal alternative to litigation. It is important for all parties and counsel to understand this inherent characteristic of the process, in order to avoid unrealistic expectations. For trial lawyers who are well-versed in evidentiary rules and advocating a strong legal position, this informality can be enormously frustrating, as the arbitrators agree to admit all evidence “for what it is worth,” and then issue an award grounded entirely in their personal views of what is fair, regardless of what the governing law might actually provide.

It may be possible to limit this informality when drafting the arbitration clause by, for example, requiring the arbitrator(s) to follow the Federal Rules of Evidence. If the clause includes such a requirement, when choosing arbitrators it is important to consider whether the candidates are likely familiar with these rules and inclined to apply them. It is also important to recognize, however, that a reviewing court is unlikely to vacate an arbitration award because the arbitrator misapplied an evidentiary rule.

In any event, whatever the specific language of the arbitration clause, counsel should try to define the “strike zone” early in the proceeding by objecting to questions and to proffered documentary evidence as they would in court. Certain arbitrators appreciate the order and predictability derived from evidentiary rules; they may actually sustain objections to hearsay and leading questions (often to the consternation of opposing counsel who were assuming that all their evidence would go into the record and do not have the capacity to adjust).

An arbitration agreement might also specifically require the arbitrator to follow the law, as a court would. Certain arbitrators would tend to do this anyway, and an express contract provision might cause others to do so as well. However, if the arbitrators did not adhere to this requirement, it is questionable whether any meaningful relief would be available, unless the arbitration clause also contained a series of additional requirements. Many arbitration awards are completely conclusory, with no discussion of the facts and no citation to legal authority. As discussed below, moreover, the typical review of arbitration awards is cursory at best. If the arbitration clause also requires the arbitrator to issue a detailed, reasoned award, and a reviewing court to follow the same standards of appellate review that apply to judicial decisions (and if the latter requirement is enforced), a specific provision requiring the arbitrator to follow the law could have some real effect.

D. **The Availability of Preliminary Injunctive Relief**

By definition, a franchise is a license to use the franchisor’s trademark. Most franchisors also license their franchisees to use certain copyrighted materials and trade secrets during the term of the franchise. And in some franchise systems, patented products and/or business methods are a critical part of what the franchisee gets in exchange for paying franchise fees and royalties. Preliminary injunctions are often the most effective (and sometimes the only) way to protect intellectual property from infringement and misappropriation.

For franchisors, the inability to obtain preliminary injunctive relief has been one of the major disadvantages of arbitration. Many franchisors have addressed this shortcoming through a “carve-out” from the arbitration clause permitting the franchisor to protect its intellectual property in court. Meanwhile, in an effort to offer “one-stop shopping” for dispute resolution, leading ADR providers have amended their rules so that preliminary injunctive relief is now available. At first blush, these rules would seem to afford parties to an arbitration the
opportunity to obtain preliminary injunctive relief comparable to what is available in state or federal court. In practice, however, these new procedures may suffer from significant drawbacks compared to litigation. This is particularly true for a franchisor whose franchisee seeks or obtains preliminary injunctive relief in arbitration to prevent termination or nonrenewal of the franchise.

The potential problems with relying upon arbitration for preliminary injunctive relief include: (1) the lack of meaningful standards governing the issuance of preliminary injunctive relief; (2) the fact that arbitration awards are not self-enforcing, so that judicial confirmation is still necessary before an arbitral award of injunctive relief is truly effective; (3) the inconsistency between the interim nature of a preliminary injunction and the requirement that an arbitral award be “final” before it can be confirmed in federal court; and (4) the lack of any meaningful judicial review of arbitral awards.

This section of the paper will review the AAA’s new rules on injunctive relief; address issues related to judicial review and confirmation of arbitral preliminary injunctions; present a case study of an arbitral preliminary injunction, which illustrates the potential pitfalls of this still novel form of relief; and examine arbitration clause carve-out provisions.

1. Arbitral Provisions for Preliminary Injunctive Relief

AAA Commercial Arbitration Rule R-34 provides as follows with respect to “Interim Measures”:

(a) The arbitrator may take whatever interim measures he or she deems necessary, including injunctive relief and measures for the protection or conservation of property and disposition of perishable goods.

(b) Such interim measures may take the form of an interim award, and the arbitrator may require security for the costs of such measures.

(c) A request for interim measures addressed by a party to a judicial authority shall not be deemed incompatible with the agreement to arbitrate or a waiver of the right to arbitrate.54

The AAA Commercial Arbitration Rules also contain the following “Optional Rules for Emergency Measures of Protection”:

O-1. Applicability

Where parties by special agreement or in their arbitration clause have adopted these rules for emergency measures of protection, a party in need of emergency relief prior to the constitution of the panel shall notify the AAA and all other parties in writing of the nature of the relief sought and the reasons why such relief is required on an emergency basis. The application shall also set forth the reasons why the party is entitled to such relief. Such notice may be given by facsimile transmission, or other reliable means, but must include a statement certifying that all other parties have been notified or an explanation of the steps taken in good faith to notify other parties.

O-2. Appointment of Emergency Arbitrator

Within one business day of receipt of notice as provided in Section O-1, the AAA shall appoint a single emergency arbitrator from a special AAA panel of emergency arbitrators designated to rule on emergency applications. The emergency arbitrator shall immediately disclose any circumstance likely, on the basis of the facts disclosed in the application, to affect such arbitrator's impartiality or independence. Any challenge to the appointment of the emergency arbitrator must be made within one business day of the communication by the AAA to the parties of the appointment of the emergency arbitrator and the circumstances disclosed.

O-3. Schedule

The emergency arbitrator shall as soon as possible, but in any event within two business days of appointment, establish a schedule for consideration of the application for emergency relief. Such schedule shall provide a reasonable opportunity to all parties to be heard, but may provide for proceeding by telephone conference or on written submissions as alternatives to a formal hearing.

O-4. Interim Award

If after consideration the emergency arbitrator is satisfied that the party seeking the emergency relief has shown that immediate and irreparable loss or damage will result in the absence of emergency relief, and that such party is entitled to such relief, the emergency arbitrator may enter an interim award granting the relief and stating the reasons therefore.

O-5. Constitution of the Panel

Any application to modify an interim award of emergency relief must be based on changed circumstances and may be made to the emergency arbitrator until the panel is constituted; thereafter such a request shall be addressed to the panel. The emergency arbitrator shall have no further power to act after the panel is constituted unless the parties agree that the emergency arbitrator is named as a member of the panel.

O-6. Security

Any interim award of emergency relief may be conditioned on provision by the party seeking such relief of appropriate security.

O-7. Special Master

A request for interim measures addressed by a party to a judicial authority shall not be deemed incompatible with the agreement to arbitrate or a waiver of the right to arbitrate. If the AAA is directed by a judicial authority to nominate a special master to consider and report on an application for emergency relief, the AAA shall proceed as provided in Section O-1 of this article and the references to the emergency arbitrator shall be read to mean the special master, except that the special master shall issue a report rather than an interim award.

O-8. Costs

The costs associated with applications for emergency relief shall initially be apportioned by the emergency arbitrator or special master, subject to the power of the panel to determine finally the apportionment of such costs.55

In practice, how well are these new rules likely to work?

55 Id. at §§ O-1 to O-8 (emphasis supplied).
2. **Standards Governing Arbitral Preliminary Injunctions**

Grants of preliminary injunctive relief in federal court are discretionary, but every U.S. Circuit Court of Appeals has articulated standards for preliminary injunctive relief pursuant to Federal Rule of Civil Procedure 65. The factors governing the exercise of this discretion are virtually the same in federal courts nationwide, although some Circuits place more emphasis on irreparable harm and the “balance of hardships” than they do on likelihood of success on the merits.\(^\text{56}\) Consistent with the Federal Rules, the AAA’s “Optional Rules” do purport to require a showing of irreparable harm before a preliminary injunction will issue. It is not clear, however, what (if any) recourse a franchisor or franchisee would have if an arbitrator issued a preliminary injunction without requiring any showing of irreparable harm.

The Federal Rules of Civil Procedure require that any preliminary injunction “describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained . . . .”\(^\text{57}\) The AAA Rules contain no comparable specificity requirement.

