

**American Bar Association
35th Annual Forum on Franchising**

THE STRATEGY OF ARBITRATION

**Arthur L. Pressman
Nixon Peabody LLP**

and

**Justin M. Klein
Marks & Klein, LLP**

October 3 – 5, 2012
Los Angeles, CA

Table of Contents

I.	INTRODUCTION.....	1
II.	ARBITRATION MATTER OF CONTRACT OR AGREEMENT.....	1
	A. Arbitration Basics	1
	1. The Federal Arbitration Act.....	2
	2. State Law.....	3
III.	CLAUSE ANALYSIS AND MODIFICATION	4
	A. Rules.....	4
	B. Venue.....	6
	C. Selecting the Arbitrator	6
	1. Process of Selecting Arbitrators	7
	2. How Many Arbitrators	7
IV.	WHO IS COVERED	8
	A. Franchisor and Franchisee.....	8
	B. Third Parties and Non-Signatories	9
	C. Joinder of Parties	9
V.	WHAT IS COVERED	10
	A. Disputes “Arising Out Of” or “In Connection With” the Franchise Agreement	11
	B. Disputes Involving Interpretation of the Franchise Agreement.....	11
	C. Injunctive/Declaratory Relief Carve-Out.....	12
	D. Class Actions and Multi-Party Dispositions	12
	1. Class.....	12
	2. Multiple Party Disputes	13

VI. PREHEARING CONSIDERATIONS FOR THE PARTIES	14
A. Franchisee	14
1. Filing Suit.....	14
2. Counter-Filing for Arbitration.....	14
3. Disputing Venue or Forum.....	14
4. Disputing Fees.....	15
B. Franchisee Association	16
1. Standing	16
2. Injunctive and Declaratory Relief v. Damages	18
3. Claims.....	18
4. Obstacles.....	18
a. Standing	19
b. Jurisdiction.....	19
c. Sham Organization	20
C. Franchisor	20
1. To Include or Not Include?.....	20
2. Class and Consolidated Prohibitions	22
VII. OTHER PRE-HEARING CONSIDERATIONS	24
A. Affirmative Claims v. Injunctive Relief in Arbitration	24
B. Parallel Injunction Litigation.....	25
C. Discovery	25
D. Motion Practice	25
E. Parallel Mediation.....	26
F. Costs	26
G. Consequences and Strategy of Non-Payment.....	27

H. Awards and Decisions	27
VIII. POST-HEARING.....	28
A. Appellate Rights Post-Arbitration	28
1. Challenges Under the FAA.....	28
2. Private Agreements Regarding Further Review	29
B. Confirmation of the Award.....	30
C. The Consideration of Limited Appellate Rights for Franchisors and Franchisees	30
IX. CONCLUSION	31
Biographies	32

THE STRATEGY OF ARBITRATION

“When will mankind be convinced and agree to settle their difficulties by Arbitration?”

- Benjamin Franklin

I. INTRODUCTION¹

Arbitration is a unique dispute resolution forum requiring multiple strategic decisions by franchisor and franchisee legal counsel before an arbitration demand is even filed. This workshop will focus on prehearing decisions and strategies in arbitrations unique to franchise system disputes and their participants. Who may invoke or avoid an arbitration clause? How do state law principles of unconscionability impact arbitration? May franchisee groups or associations bring arbitration claims? These issues, along with other issues such as venue choice, injunctive relief, panel composition, parallel court action, offer counsel opportunities for procedural parries and thrusts that require careful evaluation. This workshop examines effective strategies from experienced practitioners regarding practical, legal, financial and tactical considerations when a dispute arises between a franchisor and franchisee that involves arbitration.

II. ARBITRATION MATTER OF CONTRACT OR AGREEMENT

A. Arbitration Basics

Arbitration offers a franchise system the opportunity to resolve disputes between franchisors and franchisees in a forum outside the litigation system.² While some stigmatize arbitration because it may subjugate “weaker” parties (individuals) to control by “stronger” parties (corporations), coercion arguments are often inapplicable “in the franchising context, since both parties are [sophisticated] businesses that consult with lawyers” prior to entering franchise agreements.³ In fact, there are several policy considerations that support the use of arbitration, as opposed to litigation, in the franchise system.

First, arbitration can bring the “damage awards closer to the optimal level” by regulating the number of claims brought between franchisors and franchisees.⁴ Second, arbitration offers franchisors and franchisees the benefit of entering a “resolution forum in which industry experts rather than uninformed jurors” evaluate the claims presented.⁵ Third, some experts propose that

¹ Mr. Pressman and Mr. Klein acknowledge the hard work and enthusiastic help of Kristen A. Curatolo, an associate at Marks & Klein, LLP, and Sara Farber, an associate at Nixon Peabody, LLP. Without their contributions, this paper would not be the same.

² The term “litigation system” in this piece to refer to the American judicial system, which is traditionally used to resolve disputes between parties.

³ Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549, 558 (2006).

⁴ *Id.*

⁵ *Id.* at 560.

franchise disputes resolved through arbitration result in a more “accurate” result than those resolved through litigation.⁶ For example, unlike judges, arbitrators are incentivized to achieve an accurate and efficient resolution because they are paid to resolve disputes.⁷ Lastly, while arbitration may not always be a “cost saver,” its model can promote cost efficiency by removing the standard litigation discovery schedule from the process.⁸ As discussed below, the Federal Arbitration Act and state law provide the legal limits for arbitration in the United States.

1. The Federal Arbitration Act

The Federal Arbitration Act (the “FAA”) is among the most important pieces of legislation regarding arbitration in the United States.⁹ Enacted in 1925, the FAA establishes a basic foundation for federal and state arbitration proceedings.¹⁰ Congress implemented the FAA as a response to certain states’ refusal to recognize and enforce “arbitration provisions contained in contracts from other [jurisdictions].”¹¹ The Act’s passage marked the beginning of a federal policy that favors alternative dispute resolution and provides a preemption tool against those state courts that would otherwise invalidate arbitration agreements.¹²

Recently, the Supreme Court affirmed the notion that the FAA’s primary purpose is to enforce “arbitration agreements according to their terms so as to facilitate streamlined [arbitration] proceedings.”¹³ The FAA accomplishes this by ensuring the enforcement of consented-to arbitration agreements in which parties negotiate the specific terms governing their arbitration proceedings.¹⁴ For example, parties are left to determine the intricacies of their arbitration provisions, including: (1) the applicable rules; (2) the venue of the arbitration; (3) the number of arbitrators; (4) the applicable law; (5) the qualifications of the selected arbitrators; (6) the permissibility of clause modification; (7) the parties and claims covered by the clause; and (8) the procedure for pre- and post-arbitration hearings and processes.