The Federal Rules of Civil Procedure also require the posting of a bond as a prerequisite for preliminary injunctive relief.\(^\text{58}\) The AAA Rules say only that “the arbitrator may require security for the costs of” any interim relief.\(^\text{59}\)

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\(^{56}\) For example, in the Second and Fourth Circuits, if the balance of hardships tips decidedly in its favor, the movant need only demonstrate “questions going to the merits so serious, substantial, difficult and doubtful, as to make them fair ground for litigation . . . .” Blackwelder Furniture Co. of Statesville v. Seilig Mfg. Co., 550 F.2d 189, 195 (4th Cir. 1977). The first step in a Rule 65(a) situation is for the court to balance the “likelihood” of irreparable harm to the plaintiff against the “likelihood” of harm to the defendant; and if a decided imbalance of hardship should appear in plaintiff’s favor, then the likelihood-of-success test is displaced by Judge Jerome Frank’s famous formulation:

\[ \text{If it will ordinarily be enough that the plaintiff has raised questions going to the merits so serious, substantial, difficult and doubtful, as to make them fair ground for litigation and thus for more deliberate investigation.} \]

Id. (quoting Hamilton Watch Co. v. Benrus Watch Co., 206 F.2d 738, 740, 743 (2d Cir. 1953) (second modification in Blackwelder). Although Blackwelder’s emphasis on the balance of the burdens of an injunction has been called “inconsistent with Supreme Court precedent” by later decisions within the Fourth Circuit, those decisions have nevertheless left “re-examination of the Blackwelder approach for another day.” Scotts Co. v. United Indus. Corp., 315 F.3d 264, 271 n.2 (4th Cir. 2002).

In contrast, the Fifth Circuit has held that “[a] preliminary injunction is an extraordinary remedy. It should only be granted if the movant has clearly carried the burden of persuasion on all four Callaway prerequisites.” Miss. Power & Light v. United Gas Pipeline Co., 760 F.2d 618, 621 (5th Cir. 1985). The “four prerequisites” governing the district court’s exercise of its discretion whether to grant preliminary injunctive relief are otherwise the same in the Fifth Circuit as they are in the Fourth and Second Circuits:

1. a substantial likelihood that plaintiff will prevail on the merits,
2. a substantial threat that plaintiff will suffer irreparable injury if the injunction is not granted,
3. that the threatened injury to plaintiff outweighs the threatened harm the injunction may do to defendant, and
4. that granting the preliminary injunction will not disserve the public interest.

Canal Auth. of Fla. v. Callaway, 489 F.2d 567, 572 (5th Cir. 1974).

\(^{57}\) FED. R. CIV. P. 65(d) (2004).
3. Confirmation and Enforcement of Arbitral Injunctions

A preliminary injunction issued by an arbitrator is not "self-enforcing": any arbitration award, whether for money damages or preliminary injunctive relief, requires judicial confirmation in order to be enforced. Under the FAA, moreover, an arbitration award must be "final" before it can be confirmed. 60 There is an inherent tension between the FAA's requirement of finality and a preliminary injunction, which by definition is not final. The need for arbitrators and parties to characterize preliminary injunctive relief as "final" for the purpose of obtaining judicial confirmation can lead to perverse outcomes, as discussed in greater detail below.

At the very least, the need to obtain judicial confirmation of an arbitral preliminary injunction increases the cost and adds an element of delay that is inconsistent with the very purpose of preliminary injunctive relief.

4. Judicial Review of Arbitral Preliminary Injunctions

The standard of review of an arbitral preliminary injunction, assuming that it is sufficiently "final" to be confirmed, is the same as that for any other arbitration award. Thus, a district court may confirm, without any meaningful analysis, an arbitral preliminary injunction issued without any showing of irreparable harm and without a bond. Once the district court has done so, the arbitrators' preliminary injunction becomes a judgment of the court. 61


Although not a franchise case, the emotions on both sides of Arrowhead ran as high as they do in the most bitter of franchise disputes. Arrowhead was the prime contractor on a contract ("Task Order 27") for the delivery of a global communications system, including earth terminals, related to homeland security. The ultimate customer was the Defense Information Systems Agency. Pursuant to a subcontract with Arrowhead, DataPath supplied the earth terminals covered by the prime contract. When the government sought bids for some follow-on

58 See, e.g., Hoechst Diafoil Co. v. Nan Ya Plastics Corp., 174 F.3d 411, 421 (4th Cir. 1999) ("In view of the clear language of Rule 65(c), failure to require a bond upon issuing injunctive relief is reversible error.").

59 COMMERCIAL ARBITRATION RULES, supra note 54, at § R-34 (emphasis supplied).


61 See 9 U.S.C. § 13 (2004) ("The [arbitration award] so entered shall have the same force and effect, in all respects, as . . . a judgment in an action . . . ."). See also Domino Group, Inc. v. Charlie Parker Mem'l Found., 985 F.2d 417, 420 (8th Cir. 1993) (arbitrator's equitable award was "converted" into a "court judgment . . . ." subject to the mandates of Federal Rule of Civil Procedure 65(d)).

62 The matter of DataPath, Inc. and Arrowhead Global Solutions, Inc. was the subject of AAA Arbitration No. 30 Y 110 00961 03. The case of Arrowhead Global Solutions, Inc. v. DataPath, Inc. is pending before the U.S. District Court for the Eastern District of Virginia as Civil Action No. 04-CV-391. This case is still pending before the Eastern District of Virginia and the U.S. Court of Appeals for the Fourth Circuit. Arrowhead's three pending appeals to the Fourth Circuit have been consolidated with one another and with Arrowhead's Petition for a Writ of Mandamus. The Fourth Circuit denied the immediate relief requested in the mandamus petition. However, Arrowhead raised the same issues in its consolidated appeals, which are still pending. Following a preliminary arbitration hearing in which the respondent was represented by another law firm, Mr. Lockerby has been lead counsel for Arrowhead in proceedings before the AAA, the Virginia federal court, and the Fourth Circuit.
work ("Annex E"), Arrowhead and DataPath collaborated to submit a joint bid. During the course of the bid submissions, however, issues arose between the parties, so when Arrowhead was ultimately awarded the contract for Annex E, it chose a different subcontractor.

DataPath brought an arbitration, and once a panel of arbitrators had been selected, also sought a preliminary injunction. The arbitrators awarded some of the preliminary injunction relief that DataPath requested, enjoining Arrowhead from performing its contract without DataPath’s consent. Notably, the Arbitrators did not require DataPath to demonstrate irreparable harm, or to post a bond. The Arbitrators issued an Interim Award pursuant to a AAA Construction Industry Arbitration Rule that states: “In addition to the final award, the arbitrator may make other decisions, including interim, interlocutory, or partial rulings, orders and awards.” The Interim Award nevertheless contained some language that the Arbitrators inserted for the apparent purpose of making it “final” and therefore confirmable under the FAA: “This AWARD is dispositive of all other equitable relief requested by the parties in this matter.”

In the later confirmation proceedings, the district court initially refused to confirm the Interim Award because it was interlocutory. Rather than appeal that decision, DataPath’s counsel sent a series of e-mails and letters to the arbitrators complaining about the arguments that Arrowhead raised in opposition to confirmation and about the district court’s ruling. The Arbitrators’ then issued a “Clarification Award”, which stated that the Interim Award was “intended to be final and enforceable by the court and not interlocutory . . . .” (emphasis in original). Upon obtaining the Confirmation Award, DataPath moved the district court to reconsider the issue of confirmation. The district court ultimately confirmed the Interim Award, as “clarified.” Arrowhead then took the first of what would ultimately be three appeals to the Fourth Circuit.

While Arrowhead’s appeal of the confirmation order was pending, the parties proceeded to prepare for arbitration of their underlying dispute. As the arbitration date approached, DataPath took the position that Arrowhead was in contempt of the injunction and sought sanctions from the district court. At the hearing on DataPath’s motion, the district judge questioned whether the Interim Award that he had previously confirmed was ambiguous. Both parties invoked the doctrine of functus officio to argue to the district court that the issues of contempt and whether the Interim Award was ambiguous could not be remanded to the Arbitrators. Around the same time, Arrowhead moved to vacate the confirmation order based on newly discovered evidence that it was the product of fraud or mistake.

After the arbitration hearing had been completed but before the Arbitrators had issued a decision, the district court remanded to the Arbitrators the issue whether the Interim Award was ambiguous. The district court’s remand order also directed the Arbitrators to make findings of fact relevant to whether Arrowhead was in contempt and whether the Interim Award should be set aside based on newly discovered evidence. Arrowhead immediately sought a writ of mandamus from the Fourth Circuit to block the remand order and also appealed to the Fourth Circuit. The grounds for the mandamus petition and the appeal included that the remand violated the functus officio doctrine. In support of this argument, Arrowhead cited Eighth Circuit authority that “such a result would effectively grant an arbitration panel power to conduct appellate review of a federal district court decision. This would be absurd.” In support of its

63 See, e.g., Colonial Penn Ins. Co. v. Omaha Indem. Co., 943 F.2d 327, 331 (3d Cir. 1991) ("[O]nce an [arbitrator] renders a decision regarding the issues submitted, [he] becomes functus officio and lacks any power to reexamine that decision.").

64 Legion Ins. Co. v. VCW, Inc., 198 F.3d 718, 720 (8th Cir. 1999) (emphasis supplied).
appeal from the remand order, Arrowhead also argued that only an Article III judge could make findings of fact relevant to the motions pending before the court.

While Arrowhead’s appeal of the Remand Order was still pending, the Arbitrators issued a final damage award in favor of DataPath. The Arbitrators disclaimed the authority to make findings of fact in response to the district court’s remand order, but stated that their Interim Award was unambiguous. In opposing confirmation of a portion of the final arbitration award, Arrowhead also took the position that the Arbitrator’s award of “lost profits” on Annex E — a contract to which DataPath was not a party — was a thinly disguised award of contempt sanctions. The district court nevertheless confirmed the final arbitration award in its entirety. Arrowhead’s appeal from that decision is currently pending before the Fourth Circuit.

In short, owing to the unsettled procedures associated with arbitral preliminary injunctions, Arrowhead was at one point funding simultaneous proceedings before a panel of three arbitrators, a district court, and the Fourth Circuit. Three appeals are still pending, moreover, before the Fourth Circuit — with respect to confirmation of the Interim Award, the remand order, and confirmation of the final damages award. This procedural history certainly does not reflect the speed, economy, and finality that are supposed to be arbitration’s principal attributes. Also, because the federal court confirmed an arbitral preliminary injunction, the respondent faced a contempt motion for failure to comply with an order that the court would never have issued itself, since there was no showing of irreparable harm and no requirement of a bond.

6. Carve-outs from Arbitration Clauses

To avoid the pitfalls of obtaining and enforcing preliminary injunctions in arbitration, franchisors can (and probably should) include a carve-out provision in the arbitration clause. The franchisor will at a minimum want the right to obtain preliminary injunctive relief in court to protect its intellectual property. Here is an example of an even broader carve-out:

    Franchisor shall have the right, without having to arbitrate any Claim, to proceed directly to court to bring an action for money damages or equitable relief related to the Proprietary Marks, Confidential Information, or other of Franchisor’s intellectual property. With respect to any Claim described in this section, Franchisor may bring such action in any state or federal court which has jurisdiction. Nothing in this Agreement shall prohibit Franchisor from also asserting the same or similar Claims as a defense or counterclaim in any arbitration proceeding.

It is important for franchisors to remember that too many exceptions to compulsory arbitration can create a complicated clause that may also strike a court as unbalanced and unfair, jeopardizing the franchisor’s ability to enforce the franchisee’s obligation to arbitrate. In addition, the franchisee may want the right to obtain preliminary injunctive relief in court to prevent termination or nonrenewal of the franchise agreement. As a practical matter, such a carve-out may eviscerate the arbitration clause. Most if not all of the merits of the parties’ dispute may be related to termination or nonrenewal. Although not a final decision on the merits, the preliminary injunction decision often prompts a final resolution of the parties’ dispute, and a franchisee that has obtained a preliminary injunction against termination or nonrenewal has little incentive to cooperate in an expeditious final resolution in arbitration.

Even without this carve-out, however, a franchisee may be able to obtain a preliminary injunction against termination or nonrenewal pending the outcome of the arbitration. There is authority to the effect that the federal courts have the inherent power to preserve the status quo
pending arbitration. This same authority would obviously entitle a franchisor to preliminary injunctive relief to protect its intellectual property pending the outcome of the arbitration.

E. Motion Practice

The absence of meaningful motion practice is generally seen as another drawback of arbitration. Arbitration claims are rarely dismissed, and one seldom hears of arbitrators granting "summary judgment" motions, or otherwise disposing of claims without the arbitral equivalent of a trial. Cynics attribute this phenomenon to the fact that arbitrators are typically paid by the hour.

Whatever accounts for the relative paucity of claims resolved by motion in arbitration, it is a fact of life. This is another example of an inherent characteristic of arbitration that franchisors need to recognize and accept as part of their arbitration bargain. It is hard to envision any cure for this that the franchise agreement can "legislate." It also bears repeating, however, that deciding whether to arbitrate always requires a relative analysis, and courts do not grant motions to dismiss or for summary judgment nearly as often as franchisor lawyers would like.

F. Outcomes

For every franchisor, the most important factor in deciding whether to arbitrate should be whether arbitration is likely to produce "better" results in the type of disputes that the franchisor will probably encounter with franchisees. And "better" should never be a simple tally of wins and losses. This analysis needs to assess, among other things, the possible expense and drain on management time of litigation or arbitration, as well as each forum's risks — not just the risk of isolated defeats, but the risk of severely adverse outcomes that could cost the franchisor substantial sums and interfere with its business plans.

Of course, no one's crystal ball is clear enough to foretell with any certainty the number and results of actual future disputes in a given franchise system. And there is rarely the opportunity for the truly controlled experiment of litigating and then arbitrating the same case to a conclusion. Because of franchisors' disclosure obligations under the FTC Franchise Rule and the Uniform Franchise Offering Circular ("UFOC") guidelines, however, there is a large body of publicly available data concerning dispute resolution in hundreds of franchise systems. According to one study of a sample of that data, included in a presentation by one of these

65 See, e.g., Guinness-Harp Corp. v. Jos. Schlitz Brewing Co., 613 F.2d 468, 472 (2d Cir. 1980):

Applying the federal policy of the Arbitration Act, a federal court is entitled to adjudicate "issues relating to the making and performance of the agreement to arbitrate," Prima Paint Corp. v. Floor & Conklin Mfg. Co., 338 U.S. 395, 404, 87 S.Ct. 1801, 1806, 1807, 18 L.Ed.2d 1270 (1967) (emphasis added), and it is empowered to grant specific performance of the agreement to arbitrate. Here maintenance of the status quo pending arbitration relates in a substantial way to the performance of the agreement. Guinness is therefore entitled to specific performance of its arbitration agreement, including the status quo provision.

(footnotes omitted).

66 In practice, arbitration likely eliminates most of the "outliers": the punitive damages that juries sometimes award, and the dismissals as a matter of law that franchisor lawyers typically seek. But it is also true that arbitrators can award significant compensatory damages on claims that a court might well have dismissed altogether. See Lockerby, supra note 13, at 215.
authors and the mediator David Geronemus at the 2002 American Bar Association Forum on Franchising:67

- Of all lawsuits and arbitrations involving franchises, 71% settled, but the settlement rate for arbitrations was far lower than for litigation;
- Fewer than 20% of lawsuits involving franchisors were resolved by dispositive motion;
- Franchisors lost a higher percentage of arbitrations than they did of either bench or jury trials; and
- The average and median arbitration awards against franchisors were dramatically lower than the average and median jury verdicts against franchisors.68

This study reviewed the Item 3 disclosures in the UFOCs of 30 of the largest franchise systems (as reported by Franchise Times Magazine), measured in total units. The sample included the ten largest systems, and twenty others picked to reflect a range of industries where franchising is prominent (e.g., quick serve restaurants, hotels/motels).69 The survey results were subject to several important disclaimers concerning their reliability.70 They nevertheless yielded information of interest to any franchisor pondering the question “shall we arbitrate?”

1. **Settlement Rates**

In this survey of 420 concluded matters, 76% of the reported state court cases, and 64% of the federal court matters, settled, compared to only 40% of the arbitrations.71

Five factors may help explain this marked difference in settlement rates:

1. Many lawsuits settle because at least one party fears the jury. Arbitrators are generally (and probably accurately) perceived as less likely than jurors to issue enormous, system-threatening awards.

2. The logistical burdens, expense and time of discovery often play a significant role in inducing settlement of lawsuits. In most arbitrations, discovery is much less extensive and expensive than in litigation.

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67 Dunham & Geronemus, supra note 41, at 12-19.

68 Id. at 12, 15-18.

69 Id. at 8.

70 Id. at 9 (noting, among other concerns, that “neither author is a statistics expert”, and that “[w]e do not know whether our sample is in fact representative of franchising in general”).

71 Id. at 12-14.
3. Also, meaningful fact discovery educates parties and counsel about the strengths, weaknesses and economic value of their case. In arbitrations, involving limited, if any, document discovery and depositions, key facts may not surface until the hearing, reducing the chances that this information will influence views on settlement values.