The FAA only applies to arbitration agreements if two threshold requirements are met.¹⁵ First, parties must expressly agree to arbitration in writing.¹⁶ Second, the arbitration agreement

⁶ *Id.*

⁷ *See id.*

⁸ *But see*, Lynne Marek, *As Franchises Take Off, So Do Lawsuits*, NAT’L L.J., Aug. 13, 2007, at 8, for a discussion on the declining use of arbitration in the franchise context.

⁹ 9 U.S.C. § 1 et seq.

¹⁰ Andrew Dodd, Edgar Grajeda, Judy Rost & Robin Schachter, *Comparative International Perspectives of Arbitration in the Franchising Context*, 31 FRANCHISE L.J. 124, 130 (2012).

¹¹ Joel D. Rosen & James B. Shrimp, *Yes to Arbitration, but Did I Also Agree to Class Action and Consolidated Arbitration?*, 30 FRANCHISE L.J. 175 (2011).

¹² *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1984).

¹³ *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, at 1748 (2011).

¹⁴ 9 U.S.C. §. 2; Dodd, *supra*, note 9 at 124.

¹⁵ 9 U.S.C. § 2 (1999).

¹⁶ *Id.*

must have a connection to interstate commerce.¹⁷ The Supreme Court holds that an agreement will satisfy this second requirement if the contract of which the arbitration clause is a part “affects” interstate commerce.¹⁸ The underlying contract will satisfy this test if, “in the aggregate the economic activity in question would represent ‘a general practice... subject to federal control.’”¹⁹ The multi-state nature of a franchise system, and its reliance on federal trademark protection, generally satisfies this criterion, making arbitration agreements within franchise agreements enforceable under the FAA.²⁰

2. State Law

State laws add additional requirements above and beyond the FAA. Several states model their own arbitration statutes after the Uniform Arbitration Act (the “UAA”).²¹ In response to the FAA’s broad scope, the National Conference of Commissioners on Uniform State Laws (“the Conference”) created the UAA in 1955.²² The UAA’s goal is to clarify some of the specific details regarding arbitration in order to ensure the enforceability of agreements for the same.²³ To date, thirty-five states and the District of Columbia have adopted the UAA in some form, while fourteen others have adopted similar legislation.²⁴ Arbitration’s widespread use and increasing complexity resulted in the Conference in 1995 appointing a drafting committee to revise the UAA.²⁵ In 2000, this panel of experts examined the UAA, approving the Revised Uniform Arbitration Act (the “RUAA”).²⁶ The RUAA examines a number of issues left untouched by the UAA,²⁷ and a recent survey shows that twelve states have adopted it thus far.²⁸

¹⁷ *Id.*

¹⁸ *Allied-Bruce Terminex Cos., Inc. v. Dobson*, 513 U.S. 265 (1995).

¹⁹ *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003).

²⁰ *Allied-Bruce*, 513 U.S. 265.

²¹ Ann H. Nevers, *Medical Malpractice Arbitration in the New Millennium: Much Ado About Nothing?*, 1 PEPP. DISP. RES. L.J. 45, 66 n. 157 (2000).

²² Trachte-Huber & Stephen K. Huber, ALTERNATIVE DISPUTE RESOLUTION: STRATEGIES FOR LAW AND BUSINESS, 619 (1996).

²³ REVISED UNIF. ARBITRATION ACT, Prefatory Note (2000), available at <http://www.law.upenn.edu/bll/ulc/uarba/arbitrat1213.htm>.

²⁴ *Id.*

²⁵ *Id.*

²⁶ LeRoy, Michael H., *Irreconcilable Differences? The Troubled Marriage of Judicial Review Standards Under the Steelworkers Trilogy and the Federal Arbitration Act*, 2010 J. DISP. RESOL. 89, 95 (2010).

²⁷ *Id.* For example, the RUAA specifically provided guidance as to (1) who decides the arbitrability of a dispute and by what criteria; (2) whether a court or arbitrators may issue provisional remedies; (3) how a party can initiate an arbitration proceeding; (4) whether arbitration proceedings may be consolidated; (5) whether arbitrators are required to disclose facts reasonably likely to affect impartiality; (6) what extent arbitrators or an arbitration organization are immune from civil actions; (7) whether arbitrators or representatives of arbitration organizations may be required to testify in another proceeding; (8) whether arbitrators have the discretion to order discovery, issue protective orders, decide motions for summary dispositions, hold prehearing conferences and otherwise manage the arbitration process; (9) when a court may enforce a pre-award ruling by an arbitrator; (10) what remedies an arbitrator may award, especially in regard to attorney’s fees, punitive damages or other exemplary relief; (11) when a court can award attorney’s fees and costs to arbitrators and arbitration organizations; (12) when a court can award attorney’s

State law is also the most available mechanism for invalidating arbitration agreements. In recent years, state courts and some federal courts have increased their attack on arbitration clauses.²⁹ The reasons for this trend vary, and include judicial bias against arbitration, because it is sometimes perceived as an “inherently unfair and inferior method of resolving disputes.”³⁰ While latitude is afforded to parties in constructing and contracting to arbitration agreements, courts have found arbitration provisions unconscionable where they impose unreasonable limits on discovery or invalidate a class arbitration waiver.³¹

III. CLAUSE ANALYSIS AND MODIFICATION

One of the hallmarks of arbitration is the parties’ abilities to craft arbitration clauses that satisfy all parties’ wishes. In that process, parties must be mindful that some factors will affect the arbitration clause’s enforceability and modification; namely: the rules governing the arbitration agreement, the venue selected by the agreement, and the selection of an arbitrator or arbitrators.

A. Rules

One of the initial tasks when creating an arbitration agreement is determining the body of rules that will govern disputes between the parties. “Many franchise agreement[s]’ arbitration clauses designate the American Arbitration Association (the “AAA”) as the arbitration provider....”³² Some members of the legal community have voiced dissatisfaction with the AAA’s associated cost and the time it takes the Association to resolve disputes.³³ Nonetheless, the

fees and costs to a prevailing party in an appeal of an arbitrator’s award; and (13) which sections of the UAA would not be waivable, an important matter to insure fundamental fairness to the parties will be preserved, particularly in those instances where one party may have significantly less bargaining power than another; and (14) the use of electronic information and other modern means of technology in the arbitration process. *Id.*

²⁸ See LeRoy, *supra*, n. 25 at 94. The states are Alaska, Colorado, Hawaii, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Utah, and Washington. *Id.* at n.47.