4. Today, many judges manage their dockets by acting as settlement brokers, vigorously encouraging settlement discussions, often from an early stage in the case, and referring parties to other judges, magistrates, or special masters to supervise negotiations. In arbitration, generally speaking nobody performs that function, and arbitrators may be disinclined to do so because they get paid to hear and decide the case.\(^{72}\)

5. Except for TROs and preliminary injunction proceedings, litigation, if it goes to term, typically takes longer than arbitration, and “lawsuits sometimes settle simply because parties become frustrated by the snail’s pace.”\(^{73}\)

2. **Trial Outcomes**

These thirty franchisors reported only fifty-seven cases, including arbitrations, tried to a conclusion during the subject ten year period. There was a substantial difference in franchisor win rates, depending on the forum:

- In state courts, franchisors won 45% of the cases, lost 45% of the cases, and 10% of the time achieved mixed results.\(^{74}\)

- In federal court, franchisors won 60% of the time, lost 33% of the time, and got mixed results in 7% of the cases.\(^{75}\)

- In the 22 reported arbitrations, franchisors lost 64% of the time, won only 18% of the cases, and obtained mixed results in the remaining 18%.\(^{76}\)

As the authors of this study concluded:

It is difficult to know what, if anything, to make of this data. It may be that in litigation, because of the various settlement incentives already identified, franchisors eliminate more of their problematic cases by negotiation, leaving the relatively stronger matters to try. At first blush, the franchisor success rate in arbitration is hardly an advertisement for this form of dispute resolution, but the question bears repeating - - compared to what? Without an arbitration clause, would these franchisors have paid larger amounts to settle, or been hit with substantial jury verdicts? As long as arbitration, even with a low percentage of outright “wins” for the franchisor, produces no knee-buckling damage awards, it may still be serving every franchisor’s essential risk

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\(^{72}\) Id. at 14.

\(^{73}\) Id.

\(^{74}\) Id. at 15.

\(^{75}\) Id. at 16.

\(^{76}\) Id.
management goal: ensuring that claims, and the burden of handling them, do not impair the franchise system’s success.\textsuperscript{77}

The study also found that arbitrations “generally produced modest damage awards against franchisors.”\textsuperscript{78} The average arbitration award against losing franchisors was $136,325; the median was $74,500. The average and median awards for prevailing franchisors were each $23,300.\textsuperscript{79} In jury trials, the average verdict against franchisors was $814,914; that figure was skewed by one especially large verdict, but the median was still $421,973. The median and average verdict when a jury awarded the franchisor damages were each $285,000.\textsuperscript{80}

Franchisors won 63% of the bench trials in this sample, and when they lost, the average and median damages ($133,611 and $67,500) were quite low.\textsuperscript{81} Bench trials avoid the risks of juries, but unlike arbitrations are also subject to the rules of evidence and meaningful appellate review. The risk management problem, however, is that securing bench trials of suits with franchisees requires an enforceable jury trial waiver in the franchise agreement, and as discussed above, in many jurisdictions that contract provision is unlikely to withstand challenge.\textsuperscript{82} In contrast, courts enforce franchise agreement arbitration clauses in the overwhelming majority of cases.\textsuperscript{83}

G. Punitive Damages

As a result of the United States Supreme Court’s decisions in \textit{BMW v. Gore}\textsuperscript{84} and \textit{State Farm v. Campbell},\textsuperscript{85} it is now well-settled that there are meaningful constitutional limits on punitive damages in litigation. According to the majority of courts that have considered the

\textsuperscript{77} Id. at 16-17 (internal citations omitted).

\textsuperscript{78} Id. at 19.

\textsuperscript{79} Id.

\textsuperscript{80} Id.

\textsuperscript{81} Id.

\textsuperscript{82} Id. \textit{See also supra} notes 26 & 28 and accompanying text.

\textsuperscript{83} The California Supreme Court’s August, 2005 decision holding that pre-dispute, contractual jury trial waivers are unenforceable in California, Grafton Partners, L.P. v. Superior Court of Alameda County, No. S123344, 2005 WL 1831995 (Cal. Aug. 4, 2005), illustrates the different status of arbitration clauses. As Chief Justice George wrote for the majority, “[u]nlike predispute jury waivers, predispute arbitration agreements are specifically authorized by [California] statute,” and “arbitration agreements are distinguishable from waivers of the right to jury trial in that they represent an agreement to avoid the judicial forum altogether.” \textit{Grafton}, 2005 WL 1831995, at *4, *9.

Moreover, the FAA applies in state and federal court, and pre-empts any state statutes and case law that would impose on arbitration agreements any enforcement requirements that do not apply to contracts generally. Thus, while one-sided arbitration clauses are sometimes vulnerable to attack in certain jurisdictions on grounds of unconscionability and lack of mutuality, the odds of successfully enforcing a fair and balanced arbitration clause (including one that allows the franchisor to go to court to enforce its intellectual property rights) remain overwhelmingly high.

\textsuperscript{84} BMW of N. Am., Inc. v. Gore, 517 U.S. 559 (1996).

question, however, those limits do not apply to arbitration. In many jurisdictions, there also may be no public policy constraints on arbitral punitive damage awards. Most courts, including the Supreme Court, have not yet addressed this issue, so the evolving precedent may yet shift course, and in any event, punitive damages are apparently a rare occurrence in arbitration. But from the franchisor’s perspective, the potential exposure to open-ended punitive damage awards may be one of arbitration’s greatest demerits, especially in light of recent developments with class arbitrations, discussed in the next section.

Under Gore’s three-part due process test, courts considering punitive damages must assess, on the facts and circumstances of each case, (1) the degree of reprehensibility of the conduct at issue, in light of all the facts in the record; (2) the ratio of the punitive damages to the actual and potential harm inflicted on the plaintiff; and (3) the criminal or civil penalties that could be imposed for comparable misconduct. State Farm appears to have modified the constitutional analysis in several important respects. As a result, it will likely be more difficult for plaintiffs to win, and hold on appeal, large punitive damage awards. State Farm majority stressed that “[a] defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business.” The Court also said that a state generally has no legitimate interest in punishing a party for harm caused outside the jurisdiction, because “proper adjudication of that conduct would require adding as parties the alleged victims of the conduct, and applying the law of other jurisdictions where the conduct or injury occurred. These aspects of State Farm will probably limit the ability of a plaintiff franchisee (absent a certified class action) to rely upon the franchisor’s interactions with other franchisees as a basis for punitive damages.

In addition, after State Farm, a defendant’s wealth “cannot justify an otherwise unconstitutional punitive damages award.” Thus, “if the punitive damages would flunk the Gore test when awarded against a less well-heeled defendant, that the defendant is a large corporation or rich individual cannot, as a matter of constitutional law, pull the award to a passing grade.” And State Farm also made clear that, while there may still be no “bright-line ratio which a punitive damages award cannot exceed . . . in practice, few awards exceeding a

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86 Dunham, supra note 14.

87 Gore, 517 U.S. at 574-86.


89 State Farm, 538 U.S. at 425 (“Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.”).

90 Id.

91 Dunham, supra note 88.

92 State Farm, 538 U.S. at 427.

93 Dunham, supra note 88, at 205.
single digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.”

Because the Gore-State Farm standards embody the Supreme Court’s interpretation of the federal constitution, they govern every lawsuit, tried in federal or state court, to the bench or to a jury. Given the current state of the law, every franchisor’s operating assumption should be that those standards do not apply to arbitration awards, including judicial orders confirming those awards.

The leading federal decision so holding is Davis v. Prudential Securities, Inc., a 1995 opinion in which the Eleventh Circuit rejected the argument that judicial confirmation of an arbitration award is state action that must comply with the Constitution. Other federal courts have reached the same conclusion, and in two 2005 decisions, one involving the Subway franchisor, the Connecticut Supreme Court rejected Gore-based constitutional challenges to judicial confirmation of arbitration awards that included no compensatory damages but substantial punitive damages ($300,000 in one case, $5,000,000 in the other).

The Court performed a detailed constitutional and public policy analysis in MedValUSA Health Programs, Inc. v. MemberWorks, Inc., which did not involve franchising. MedVal was in the business of selling subscriptions for medical services to persons without health insurance. It entered a contract with MemberWorks to create a network of health care providers, and to provide certain marketing materials and support services in connection with the project. The venture failed, and MedVal brought an arbitration against MemberWorks for breach of contract, breach of the implied covenant of good faith and fair dealing, and violation of the Connecticut Unfair Trade Practices Act (CUTPA). MedVal alleged that MemberWorks repeatedly failed to supply it with necessary materials and information, and misrepresented the status of the project and the parties’ agreement. The arbitrators agreed and concluded that MemberWorks had violated CUTPA. Though the panel found no basis for compensatory damages, it awarded $5 million in punitive damages for the CUTPA violation, and the Superior Court entered a judgment confirming the award.

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94 State Farm, 538 U.S. at 425.
95 59 F.3d 1186 (11th Cir. 1995).
97 MedValUSA Health Programs, Inc. v. MemberWorks, Inc., 872 A.2d 423 (Conn. 2005); Hadelman v. DeLuca, 274 Conn. 442 (2005). Hadelman arose out of a dispute over the election of franchisee trustees to the Subway franchise system’s advertising fund trust. Mr. Dunham represented the franchisor in the Hadelman arbitration, and in the initial appeal of the arbitration award. His firm also represented the franchisor before the Connecticut Supreme Court. Wiggin and Dana was not counsel in the MemberWorks arbitration, but represented MemberWorks in the appellate challenge to the punitive damage award.
98 MemberWorks, 872 A.2d at 426, 443.
99 Id. at 427.
100 Id.
101 Id.
On appeal, MemberWorks argued that judicial confirmation of the award violated its constitutional right to due process, as well as Connecticut's public policy against excessive punitive damage awards. The Connecticut Supreme Court rejected both arguments and affirmed the judgment.\textsuperscript{102}

Writing for the majority, Justice Borden explained that an arbitral award of punitive damages does not implicate the due process clause, regardless of how excessive the award may be, because "an arbitration award does not constitute state action and is not converted into state action by the trial court's confirmation of that award."\textsuperscript{103} According to the Court, the essential state action question was "whether the injury caused [was] aggravated in a unique way by the incidents of governmental authority."\textsuperscript{104} The Court then discussed the leading case on the issue, \textit{Shelley v. Kraemer},\textsuperscript{105} where the United States Supreme Court held that judicial enforcement of a restrictive covenant that prohibited landowners from selling their property to minorities constituted state action.\textsuperscript{106} In the \textit{MemberWorks} majority's view, the \textit{Shelley} Court found state action because "but for the active intervention of the state courts, supported by the full panoply of state power, [the defendants] would have been free to occupy the properties in question without restraint."\textsuperscript{107}

Justice Borden acknowledged that "at first glance, judicial confirmation of an arbitration award fits the \textit{Shelley} pattern perfectly [and that] the same 'but for' reasoning that guided the analysis of the Supreme Court in \textit{Shelley} would seem to compel the conclusion that judicial confirmation of an arbitration award constitutes state action."\textsuperscript{108} Nevertheless, the Court declined to apply \textit{Shelley} because, it concluded, "\textit{Shelley's} precedential authority . . . outside the context of racially restrictive covenants, is at best questionable."\textsuperscript{109} The Court agreed with criticism that "\textit{Shelley's} reasoning, if consistently applied, would require individuals to conform their private agreements to constitutional standards whenever, as almost always, the individuals might later seek the security of potential judicial enforcement."\textsuperscript{110} For these reasons, the Connecticut Supreme Court held that judicial confirmation of an arbitration award does not convert the action of an arbitrator into state action.\textsuperscript{111}

\textsuperscript{102} Id. at 428.

\textsuperscript{103} Id. at 428.

\textsuperscript{104} Id. at 429.

\textsuperscript{105} 334 U.S. 1 (1948).

\textsuperscript{106} Id. at 19.

\textsuperscript{107} MedValUSA Health Programs, Inc. v. MemberWorks, Inc., 872 A.2d 423, 430 (Conn. 2005) (quoting Shelley v. Kraemer, 334 U.S. 1, 19 (1948) (modification in \textit{MemberWorks})).

\textsuperscript{108} Id. at 430.

\textsuperscript{109} Id. at 430-31.

\textsuperscript{110} Id. at 431 n.10 (quoting \textsc{Lawrence Tribe}, \textsc{American Constitutional Law} 1697 (2d ed. 1988)). The Court further noted that the Supreme Court itself has expressed reservations about extending \textit{Shelley}. \textit{Id.} (citing Bray v. Alexandria Women's Health Clinic, 506 U.S. 263, 266 (1993)).

\textsuperscript{111} Id. at 434-35. The Court cited several decisions that have reached the same conclusion. See Smith v. Am. Arbitration Ass'n, Inc., 233 F. 3d 502, 507 (7th Cir. 2000); Davis v. Prudential Sec., Inc., 59 F. 3d 1186, 1191 (11th
The Court then considered whether the award should be vacated as against public policy. Under Connecticut law, an arbitrator’s award may be vacated if it violates an “explicit public policy that is well defined and dominant, and is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests.” The Court reviewed these sources and determined that, while Connecticut has a variety of general limitations on excessive damage awards in litigation, it does not have “the kind of well-defined and dominant public policy against excessive punitive damages that would justify setting aside a private, consensual arbitration award . . . .” The majority was also unmoved by MemberWorks’ argument that allowing the punitive damages to stand would create a substantial disincentive to arbitration. Justice Borden asserted that parties can still protect themselves against large punitive damage awards by including in arbitration clauses “language that either caps or precludes punitive damages altogether, or subjects an arbitral punitive damages award to judicial review.”

The two dissenting justices joined the holding that judicial confirmation of an arbitration award is not state action, but disagreed that Connecticut does not have a well-defined and dominant public policy against excessive punitive damage awards. Justice Zarella asserted that “a $5 million punitive damage award under the circumstances of this case not only violates that policy, but also undermines the equally well settled policy encouraging arbitration as an efficient method of dispute resolution . . . .” He expressed concern that the decision could alter the way that parties view arbitration. “[The Court’s reasoning] extends to any punitive damage award issued by an arbitrator no matter how large that award may be . . . . After today’s decision, I wonder how any attorney could, in good conscience, expose his client to the risk of excessive damages by agreeing to an arbitration clause in a contract.”

The case involving the Subway franchise system, *Hadelman v. DeLuca*, simply adopted the MemberWorks constitutional analysis. That analysis was scholarly and thorough, but at least two other courts considering the issue have come out differently. In *Birmingham News Co. v. Horn*, a 2004 appeal challenging judicial confirmation of an arbitration award, the Alabama Supreme Court noted that the Eleventh Circuit’s decision in *Davis, supra*, “has been criticized by
legal commentators,” and refused to follow it. As Justice Harwood explained for the majority, “[t]hese appeals are appeals from the circuit court judgments of confirmation, not from the underlying awards. Accordingly, we readily perceive the requisite state action . . . sufficient to justify our review of the awards under governing federal due-process considerations . . . .”

In Sawtelle v. Waddell & Reed, Inc. an intermediate New York state appellate court, without determining whether judicial confirmation of an arbitration award would constitute state action, nonetheless vacated an arbitral punitive damage award because it was grossly excessive under Gore. The court reasoned that Gore applied even without state action because the Supreme Court’s decision “provides a guide for determining whether an [arbitral punitive damages] award is irrational,” and declared that in agreeing to arbitrate, a party does not “waive its right to the protection of any constitutional . . . constraints on the award of punitive damages.”

Because the highest courts of two states have now reached conflicting conclusions on a matter of federal constitutional law with enormous potential implications for the commercial life of the nation, there is at least some chance that the United States Supreme Court will decide to settle the issue. (At this writing, petitions for certiorari are pending in both Birmingham News and MemberWorks.) In the meantime, however, franchisors with arbitration clauses must recognize that their exposure to punitive damages may be unlimited. If the MemberWorks majority opinion is correct, franchisors can reduce or eliminate this risk — prospectively — by disclaiming punitive damages or requiring judicial review of any punitive damage award pursuant to constitutional standards.

The current state of the law on contract provisions purporting to expand the scope of judicial review of arbitration awards is discussed later in this paper. In theory, a punitive damage disclaimer embedded in the arbitration clause should work. Arbitration is a creature of contract, and the United States Supreme Court has repeatedly stressed that the FAA requires enforcement of arbitration agreements according to their terms, unless they are subject to a generally applicable contract defense (e.g., fraud in the inducement). Moreover, franchise agreements are the product of arm’s-length transactions between commercial actors, who generally have the right to agree to contractual limitations and exclusions of damages.

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120 Id. at 66.
121 Id.
123 Id. at 261.
124 Id. at 274.
125 Petition for Writ of Certiorari, Vertrue Inc. v. MedValUSA Health Programs, Inc., No. 05-117, 2005 WL 1714171 (U.S. July 20, 2005). Wiggin and Dana continues to represent MemberWorks (now known as Vertrue) before the United States Supreme Court.
126 See pp. 35-38, infra.
128 Franchisees “are not vulnerable consumers or helpless workers. They are business people”. Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 281 (7th Cir. 1992) (Posner, J.).
However, several courts have recently refused to enforce punitive damage disclaimers in consumer contracts on the ground of unconscionability; franchisee advocates will rely on that precedent to try to achieve the same result. And many franchisors still have a substantial number of franchised units operating pursuant to earlier generation franchise agreements that do not purport to exclude punitive damages, leaving them with neither constitutional nor contractual safeguards against a staggering punitive damages blow in arbitration.