²⁹ Kevin M. Kennedy, *Drafting an Enforceable Franchise Agreement Arbitration Clause*, 22 FRANCHISE L.J. 112 (2002).

³⁰ *Id.* The FAA allows the invalidation of arbitration agreements by state and federal courts through the application of general contract defenses, including unconscionability, fraud, and duress. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995). Federal courts are equally charged with applying state-law principals governing contract formation to invalidate arbitration agreements where appropriate. *Id.*

³¹ See e.g. *Ferguson v. Countrywide Credit Indus., Inc.*, 298 F.3d 778, 786-87 (9th Cir. 2002). For example, courts have found arbitration provisions that impose unreasonable limits on discovery to be unconscionable. *Id.* Other courts have found provisions agreed to by the parties concerning statutes of limitation and damage waivers to be unconscionable. *Davis v. O’Melveny & Meyers*, 485 F.3d 1066, 1076-78 (9th Cir. 2007) (finding that under California law, a one-year state of limitation is unconscionable). Recently, the Supreme Court has even provided opinion on the conscionability of action waivers in arbitration agreements based on the use of state law to invalidate the same. *Concepcion*, 131 S. Ct. 1740; *but see Skirchak v. Dynamics Research Corp.*, 508 F.3d 49, 51 (1st Cir. 2007) (invalidating a class arbitration waiver on grounds of unconscionability).

³² Kennedy, *supra*, note 28 at 122.

³³ *Id.* See also Christopher R. Drahozal & Quentin R. Wittrock, *Is there a Flight From Arbitration*, 37 HOFSTRA L. REV. 71, 101 (2008).

AAA provides its adoptees with a standard set of commercial rules that provide guidance for arbitration proceedings from initiation of the action through final adjudication.³⁴

The AAA's commercial rules are flexible and parties may agree to vary them. For example, under the standard AAA rules, legal rules of evidence are not applicable, there is no regulated or mandated motion practice or court conference, and there is no requirement for transcripts of the proceedings or for written opinions of the arbitrators.³⁵ Although there is no formal discovery process, the AAA's rules allow the arbitrator to require the production of relevant documents, the deposition of factual witnesses, and an exchange of reports of expert witnesses.³⁶

While many franchise agreements incorporate the AAA rules of procedure, franchisors and franchisees should also consider use of other arbitration organizations.³⁷ JAMS, for example, offers "Comprehensive Arbitration Rules and Procedures" that franchisors and franchisees can incorporate into their franchise agreements.³⁸ Like the AAA's rules, JAMS rules are flexible and may be modified by mutual agreement of the parties.³⁹ In addition to its standard track arbitration procedures and rules, JAMS also offers expedited arbitration procedures that allow parties to limit traditional, cost-prohibitive discovery mechanisms such as depositions, document requests, and e-discovery.⁴⁰ Similar to the AAA's approach, under the JAMS rules, strict conformity to the rules of evidence is not required, except that the Arbitrator shall apply applicable law relating to privileges and work product.⁴¹ JAMS rules allow pre-hearing submissions and provide for an expedited discovery procedure, which includes the right

³⁴ American Arbitration Association, AAA court- and time-tested rules and procedures, *available at* http://www.adr.org/aaa/faces/rules?_afLoop=334905180770616&_afWindowMode=0&_afWindowId=11x02qbfyr_59#%40%3F_afWindowId%3D11x02qbfyr_59%26_afLoop%3D334905180770616%26_afWindowMode%3D0%26_adf.ctrl-state%3D11x02qbfyr_84 (last visited on July 28, 2012).

³⁵ American Arbitration Association, *Resolving Commercial Financial Disputes – A Practical Guide*, at 3 (2008).

³⁶ *Id.*

³⁷ As between the AAA and JAMS, at least one practitioner has noted that "there are more former judges on the JAMS panel than are found on a typical AAA roster," and that "JAMS arbitrators also tend to be more expensive," and "include more of the formalities and procedures of litigation than are found in the AAA's Commercial Arbitration Rules." *FAM Arbitration Costs*, *available at* <http://www.franarb.com/arbitration.aspx> (last visited on June 6, 2012).

³⁸ Founded in 1979, JAMS is the largest private alternate dispute provider in the world. *About JAMS*, *available at* http://www.jamsadr.com/aboutus_overview/ (last visited on June 6, 2012). JAMS touts more than 280 full-time neutrals, including retired judges and attorneys, and offers, among other things, facilitative and evaluative mediation, and binding arbitration. *Id.* In 2011, JAMS and ADR Center in Italy formed JAMS International to provide mediation and arbitration of cross-border disputes. *Id.*

³⁹ Rule 2, *JAMS Comprehensive Arbitration Rules & Procedures* (Oct. 1, 2010).

⁴⁰ *Id.*

⁴¹ *JAMS Streamlined Arbitration Rules*, *available at* http://www.jamsadr.com/files/Uploads/Documents/JAMSRules/JAMS_streamlined_arbitration_rules-2009.pdf (last visited on June 6, 2012).

to take one deposition and exchange unprivileged relevant documents.⁴² However, where all participants desire unlimited discovery, JAMS arbitrators will respect that decision.⁴³

Additionally, Franchise Arbitration and Mediation Services (“FAM”) specializes in arbitration and mediation services for the resolution of disputes or franchising issues between franchisors and franchisees.⁴⁴ Recognizing that other arbitration organizations may lack franchise expertise on its panels, FAM provides neutral arbitrators whose background and experience equips them to resolve franchise industry disputes exclusively.⁴⁵

Like the AAA and JAMS, FAM rules are flexible and may be modified by the agreement of the parties. Similarly, the rules of evidence are not strictly observed during arbitration hearings.⁴⁶

B. Venue

When drafting arbitration clauses, venue is an important consideration for franchisors. Recently, there has been an increase in litigation regarding the validity of arbitration agreements that compel franchisees to arbitrate claims in franchisors’ home states. Some states’ franchise statutes operate to invalidate such agreements as unconscionable because they are considered “inconvenient” for the non-drafting parties. But, in the absence of such a statute, courts are not often persuaded by attempts to nullify agreements that venue arbitrations in the franchisor’s home state. Rather, they often find that the FAA preempts state laws invalidating the same. Nevertheless, franchisors should consider explicitly referencing the applicability of the FAA to any arbitration clause that venues arbitration proceedings in the franchisor’s home state in order to promote the enforceability of the provision.⁴⁷

C. Selecting the Arbitrator

The right arbitrator can make or break the success of arbitration proceedings. Simply put, “[a] neutral decision maker is central to the fairness of an arbitration proceeding (and to the enforceability of an arbitration clause).”⁴⁸ One of the primary decisions parties must make when

⁴² Rules 17, 20, 22, *JAMS Comprehensive Arbitration Rules & Procedures* (Oct. 1, 2010).