H. Class and Consolidated Proceedings

For franchisors, one of arbitration’s greatest potential advantages over litigation is the ability to avoid class and consolidated actions in distant, hostile forums, by requiring individual franchisees to prosecute their individual claims in separate arbitrations, at a location designated in the franchise agreement. We say “potential,” with emphasis, because the law governing both class arbitration and class litigation has changed dramatically in recent years, casting serious doubt on the efficacy of certain arbitration clauses as vehicles for avoiding class and consolidated claims, and perhaps reducing the risk that franchisors will confront class litigation in decidedly pro-plaintiff state courts.

1. Changes in the Law Governing Class Arbitrations

Before the Supreme Court’s 2003 decision in Green Tree Financial Corp. v. Bazzle, the overwhelming majority of federal circuits that had addressed the issue held that, unless an arbitration agreement expressly contemplated class or consolidated proceedings, they could not occur. The courts did not defer to arbitrators, but construed the arbitration clauses and decided the matter themselves.

In Green Tree, a “badly splitted” Supreme Court re-plowed this settled terrain. Justice Breyer’s plurality opinion, without “even mention[ing] any of the earlier federal appellate decisions holding that the FAA prohibits class arbitrations where the ... arbitration agreement is silent on the issue”, concluded that, because it was not “completely obvious” that the

129 See, e.g., Circuit City Stores, Inc. v. Adams, 279 F.3d 889 (9th Cir. 2002); Rickin v. Fantasy Mobile Homes, Inc., 824 So.2d 723, 733 (Ala. 2002); State ex rel. Dunlap v. Berger, 567 S.F.2d 265, 279-80 (W. Va. 2002). There is a split of authority about whether an arbitrator or a court should decide challenges to punitive damage waivers. Compare Hawkins v. Aid Ass’n for Lutherans, 338 F.3d 801 (7th Cir. 2003) (unconscionability decided by an arbitrator) with Alexander v. Anthony Int’l, 342 F.3d 256, 264 (3d Cir. 2003) (issue should be decided by a court).


131 See, e.g., Dominium Austin Partners, LLC v. Emerson, 248 F.3d 720, 728-29 (8th Cir. 2001); Champ v. Siegel Trading Co., 55 F.3d 269, 274-75 (7th Cir. 1995) (agreeing with “[t]he Second, Fifth, Sixth, Eighth, Ninth and Eleventh Circuits [which] have held that absent an express provision in the parties’ arbitration agreement”, district courts are barred from requiring parties to participate in a class arbitration “even where consolidation would promote the expeditious resolution of related claims”); United Kingdom v. Boeing Co., 998 F.2d 68, 74 (2d Cir. 1993) (holding that a district court cannot consolidate arbitration proceedings arising from separate agreements to arbitrate, absent the parties’ agreement to allow consolidation); Baesler v. Cont’l Grain Co., 900 F.2d 1193 (8th Cir. 1990).

132 Kennedy & Appleby, supra note 20, at 85. Mr. Kennedy is Mr. Dunham’s partner, and Ms. Appleby is his associate.

133 Id.

134 Green Tree, 539 U.S. at 451.
subject arbitration agreement precluded class treatment, it was the arbitrator's job to construe that clause and decide whether it allowed class arbitrations. The Supreme Court's decision has already had an impact on at least one significant franchise dispute. In a 2005 case involving the Blimpie's franchise system, a New York federal judge relied on Green Tree to hold that it was for the arbitrator to decide whether the claims of the forty-four claimant sub-franchisors could properly be consolidated in one proceeding.

In Green Tree's wake, the AAA and JAMS each adopted new rules governing class arbitrations. The AAA's policy is still not to accept class claims if the parties' underlying agreement prohibits class actions, although a recent federal court decision suggests that case managers may not be rigidly following that policy. In November 2004, JAMS announced that it would not enforce class-action prohibitions in consumer arbitrations. However, after receiving widespread criticism and losing several corporate clients, JAMS reversed its policy. On March 10, 2005, JAMS stated that it would not automatically refuse to enforce class action prohibitions in consumer disputes, but would instead address the issue “case-by-case.” To date, neither the AAA nor JAMS has adopted rules suggesting that class prohibitions would not be enforced in commercial disputes.

When the arbitration clause does not prohibit class actions, the AAA Supplementary Rules on Class Arbitration establish a procedure somewhat akin to class certification pursuant to Rule 23 of the Federal Rules of Civil Procedure. The Supplementary Rules provide for an arbitrator drawn from a special pool of class arbitrators to interpret the clause and otherwise determine whether the AAA should administer a class arbitration. Those rules provide that,

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135 Id. at 452.


137 Lawrence J. Bracken II & Caroline H. Dixon, AAA Releases Rules on the Administration of Class Actions, 23 FRANCHISE L.J. 215 (2004). Mr. Bracken is Mr. Lockerby's partner, and Ms. Dixon is an associate, in the Atlanta office of Hunton & Williams LLP.

138 According to a July 14, 2005 statement on the AAA website, “[t]he Association is not currently accepting for administration demands for class arbitration where the underlying agreement prohibits class claims, consolidation or joinder, unless an order of a court directs the parties to the underlying dispute to submit any aspect of their dispute involving class claims, consolidation, joinder or the enforceability of such provisions, to an arbitrator or to the Association . . . . The Association's determination not to administer class arbitrations where the underlying arbitration agreement explicitly precludes class procedures was made because the law on the enforceability of class action waivers [is] unsettled; the Association takes no position as to whether such clauses are or should be enforceable.” American Arbitration Association Policy on Class Arbitrations, at http://adr.org/ClassArbitrationPolicy (July 14, 2005).

139 In Universal Serv. Fund Tel. Billing Practices Litig., 370 F. Supp. 2d 1135 (D. Kan. 2005), the agreement at issue between the claimant consumer and AT&T included an arbitration clause that expressly precluded class arbitration. After being compelled to arbitrate, the consumer ignored the clause and filed a request for class arbitration. Rather than deny the request, as the AAA Rules seem to require, an AAA administrator sent the parties a letter stating that because there was a claim for class relief, the consumer's request for class certification would be submitted to an arbitrator for resolution. Counsel for AT&T objected, but the case manager reiterated that the arbitrator would decide whether to grant the claim for class relief. AT&T's counsel then sent a letter to the AAA's CEO, asking the CEO to overrule the staff decision, pointing out that it was completely at odds with governing law and the AAA's rules. AT&T's lawyer also stated that the AAA could have a “mass exodus” of cases if it left enforcement of its class prohibition to individual arbitrators. The AAA finally reversed course, deciding that it would not administer the case under the class action rules. The consumer then brought another action, challenging the AAA's impartiality. The court refused to get involved at that stage, but noted that it “does not condone the manner in which counsel for AT&T handled this matter,” and left open the possibility that any award might eventually be set aside because of the “undue means” employed to obtain it. Universal Serv. Fund Tel. Billing Practices Litig., 370 F. Supp. 2d at 1138.
where a contract is silent, the arbitrator must determine: (1) whether the clause can be construed to permit class action (the “Clause Construction phase”); (2) if the clause permits class actions, whether the particular dispute should be certified as a class (the “Class Certification Phase”); and (3) if class treatment is appropriate, who are the members of the class, and what are the procedures for class certification (the “Class Determination Phase”). At each step in the process, the arbitrator must issue a “Partial Final Award,” which either party has the right to appeal to a court of competent jurisdiction, within 30 days of the arbitrator’s ruling.

In a June 14, 2005 teleseminar sponsored by the American Bar Association, the AAA’s General Counsel, Eric Tuchman, reported that there were 68 cases on the AAA’s class action docket as of June 1, 2005. In these matters, ten “clause construction” awards have been issued, and in each case, the arbitrator held that an arbitration clause that was silent permitted class certification. Mr. Tuchman also reported, however, that in two of the three cases that have reached the “class certification phase,” the arbitrators denied certification. When this paper went to press, there were no reported judicial decisions reviewing an arbitrator’s clause construction or class certification awards under the AAA’s rules. However, in light of the deference traditionally afforded to arbitrator decisions and the AAA’s track record to date, any franchisor with an arbitration clause that designates the AAA as the ADR provider but does not expressly disclaim class or consolidated proceedings must recognize that it could have a difficult time persuading an arbitrator not to certify a class.