⁴³ *JAMS Arbitration Discovery Protocols*, at 5, available at http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Arbitration_Discovery_Protocols.pdf (last visited on June 6, 2012).

⁴⁴ *About FAM*, available at <http://www.franarb.com/default.aspx> (last visited June 6, 2012).

⁴⁵ *Id.* FAM charges a one-time administrative processing fee of \$1,000 for arbitrations involving a single arbitrator and \$2,750 for arbitrations involving multiple arbitrators (some franchise agreements call for a panel of three arbitrators when the amount in dispute exceeds a certain sum). Rule 7.3, *FAM Arbitration Guidelines*, <http://www.franarb.com/pdf/ARBGDL.pdf> (March 17, 2011) (last visited on June 7, 2012). FAM-referred arbitrators have agreed to charge their normal hourly rate (but not to exceed \$500) for FAM-referred matters. Rule 7.3, *FAM Arbitration Guidelines*, <http://www.franarb.com/pdf/ARBGDL.pdf> (March 17, 2011) (last visited on June 7, 2012).

⁴⁶ *Id.* at Rule 7.3.

⁴⁷ Kennedy, *supra*, note 28 at 113. A recent study shows that even though there has been an increase in litigation regarding the location of arbitration proceedings, a recent article notes that the majority of arbitration clauses it analyzed “specified the franchisor’s home as the place of arbitration.” See Drahozal & Wittrock, *supra*, n. 32 at 109.

⁴⁸ See Drahozal & Wittrock, *supra*, note 32 at 101-102.

drafting arbitration clauses is whether to use one or three arbitrators. On one hand, the principle that complexity in a case warrants appointing three experienced arbitrators is sound because complex facts or issue may require different kinds of expertise or perspectives that would be hard to find in a single arbitrator, and even if one could locate such as arbitrator, he or she might not be available to hear the case.⁴⁹ Additionally, while three bright minds can theoretically contribute to the deliberative process, using a single arbitrator is less expensive and may be more efficient (it is also easier to arrange schedules with one arbitrator than with three).⁵⁰ However, these benefits could be lost if the parties agree to conduct very broad discovery, including numerous depositions, and file an assortment of jurisdictional, discovery and motions.

1. Process of Selecting Arbitrators

One advantage of arbitration over court litigation is the parties' ability to select the arbitrators. Once a dispute has arisen and arbitration pleadings have been filed, the time will come for the parties to make the selection decision. Arbitration providers maintain a roster of arbitrators who possess business or legal experience in a variety of industries.⁵¹ One way to discern whether a candidate is impartial, unbiased and knowledgeable is to conduct a joint interview with opposing counsel of the arbitrator candidates. Alternatively, counsel for the parties may confer and decide to jointly select an arbitrator together in order to save their clients the high costs and fees associated with using formal alternative dispute resolution institutions.

Parties may require that the arbitrators possess knowledge of the industry, applicable law, technical knowledge, business acumen, judicial temperament, and case management skills.⁵² Knowledge of the franchise industry and applicable law are particularly important because arbitrators who are familiar with federal and state specific franchise laws, decisions and regulations will generally understand the evidence in a case fairly quickly and will not likely need as much time to reach a decision. Additionally, an arbitrator's predispositions may be revealed by researching the arbitrator's litigation history, locale, cost, career experience and prior rulings.

2. How Many Arbitrators

A franchise agreement's arbitration clause often specifies the number of arbitrators (one or three) and the method of arbitrator selection. When three arbitrators are contemplated, the arbitration clause frequently provides that the parties use the Party-Appointed method.⁵³ This method requires that each party appoint one arbitrator, and the two party-appointed arbitrators name the third arbitrator who shall serve as the chair of the panel.⁵⁴ Historically, this process benefits each party by affording an advocate for each that will attempt to sway the third

⁴⁹ Bender, Raymond G., *Critical First Steps in Complex Commercial Arbitration*, Dispute Resolution Journal, vol. 64, no. 1, at 2 (Feb.-April 2009).

⁵⁰ *Id.* at 3.

⁵¹ *Id.*

⁵² *Id.*

⁵³ Shampnoi, Elizabeth, *The Arbitration Process and New Ethical Standards*, The CPA Journal (Dec. 2005), available at <http://www.nysscpa.org/cpajournal/2005/1205/essentials/p60.htm> (last visited on June 6, 2012).

⁵⁴ Bender, *supra*, note 52 at 2.

arbitrator.⁵⁵ The party-appointed arbitrator is generally paid by the party that selects them, and the opposing party has no input into the selection process.⁵⁶

At other times, the arbitration clause provides that a particular arbitral institution, such as the AAA, will govern the arbitration.⁵⁷ In that situation, the designated institution's rules will govern the arbitrator selection process.⁵⁸ When ready to select arbitrators, the parties should try to mutually agree on the appropriate individual for their case. However, in a highly contentious case, this may not be possible.

When parties cannot agree, they may opt for Panel-Selected arbitrators by employing the "strike and rank method" outlined in R-11 of the AAA's Commercial Arbitration Rules and Mediation Procedures.⁵⁹ This method begins with the parties providing the case manager with the qualifications they are seeking in an arbitrator.⁶⁰ For example, they might desire commercial litigators with experience in accounting disputes, or CPAs that handle business valuations. The case manager then develops a list that meets the parties' expectations.⁶¹ If the parties cannot agree, they must choose who they want to eliminate, and rank those remaining in order of preference.⁶² The AAA then tallies the results and appoints the arbitrator ranked highest by the parties; if the parties do not return the lists within seven days, the AAA will deem all arbitrators to be acceptable and invite an arbitrator from that list to serve.⁶³

IV. WHO IS COVERED

A. Franchisor and Franchisee

As almost always both franchisor and franchisee is each a signatory to the franchise agreement, all disputes between an individual franchisee and franchisor arising out of or in connection with the franchise agreement are covered by the agreement's arbitration provision. Recently, it has become commonplace for franchisees to sign franchise agreements both individually and on behalf of their self-formed entity, such as a corporation or limited liability company. As a result, 1) the franchisor, 2) the individual franchisee, and 3) the franchisee's entity are subject to the terms of the franchise agreement's arbitration provision.

⁵⁵ Champnoi, *supra*, note 63.

⁵⁶ *Id.*

⁵⁷ Bender, *supra*, note 52 at 2.

⁵⁸ *Id.*

⁵⁹ Champnoi, Elizabeth, *supra*, note 63.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

B. Third Parties and Non-Signatories

In certain circumstances, under ordinary principles of contract and agency law, non-signatories may enforce or be bound by arbitration clauses in contracts signed by other persons.⁶⁴ The United States Courts of Appeal for the Second, Third, Fifth, Sixth, Seventh and Eleventh Circuits recognize five traditional theories under which a non-signatory to an arbitration agreement may be bound or benefited by an arbitration agreement: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter-ego; and (5) estoppel.⁶⁵ These theories support the proposition that a party will be required to submit to arbitration if he has consented to it through affirmative acts or omissions.

In the franchise context, a franchisor will sometimes seek to arbitrate disputes with third parties and/or non-signatories to the franchise agreement. For example, the franchisor may seek to compel arbitration with a non-signatory closely-held entity that is controlled by the franchisee that is running a competing business with the franchise system. Or a franchisor may seek to compel a franchisee's spouse or close relative who acts in concert with the franchisee and breaches the franchise agreement.⁶⁶ In these instances, the third party non-signatories may raise a personal jurisdiction defense. However, if the franchisor successfully raises one or more of the five traditional theories set forth above, then the franchisor will likely be able to compel the third party non-signatory to arbitration.

C. Joinder of Parties

While the ability to join additional parties in an arbitration proceeding is usually explicitly addressed in a franchise agreement (and is commonly prohibited), the common-law principles of contract and agency may produce different results.

In the context of arbitrability, non-signatories of arbitration agreements may be bound by the agreement under ordinary contract and agency principles.⁶⁷ In addition, non-signatories can enforce arbitration agreements as third party beneficiaries.⁶⁸ A non-signatory needs an alter

⁶⁴ *Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, 417 (4th Cir. 2009); *Thomson-CSF, S.A. v. Am. Arbitration Ass'n*, 64 F.3d 773, 776 (2d Cir. 1995).

⁶⁵ Williams, Dwayne E., *Binding Nonsignatories to Arbitration Agreements*, 25 FRANCHISE L.J. 175, 176 (Spring 2006); (citing *Denney v. BDO Seidman, L.L.P.*, 412 F.3d 58, 71 (2d Cir. 2005); *Trippe Mfg. Co. v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005); *Bridas S.A.P.I.C. v. Gov't of Turkmenistan*, 345 F.3d 347, 356 (5th Cir. 2003); *Javitch v. First Union Securities, Inc.*, 315 F.3d 619, 628-29 (6th Cir. 2003); *Zurich Am. Ins. Co. v. Watts Indus., Inc.*, 417 F.3d 682, 687 (7th Cir. 2005); *Employers Ins. Of Wausau v. Bright Metal Specialties*, 251 F.3d 1316, 1322 (11th Cir. 2001)).

⁶⁶ *CD Partners v. Grizzle*, 424 F.3d 795, 798-99 (8th Cir. 2005) (finding a non-signatory can enforce arbitration clause against signatory to agreement when relationship between signatory and non-signatory defendants is sufficiently close that only by permitting non-signatory to invoke arbitration may evisceration of underlying arbitration agreement between signatories be avoided).

⁶⁷ *Comer v. Micor, Inc.*, 436 F.3d 1098, 1102 (9th Cir. 2006). These principles include: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter ego; and (5) estoppel.

⁶⁸ *Id.*

ego, parent/subsidiary, or agency relationship, or another comparable legal relationship, with a signatory to satisfy the close-relationship test.⁶⁹

On the other hand, a non-signatory to an arbitration clause may, in certain situations, compel a signatory to arbitrate despite the lack of an agreement to the same. One such situation exists when the signatory is equitably estopped from arguing that a non-signatory is not a party to the arbitration clause.⁷⁰ The doctrine of equitable estoppel applies when the signatory raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract.⁷¹

V. WHAT IS COVERED

Generally, the scope of an arbitration provision is broadly construed.⁷² The franchise agreement's arbitration provision typically covers the franchise agreement itself, personal and corporate guarantees, a non-competition agreement, vendor contracts, area development agreements, and other ancillary documents. A franchise agreement usually seeks to include in arbitration all disputes "arising out of" or "in connection with" the agreement. To avoid litigating the scope of an arbitration provision, a franchisor must carefully craft the arbitration provision in a way that covers the desired scenarios for arbitration and comports with state statutory law.⁷³

⁶⁹ *Donaldson Co. v. Burroughs Diesel, Inc.*, 581 F.3d 726, 735 (8th Cir. 2009).

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Century Indem. Co. v. Certain Underwriters at Lloyd's*, 584 F.3d 513, 526 (3d Cir. 2009) (When determining both the existence and the scope of an arbitration agreement, there is a presumption in favor of arbitrability. An order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.).

⁷³ For example, in *Arkcom Digital Corp. v. Xerox Corp.*, the Eighth Circuit was tasked with reviewing the district court's decision to determine whether there was a valid agreement to arbitrate and whether the specific dispute at issue falls within the substantive scope of that agreement. 289 F.3d 536, 537 (8th Cir. 2002). After Xerox Corporation terminated Arkcom Digital Corporation as an authorized Xerox service agent, Arkcom filed suit in Arkansas state court alleging breach of contract and violations of the Arkansas Franchise Practices Act ("AFPA"). *Id.* Affirming the district court's decision, the Eighth Circuit found that as the parties agreed to arbitrate all disputes "arising out of termination of the Agreement." *Id.* The Eighth Circuit reasoned that this general agreement encompasses Arkcom's claims under the AFPA because by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum. *Id.*

Alternatively, in *Bridge Fund Capital Corp. v. Fastbucks Franchise Corp.*, Bridge Fund Capital Corp. and Big Bad 1, LLC filed suit against its franchisor, Fastbucks Franchise Corp., in California state court alleging various claims sounding in contract, including the unconscionability of the arbitration provision of the franchise agreement. 622 F.3d 996, 998 (9th Cir. 2010). After the franchisor removed the action to federal court, the district court found that the arbitration clause was unconscionable under California law and refused to compel arbitration. *Id.* at 998. The Ninth Circuit affirmed the district court's decision because, among other things, California law holds that mandatory waivers of non-waivable statutory rights granted under the California Franchise Investment Law are the sort of one-sided and overly-harsh terms that render an arbitration provision substantively unconscionable, and the only business justification offered by Fastbucks for the non-mutual judicial remedy provision was its need to seek provisional remedies, which is insufficient under California law to justify non-mutuality. *Id.* at 1004-05.