After Green Tree, every franchisor interested in arbitration should include in its arbitration clause an express ban on class or consolidated proceedings. Because franchise agreements are business agreements, not consumer contracts, courts should enforce these prohibitions, but “as a result of recent decisions arising out of consumer disputes, a franchisor electing to exclude class claims faces some (and perhaps a growing) risk that a court would hold that the clause is unconscionable.” 140

In 1997, one of the authors of this paper confidently proclaimed that, while “[a]n arbitration clause may not be an invincible shield against class action litigation, . . . it is surely one of the strongest pieces of armor available to the franchisor.” 141 Given subsequent developments in the law of arbitration related to punitive damages and class treatment, it is no longer possible to be so sanguine. For as the same author wrote in 2003:

Suppose an arbitration panel allows a class arbitration, refuses to enforce the franchise agreement’s punitive damage disclaimer, if any, and concludes that the franchisor deserves severe punishment for reprehensible behavior? If Gore and State Farm do not limit the arbitrator’s power, that hypothetical (unfortunately not far-fetched) would satisfy every franchisor’s definition of a major league problem. 142

140 Kennedy & Appleby, supra note 20, at 86.


142 Dunham, supra note 14.
2. Changes in the Law on Class Litigation

Franchisor class action anxiety undoubtedly reached its peak with the nine-figure jury verdict in *Broussard v. Meineke Discount Muffler Shops*.\(^{143}\) The Fourth Circuit’s decision vacating that verdict and holding that the district court had erred in certifying the class calmed franchisor nerves considerably,\(^{144}\) and also demonstrated the rigorous appellate review that is one of the hallmarks of the federal judicial system. Notwithstanding the reversal of the *Broussard* class action verdict, however, franchisors still needed to recognize their exposure to the expense, distraction and overall drain of class litigation, especially in state courts.

Certain county courthouses have been “class action magnets,” attracting huge numbers of cases with no plausible connection to the jurisdiction, because an aggressive plaintiffs’ bar understands from extensive experience that the judges and juries in these forums are hospitable audiences.\(^{145}\) Plaintiffs’ counsel generally had no trouble preserving their choice of forum, even though the cases included parties from all over the nation. To remove these suits to federal court, defendants obviously needed to establish federal subject matter jurisdiction.\(^{146}\) Because plaintiffs’ lawyers never pleaded any claims under federal law, federal question jurisdiction was not available as a basis for removal. Moreover, traditional diversity jurisdiction requires complete diversity of citizenship, with every plaintiff diverse from every defendant, and if any defendant is a citizen of the forum state, the case is not removable.\(^{147}\) It was usually easy for counsel to defeat diversity by adding as a named class representative a citizen of the same state as one of the defendants, or to sue a citizen of the forum state. As a result of these gambits, defendants were often forced to litigate (or enter into exorbitant settlements) in small, out-of-the-way jurisdictions, and elected state court judges enjoyed enormous power, in effect to regulate interstate commerce.

This phenomenon was not limited to consumer or personal injury class actions: it affected franchising, too. During the 1990s, the Subway franchisor, Doctor’s Associates, Inc. (“DAI”), was the target defendant in four putative class actions filed in Madison City, Illinois,\(^{148}\) which has long had one of the largest class action dockets of any state or federal court in the country.\(^{149}\) Because each case included at least one Illinois defendant, there was incomplete

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\(^{144}\) *Broussard v. Meineke Disc. Muffler Shops*, 155 F.3d 331 (4th Cir. 1998).


\(^{146}\) See 28 U.S.C. §§ 1330-69.


\(^{149}\) According to a 2001 study by the Center for Legal Policy at the Manhattan Institute, the “Madison County Court has been the situs of more class actions in the last few years than any other county court in the United States (except Los Angeles and Cook Counties, which have populations larger than Madison County by a factor of 38 and 21 respectively). Beisner & Miller, *supra* note 145, at 161-62. In 1999, 16 class actions were filed in Madison County – a rate of 61.8 cases for every million residents; in the entire federal judicial system, the per capita filings of class
diversity of citizenship and removal was impossible. It was only through aggressive, and ultimately successful, enforcement of the franchise agreement arbitration clause in federal court, pursuant to Section 4 of the FAA, that DAI was able to avert litigation in Madison County.\textsuperscript{150}

Thanks to the Class Action Fairness Act of 2005,\textsuperscript{151} franchisors without arbitration clauses may now be able to avoid state courts in many of the putative class actions with the greatest damage exposure. The Act, whose express purpose is to “restore the intent of the framers . . . by providing for federal court consideration of interstate cases of national importance under diversity jurisdiction,”\textsuperscript{152} gives federal courts jurisdiction (subject to the exceptions described below) in any class action with a total amount in controversy above $5 million and what the Act describes as “minimal diversity” — any class member a citizen of a different state than any defendant.\textsuperscript{153} The Act allows removal of any such case to federal court, even if one defendant is a citizen of the forum state; eliminates the traditional requirement that all defendants consent to removal; dispenses with the requirement that in all events removal must occur within one year of filing; and permits expanded appellate review of district court orders remanding cases to state court.\textsuperscript{154}

However, certain franchise disputes might fit within one or more of the Act’s exceptions, which are designed to leave essentially local disputes in state court:

- Cases with fewer than 100 members of the proposed plaintiff class
- Cases in which the “primary” defendants and at least two-thirds of the plaintiff class members are citizens of the forum state
- Cases in which (i) over two-thirds of the plaintiff class members are citizens of the forum state; (ii) there is at least one in-state defendant whose conduct was a “significant” contributor to the harm, from whom “significant” relief is sought; (iii) the principal injuries occurred in the forum state; and (iv) no other class action pressing similar claims has been filed against the same defendants within the last four years.\textsuperscript{155}

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\textsuperscript{150} See We Care Hair Dev., Inc. v. Engen, 180 F.3d 838 (7th Cir. 1999); Doctor's Assocs., Inc. v. Hollingsworth, 949 F. Supp. 77 (D. Conn. 1996), aff'd, No. 96-9599 (2d Cir. Feb. 5, 1998); Doctor's Assocs., Inc. v. Distajo, 107 F.3d 126 (2d Cir. 1997), cert. denied, 522 U.S. 948 (1997); Doctor's Assocs., Inc. v. Stuart, 85 F.3d 975 (2d Cir. 1996); Doctor's Assocs., Inc. v. Jabush, 89 F.3d 109 (2d Cir. 1996); Doctor's Assocs., Inc. v. Distajo, 66 F.3d 438 (2d Cir. 1995), cert. denied, 517 U.S. 1120 (1996).


\textsuperscript{152} \textit{id.} at § 2(b).

\textsuperscript{153} \textit{id.}

\textsuperscript{154} \textit{id.} at § 5.

\textsuperscript{155} \textit{id.} at § 4.
The Act also empowers federal district judges to decline jurisdiction when over a third but under two-thirds of the class members are citizens of the forum state. In exercising this discretion, district courts are directed to consider: (i) whether the case involves issues of national or interstate interest; (ii) whether the claims will be governed by the laws of the forum state or those of other states; (iii) whether the class action was pleaded to avoid federal jurisdiction; (iv) the forum state’s connection to the class members, the alleged harm and/or the defendants; (v) the number of class members from the forum state versus the number from any other state, and how widely dispersed the other class members are; and (vi) any other class actions asserting similar claims have been filed within the last three years.156

Finally, under certain circumstances, “mass actions” — in which the claims of at least 100 people would be treated jointly as a result of common questions of law and fact — are subject to the Act as well.157

Because President Bush just signed the Act into law in February 2005, it is far too soon to measure its likely impact on franchise class litigation.158 Because the Act would allow the removal to federal court of cases that include in the putative plaintiff class all franchisees in a nationwide system, it may dissuade plaintiffs’ lawyers from filing those suits in state court in the first place.159 On the other hand, if a franchisor has a substantial number of franchisees in one state, plaintiffs’ lawyers may try to thread the needle of the Act’s exceptions, by limiting the members of the putative class to those in-state franchisees, and naming as a defendant a citizen of the same state who can, on the merits or through creative pleading, qualify as a “significant” contributor to the alleged harm, from whom “significant” damage can be sought.

I. Appellate Review

The FAA160 and state arbitration statutes all enumerate multiple grounds for vacating arbitration awards. Under Section 10 of the FAA, these include a showing that the award was procured by corruption, fraud or other “undue means”; proof of bias or corruption by the arbitrator; serious misconduct by the arbitrator, which deprived a party of its fundamental rights; and a showing that the arbitrators exceeded their powers, or executed them so poorly that a definitive award was not made.161 There are also established common law bases for overturning an award, such as manifest disregard of the law, a violation of public policy, and arbitrary and capricious or completely irrational conduct by the arbitrators.