A. Disputes “Arising Out Of” or “In Connection With” the Franchise Agreement

The Supreme Court of the United States offered two principles when interpreting the scope of a franchise agreement’s arbitration clause. First, where the parties concede that they have agreed to arbitrate some matters pursuant to an arbitration clause, the “law’s permissive policies in respect to arbitration” counsel that “any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration.”⁷⁴ Second, the presumption of arbitrability applies even to disputes about the enforceability of the entire contract containing the arbitration clause, because at least in cases governed by the FAA, courts must treat the arbitration clause as severable from the contract in which it appears, and thus apply the clause to all disputes within its scope unless a party challenges the validity of the arbitration clause or disputes the formation of the contract.⁷⁵

B. Disputes Involving Interpretation of the Franchise Agreement

Longstanding contract principles govern the interpretation of franchise agreements. For instance, if the language of an arbitration clause is ambiguous, contract law requires that the ambiguous provision be construed against the drafter.⁷⁶ In *Green Tree v. Bazzle*, the Supreme Court of the United States addressed how to interpret an arbitration provision’s scope.⁷⁷ The Court observed that a court’s function is to decide “gateway matters, such as whether the parties have a valid arbitration agreement at all or whether a concededly binding arbitration clause applies to a certain type of controversy.”⁷⁸ An arbitrator, on the other hand, has much broader, post-gateway interpretive latitude to decide what the arbitration contract in each case means.⁷⁹ Whether an arbitration agreement, for example, should be read to preclude or allow class actions in arbitration is an issue to be decided in the first instance by arbitrators, not courts.⁸⁰ Specifically, the *Bazzle* Court stated:

The question here – whether the contracts forbid class arbitration – does not fall into this narrow exception. It concerns neither the validity of the arbitration clause nor its applicability to the underlying dispute between the parties. Unlike First Options, the question is not whether the parties wanted a judge or an arbitrator to decide whether they agreed to arbitrate a matter. Rather the relevant question here is what kind of arbitration proceeding the parties agreed to. That question does not concern a state statute or judicial procedures. It concerns contract interpretation and arbitration procedures. Arbitrators are well situated to answer that question. Given these considerations, along with the arbitration contract’s

⁷⁴ *Granite Rock Co. v. Int’l Bhd. of Teamsters*, 130 S. Ct. 2847, 2857 (2010) (citations omitted).

⁷⁵ *Id.*

⁷⁶ *TMW Enters. v. Fed. Ins. Co.*, 619 F.3d 574, 580 (6th Cir. 2010).

⁷⁷ *Bazzle v. Green Tree Fin. Corp.*, 539 U.S. 444, 452 (2003).

⁷⁸ *Id.*

⁷⁹ *Id.* at 451.

⁸⁰ *Id.* at 452.

sweeping language concerning the scope of the questions committed to arbitration, this matter of contract interpretation should be for the arbitrator, not the courts, to decide.⁸¹

Accordingly, armed with common law contract principles, arbitrators are vested with the authority to determine an arbitration provision's scope and coverage.

C. Injunctive/Declaratory Relief Carve-Out

"Carve-out" provisions exempt specific categories of disputes from the arbitration clause. Typically, a franchise agreement's arbitration provision will carve-out a franchisor's sole ability, or a franchisor and franchisee's mutual ability, to seek injunctive and/or declaratory relief in a specified jurisdiction regarding trademark infringement claims or disputes arising out of the interpretation of the franchise agreement. While a carve-out provision can be a vehicle into court, if the claims are not expressly contemplated by the carve-out provision, the court will likely grant a motion to compel arbitration.

D. Class Actions and Multi-Party Dispositions

1. Class

Whether or not arbitration clauses explicitly or implicitly ban class or consolidated actions is a recent "hot topic" in both litigation and arbitration clause implementation. In the context of franchise systems, consolidated arbitrations and class actions permit multiple franchisees to bring "all of their claims" against the franchisor in a single action.⁸² Such actions enable groups of franchisees to bring high pressure actions against a franchisor worth millions of dollars and with a lot of potentially undesirable media attention. As a result, and as explained in greater detail below, franchisors that decide to utilize arbitration clauses should include specific language prohibiting consolidated and class action arbitrations in their franchise documents. Recent case law from the federal bench highlights the importance of doing so.

In *Concepcion v. AT&T Mobility*, the Supreme Court of the United States held, among other things, that class action waivers are not inherently invalid due to unconscionability.⁸³ As a result, an arbitration agreement's failure to address whether or not class arbitration is permitted can yield unpredictable results. If an agreement, no matter how broad, fails to acknowledge class arbitration, then the drafter is at the mercy of both the court's and arbitrator's interpretation. For example, in *Sutter v. Oxford Health Plans LLC*, the parties' agreement

⁸¹ *Id.* at 452-53 (internal citations omitted).

⁸² Rosen & Shrimp, *supra*, note 10 at 175.

⁸³ *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1753 (2011). Prior to the Supreme Court's *AT&T Mobility LLC v. Concepcion* opinion, the Supreme Court reviewed whether a group of shipping customers could arbitrate claims against shippers on a class basis. *Stolt-Nielson S.A. v. AnimalFeeds International Corp.*, 130 S. Ct. 1758 (2010). In denying the shipping customers the right to proceed as a class in arbitration, the Court focused on the "consensual nature of private dispute resolution" and the parties' ability to structure the arbitration process as they best saw fit. *Id.* Applying these principles to the issue of class-based arbitration, the Court held that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so." *Id.*

contained a broad arbitration clause that did not specifically address class arbitration.⁸⁴ In fact, neither the arbitration clause nor any other provision of the agreement made express reference to class arbitration.⁸⁵ Nevertheless, when a dispute arose regarding Oxford's alleged failure to make prompt and accurate reimbursement payments to participating physicians, an arbitrator construed the broad text of the clause to authorize class arbitration.⁸⁶ The Third Circuit affirmed the district court's order denying Oxford's motion to vacate the award.⁸⁷

However, a recent contradictory case has arisen in the Court of Appeals for the Fifth Circuit. In *Reed v. Fla. Metro. Univ.*, defendant schools appealed a district court's confirmation of an arbitral award that required them to submit to class arbitration.⁸⁸ On appeal, the schools contended that the district court, not the arbitrator, should have decided whether the parties' agreement provided for class arbitration, and that the district court should have vacated the arbitrator's class arbitration award.⁸⁹ The Fifth Circuit affirmed the district court's decision to refer the issue to arbitration, but reversed the district court's confirmation of the arbitral award because the arbitrator exceeded his powers.⁹⁰ Specifically, as the arbitration agreement failed to address class arbitration, the arbitrator did not have a contractual basis for forcing the parties into class arbitration.⁹¹

2. Multiple Party Disputes

To prevent parallel proceedings arising from franchise agreements which govern the actions of multiple parties, an arbitration provision normally addresses the joinder or intervention of parties. By definition, joinder refers to the joining of parties by an existing party and intervention refers to voluntary participation of any third party. The common thread is consent of all parties. Where there are more than two signatories to the same arbitration provision, joinder and intervention can be dealt with by each party agreeing to: (i) refer any dispute arising out of the contract to arbitration; (ii) be joined as an additional party to any proceedings commenced pursuant to the arbitration clause; and/or (iii) allow the intervention of another party to proceedings commenced under the arbitration clause.⁹² The franchisor's best mechanism for dealing with multi-party disputes is to explicitly address it while drafting its arbitration provision.

⁸⁴ *Sutter v. Oxford Health Plans LLC*, 675 F.3d 215, 217 (3d Cir. 2012).

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Reed v. Fla. Metro. Univ.*, Case No. 11-50509, 2012 U.S. App. LEXIS 10048, at *1-2 (5th Cir. May 18, 2012).

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² Herbert Smith Newsletter, *Avoiding the Pitfalls of Multi-Party and Multi-Contract Arbitration*, No. 105 (June 2011), available at <http://www.herbertsmith.com/NR/rdonlyres/D2E592DD-2939-4331-A193-D9293C43427C/22189/Newsletter105EJune2011.pdf> (last visited on June 11, 2012).

VI. PREHEARING CONSIDERATIONS FOR THE PARTIES

A. Franchisee

There are numerous strategic considerations a franchisee and its counsel must consider when faced with the prospect of arbitration, which include, but are not limited to, whether to file suit in court, whether to file a counter arbitration, venue, and fees.

1. Filing Suit

An arbitration provision does not preclude a party from bringing an action in court – it only means that a party that does so must proceed at its own risk. While an arbitration clause’s injunctive relief carve out provision will typically allow either a franchisor or franchisee to bring an action in court for trademark infringement or interpretation of the franchise agreement, a party who brings a claim in court that is covered by the arbitration clause is faced with the possibility that the other party may bring a petition to compel it to arbitrate.⁹³ Additionally, if a party brings an action for injunctive relief but files in its home state, the other party may move to transfer the action to the jurisdiction designated by the agreement’s forum selection clause.⁹⁴

2. Counter-filing For Arbitration

Arbitration offers many benefits to a franchisee, such as confidentiality, limited discovery, speed, expert neutrals, cost savings and the preservation of business relationships. There is no public record of the proceedings because arbitration in a private dispute resolution procedure. Extensive discovery, as well as abuse of discovery, is avoided because arbitrators arrange for limited exchange of documents, witness lists and depositions. Additionally, there is no docket or backlog in arbitration because hearings are scheduled as soon as the parties and the arbitrator are available. A franchisee can save on legal fees and transactional costs by arbitrating his or her dispute because of the limited discovery and expedited nature of the process. Moreover, for franchisees who wish to remain in their respective systems, arbitration can salvage a strained business relationship because it is less adversarial.

3. Disputing Venue or Forum

Section 9 of the Federal Arbitration Act (“FAA”) states that venue is appropriate in any jurisdiction to which the parties have agreed.⁹⁵ 28 U.S.C. § 1406(a) provides that if a case is filed in the wrong division or district, the district court “shall dismiss, or if it be in the interest of

⁹³ See *CD Partners v. Grizzle*, 424 F.3d 795, 798-99 (8th Cir. 2005) (affirming district court’s decision where principals of franchisor company were entitled to compel arbitration based on arbitration clause in franchise agreement when franchisee sued principals); *Choice Hotels Int’l, Inc. v. Chewl’s Hospitality, Inc.*, 91 Fed. Appx. 810 (4th Cir. 2003) (affirming district court’s decision granting plaintiff franchisor’s action to compel defendant franchisee to arbitration); *Saturn Distrib. Corp. v. Paramount Saturn, Ltd.*, 326 F.3d 684 (5th Cir. 2003) (same).

⁹⁴ *Allied-Bruce*, 513 U.S. at 289 (“An arbitration agreement is a species of forum-selection clause: Without laying down any rules of decision, it identifies the adjudicator of disputes.”); *Paul Green Sch. of Rock Music Franchising, LLC v. Smith*, 389 Fed. Appx. 172 (3d Cir. 2010) (affirming the district court’s upholding of California arbitrator’s decision where the parties’ franchise agreement included an arbitration clause that provided for arbitration of all disputes in Pennsylvania and Appellee moved to compel arbitration in California).

⁹⁵ *D.H. Blair & Co. v. Gottdiener*, 462 F.3d 95, 105 (2d Cir. 2006) (citing 9 U.S.C. § 9).

justice, transfer such case to any district or division in which it could have been brought.” When faced with a Section 1406(a) motion, courts have often found that dismissal is too harsh of a remedy, and have transferred the case “in the interest of justice.”⁹⁶ There is a circuit split regarding whether a forum selection clause is grounds for a FED. R. CIV. P. 12(b)(3) motion to dismiss for improper venue.⁹⁷

More importantly, certain states have legislated protections for franchisees that may permit the franchisee to arbitrate in his home state as opposed to being forced to arbitrate in a foreign jurisdiction (likely the franchisor’s home state). For example, California has a statute that limits California for franchise disputes.⁹⁸ Also as noted above, certain courts have held certain arbitration clauses to be unconscionable where the franchisee is required to arbitrate in a foreign jurisdiction.⁹⁹

4. Disputing Fees

There are no guarantees that arbitration is the more efficient and cost-effective alternative to the courts. Arbitration, depending on hourly rate of arbitrator(s) and administrative costs, can be quite costly. While many franchise agreements split the cost of fees for arbitration, this is not always the case. Moreover, the initial filing fee can be quite high (in the thousands), especially when compared to the filing fee in your local state or federal court, which is generally a few hundred dollars.¹⁰⁰

The more complex a case, the more time an arbitrator will have to spend (and charge) a party to prepare for the hearing. Depending on the amount of money at stake, the initial filing fees for arbitration can be expensive. For example, the AAA charges \$8,000 in filing fees for cases with alleged damages exceeding \$500,000.¹⁰¹ Upon adding up ongoing administration

⁹⁶ *Bbdova, LLC v. Auto, Techs., Inc.*, 358 F. Supp. 2d 387, 391 (D. Del. 2005).