156 Id.
157 Id.
158 It does appear, however, that the Act has already had a significant impact on new class action filings in Madison County. In June, 2005, in a conversation with the Director of Wiggin and Dana’s Information Center, the Madison County Court Clerk reported that, since the Act took effect, there has only been one new class action filed each month.
159 But these actions may still be filed in federal court, where “defendants might face bigger, richer, more experienced plaintiffs firms” that may still be able to get many plaintiff classes certified. Alison Frankel, Magnet Courts Losing Their Pull, LEGAL TIMES, at 2 (Apr. 11, 2005).
In practice, however, “[j]udicial review of an arbitration award is extraordinarily narrow.” As Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit once put it, “unless issues of fraud or corruption are raised,” the only question that a reviewing court actually asks “is whether the arbitrators did the job they were told to do — not whether they did it well, or correctly, or reasonably, but simply whether they did it.” In the words of Judge William Bauer, also of the Seventh Circuit, “[a]rbitrators do not act like junior varsity trial courts where subsequent appellate review is readily available to the losing party.”

This extraordinary deference to arbitrators and their awards — even awards entirely devoid of legal citation and reasoned explanation — reflects a policy judgment about the importance of “encourage[ing] the use of arbitration as an alternative to formal litigation.” The view of Chief Judge J. Harvie Wilkinson of the United States Court of Appeals for the Fourth Circuit is representative:

A policy favoring arbitration would mean little, of course, if arbitration were merely the prologue to prolonged litigation. If such were the case, one would hardly achieve the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation. Opening up arbitral awards to myriad legal challenges would eventually reduce arbitration proceedings to the status of preliminary hearings. Parties would cease to utilize a process that no longer had finality. To avoid this result, courts have resisted temptations to redo arbitration awards.

However, the Supreme Court has held that the parties “may . . . specify by contract the rules under which [an] arbitration may be conducted,” and the Fourth Circuit, joined by the Third and Fifth Circuits, has interpreted this to include the “rules” of appellate review, and therefore upheld an arbitration clause that broadened the scope of judicial review beyond that established by statute. The Seventh, Eighth and Tenth Circuits have reached a contrary conclusion, reasoning that to allow contractual expansion of judicial review would undermine the goals of arbitration (efficiency, economy and finality), infringe upon legislative determinations of subject matter jurisdiction, and interfere with judicial control of the judicial system.

162 Forsythe Int’l S.A. v. Gibbs Oil Co. of Tex., 915 F.2d 1017, 1020 (5th Cir. 1990) (quoting Antwine v. Prudential Bache Sec., 899 F.2d 410, 413 (5th Cir. 1990)).

163 Bd. of Locomotive Eng’rs v. Atchison, Topeka & Santa Fe Ry. Co., 768 F.2d 914, 921 (7th Cir. 1985). Judge Posner made this observation about a railway labor arbitration pursuant to a collective bargaining agreement under the Railway Labor Act, but other courts have quoted him with approval in cases involving commercial arbitration. See, e.g., Remmey v. PaineWebber, Inc., 32 F.3d 143, 146 (4th Cir. 1994).

164 National Wrecking Co. v. Int’l Bd. of Teamsters, Local 731, 990 F.2d 957, 960 (7th Cir. 1993).

165 Remmey, 32 F.3d at 146.

166 Id. (internal quotation marks and citations omitted).


The Ninth Circuit has embraced both views, at different stages of litigation arising from the same arbitration. In a 1997 decision ("Kyocera I")\(^ {170}\), the Ninth Circuit held that the parties to an arbitration agreement may either "leave in place the limited court review provided by §§ 10 and 11 of the FAA, or they may agree to remove that insulation and subject the result to a more searching court review of the arbitral tribunal’s decision, for example a review for substantial evidence and errors of law."\(^ {171}\) In reliance upon the Ninth Circuit’s decision in Kyocera I, the parties conducted a protracted arbitration, followed by judicial proceedings to confirm the award. ("Kyocera II"). Based on Kyocera I, the district court in Kyocera II confirmed the arbitration award in part while modifying it in certain respects.\(^ {172}\) On appeal in Kyocera II, a three-judge panel of the Ninth Circuit affirmed the district court’s decision.\(^ {173}\) But in a later en banc decision, the Ninth Circuit reversed itself on the standard of review, even though none of the parties sought reversal. In "Kyocera III",\(^ {174}\) the en banc court declared:

We agree with the Seventh, Eighth, and Tenth Circuits that private parties have no power to determine the rules by which federal courts proceed, especially when Congress has explicitly prescribed those standards. Pursuant to Volt, parties have complete freedom to contractually modify the arbitration process by designing whatever procedures and systems they think will best meet their needs — including review by one or more appellate arbitration panels. Once a case reaches the federal courts, however, the private arbitration process is complete, and because Congress has specified standards for confirming an arbitration award, federal courts must act pursuant to those standards and no others. Private parties’ freedom to fashion their own arbitration process has no bearing whatsoever on their inability to amend the statutorily prescribed standards governing federal court review.\(^ {175}\)

Notwithstanding this conflict among the circuits, the Supreme Court has yet to address this issue.\(^ {176}\)

\(^ {170}\) LaPine Tech. Corp. v. Kyocera Corp, 130 F.3d 884 (9th Cir. 1997) [hereinafter Kyocera I], overruled by Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987 (9th Cir. 2003).

\(^ {171}\) Kyocera I, 130 F.3d at 890.


\(^ {173}\) Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 299 F.3d 769 (9th Cir. 2002), aff’d in part and vacated in part en banc, 341 F.3d 987 (9th Cir. 2003), cert. dismissed, 540 U.S. 1098 (2004).


\(^ {175}\) Kyocera III, 341 F.3d at 1000.

\(^ {176}\) Margaret Moses, Can Parties Tell Courts What to Do? Expanded Judicial Review of Arbitral Awards, 52 U. KAN. L. REV. 429, 444 (2004) (“Although it is difficult to predict which view of expanded judicial review will prevail in the Supreme Court, the Fifth Circuit’s position that the FAA permits expanded judicial review appears more consistent with both legislative intent and Supreme Court decisions emphasizing the importance of enforcing arbitral agreements in accordance with their terms.”).
VI. CONCLUSION

“Arbitrate” and “arbitrary” share the same Latin root\(^\text{177}\) – an etymological fact that may illuminate the essential nature of the arbitral process. Arbitration developed, and still exists, as an alternative to, not an imitation of, the lawsuit. Accordingly, compared to litigation, there may always be a somewhat arbitrary quality to arbitration’s procedures and regard for governing law, and there is no question that arbitration can also produce arbitrary, and sometimes downright inexplicable, outcomes. But juries, and even some judges, have been known to do that, too, and in court as in arbitration, adverse outcomes often survive appellate review.

For this reason and all the others discussed above, the answer to the question “shall we arbitrate franchise disputes?” is not self-evident. Even after undertaking the comparative analysis suggested in this paper, prudent franchisors, franchisees and franchise lawyers will still reach different conclusions about the wisdom of arbitrating. In addition, many franchisors who choose arbitration will adopt a variety of further contractual requirements, dealing with matters such as discovery, evidentiary rules, injunctive relief and appellate review, in an understandable effort to graft onto (or except from) arbitration those features of litigation that they find desirable.

On this point, we offer one final cautionary observation. This attempt to improve arbitration, taken too far, can actually rob the process of important advantages over litigation, and create an awkward hybrid marred by many of the worst features of both dispute resolution systems.

Parties who are unwilling to accept a higher degree of arbitrariness in their dispute resolution lives should probably consider steering clear of arbitration, rather than trying to “fix” it. Those with a higher tolerance for the arbitrary are better candidates for arbitration, especially if they conclude that, on balance, it will probably increase their chances of avoiding a risk management disaster that could stymie their business plans.

\(^{177}\) Both words are derived from the Latin noun *arbiter*, which, like its English cognate, refers to a person who mediates a dispute between parties. Literally translated, *arbiter* means “‘one who goes to see,’ hence, who looks into or examines.” THE OXFORD ENGLISH DICTIONARY ONLINE, http://www.oed.com/ (2d ed. 1989) (definition for “arbiter”). The earliest written appearance of the word seems to have been in the year 1340 as the feminine noun “arbitress,” meaning “[a woman] who settles disputes, a mediatrix.” *Id.* (entry for “arbiter”).

The word “arbiter” has several meanings that echo in the words “arbitrator” and “arbitrary.” Whether an arbiter’s status is derived from political power, intellectual authority, or from the consent of disagreeing parties, he would be in all of those cases “[o]ne whose opinion or decision is authoritative in a matter of debate; a judge.” *Id.* If, however, his authority stems from *supreme* power (like a monarch), then he is “[o]ne who has power to decide or ordain according to his own absolute pleasure; one who has a matter under his sole control.” *Id.* (entry for “arbiter”).

It should not surprise us that the first known written use of the word “arbitrary” to indicate something “capricious, uncertain, [and] varying” (in the year 1646) appeared only 18 years after the first use of the word “arbiter” to mean someone “who has power to decide or ordain according to his own absolute pleasure” (1628). *Id.* (entries for “arbiter” and “arbitrary”).
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