⁹⁷ *Wong v. PartyGaming, Ltd.*, 589 F.3d 821, 830 (6th Cir. 2009) (a forum selection clause should not be enforced through dismissal for improper venue under FED. R. CIV. P. 12(b)(3) because these clauses do not deprive the court of proper venue); *Argueta v. Banco Mexicano, S.A.*, 87 F.3d 320, 324 (9th Cir. 1996) (a forum selection clause is grounds for a FED. R. CIV. P. 12(b)(3) motion to dismiss for improper venue); *Salovaara v. Jackson Nat’l Life Ins. Co.*, 246 F.3d 289, 299 (3d Cir. 2001) (when a defendant moves under Rule 12, a district court retains the judicial power to dismiss notwithstanding its consideration of § 1404); *Slater v. Energy Servs. Group Int’l*, 634 F.3d 1326, 1333 (11th Cir. 2011) (concluding a motion pursuant to Rule 12(b)(3) is the proper vehicle to request dismissal of a complaint on the basis of a contractual choice of forum).

⁹⁸ *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1287 (9th Cir. 2006) (citing CAL. BUS. & PROF. CODE § 20040.5).

⁹⁹ See, e.g., *Id.* at 1287; *Nino v. Jewelry Exchange, Inc.*, 609 F.3d 191, 206 (3d Cir. 2010); *Wis. Auto Title Loans, Inc. v. Jones*, 714 N.W.2d 155, 173 (Wis. 2006). But see *Rodriguez v. Tropical Smoothie Franchise Dev. Corp.*, Case No. 3:11-cv-359, 2012 U.S. Dist. LEXIS 750, at *14-15 (S.D. Ohio Jan. 3, 2012) (stating while the venue provision of the Franchise Agreement requires that all claims be submitted to binding arbitration before the American Arbitration Association in Atlanta, Georgia and Atlanta is not Tropical Smoothie’s principal place of business, this Court does not find such a provision unconscionable, nor does plaintiff franchisee cite any case law to support such an argument).

¹⁰⁰ See, e.g., State of New Jersey Court Fees, available at http://www.judiciary.state.nj.us/forms/11112_courtfees.pdf (last visited on June 12, 2012); State of Massachusetts Superior Court Fees, available at <http://www.mass.gov/courts/courtsandjudges/courts/superiorcourt/fees.html> (last visited on June 12, 2012); State of New York Court Fees, available at <http://www.nycourts.gov/forms/index.shtml#1> (last visited on June 12, 2012).

¹⁰¹ American Arbitration Association, *Resolving Commercial Financial Disputes – A Practical Guide*, at 28 (2008).

costs, attorneys' fees, expert fees, and the cost of an arbitrator at a daily or hourly rate, some may find that arbitration is not always a fiscally conservative option.

There is some financial reprieve available for eligible parties. For example, the AAA offers administrative fee waivers and pro bono arbitrators in cases where the arbitrating party's annual gross income falls below 200% of the federal poverty guidelines.¹⁰² However, as every hardship case is unique and involves many variables, the AAA reserves the right to deny or grant any request based on the information given by the requesting party.¹⁰³ Likewise, claims that seek to fall within the AAA's employment rules often result in a ruling that the employer is responsible for all AAA and arbitrator's fees.

B. Franchisee Association

A franchisee association is an independent organization of franchisees that is not sponsored or funded by a franchisor. Advisory council or other entities are distinguishable from independent franchisee associations because they are funded, and may be heavily influenced, by a franchisor.

Since July 1, 2008, the Federal Trade Commission's amended Franchise Disclosure Rule mandates that a franchisor include in its Franchise Disclosure Document the name, address, telephone number, e-mail address and web address of any trademark-specific franchisee association within the franchise system that is either (a) created, sponsored or endorsed by the franchisor, or (b) incorporated and asks to be included in the Franchise Disclosure Document for the next fiscal year.¹⁰⁴

Forming an independent franchisee association offers its members many benefits. For example, while not all members of a franchisee association have identical interests, it is the most effective and meaningful way of advocating for system-wide improvements and addressing common concerns. A franchisee association also protects individual franchisees' financial and legal interests, which serves as an equalizer of power in the franchise relationship as a carefully targeted action by franchisees may provide results that individual franchisees are incapable of obtaining by themselves.¹⁰⁵ While formal recognition and communication with the franchisor are not essential ingredients to a successful independent franchisee association, a franchisee association can more effectively communicate with the franchisor by providing a unified voice of the franchisee community to facilitate change and introduce solutions to systemic issues.

1. Standing

The Supreme Court of United States established a three-prong test to determine and evaluate associational standing:

¹⁰² American Arbitration Association, *Administrative Fee Waivers and Pro Bono Arbitrators*, available at http://www.adr.org/aaa/ShowPDF.jsessionid=R295PCqYD5MkNKhQqm9H7jhSMwYh2NnsYFSbG6yrMhgmGVB2991c1082660915?doc=ADRSTG_004098 (last visited on June 8, 2012).

¹⁰³ *Id.*

¹⁰⁴ 72 Fed. Reg. at 15559; see section 436.5(t)(8) of the amended Franchise Rule.

¹⁰⁵ Selden, Andrew C., *Forming an Independent Franchisee Association*, The American Franchise Association, available at <http://www.franchisee.org/Forming%20An%20Association.htm> (last visited on June 8, 2012).

[A]n association has standing to bring suit on behalf of its members when: (a) its members would otherwise have standing to sue in their own right; (b) the interests it seeks to protect are germane to the organization's purpose; and (c) neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit.¹⁰⁶

Recently, the National Independent Association of Cold Stone Creamery Franchisees, Inc. ("NIACCF"), an organization comprised of an unknown amount of Cold Stone franchisees, sued their franchisor, Cold Stone, for declaratory relief concerning Cold Stone's alleged failure to provide an accounting for, and disclosure pertaining to, the receipt of payments from certain third-parties.¹⁰⁷ ¹⁰⁸ The NIACCF alleged that these funds, which were derived from vendor rebates and gift card breakages, are supposed to be used by Cold Stone for the benefit of franchisees.¹⁰⁹ Cold Stone moved to stay the action on the grounds that the individual franchisees identified in the Complaint as members of the association, as well as all other franchisees, have agreements with Cold Stone requiring mandatory arbitration in Arizona of all disputes and controversies "related in any way" to their franchise agreements or the relationship between them and Cold Stone, as franchisor.¹¹⁰ The Southern District of Florida found that the matter should be stayed in favor of the Arizona actions seeking to compel arbitration as to the individual franchisees.¹¹¹

In the District of Connecticut, an independent franchisee association established associational standing and was permitted to proceed with its associational claims.¹¹² The EA Independent Franchisee Association, LLC ("EAIFA"), a franchisee association that represents more than 170 franchisees of Edible Arrangements, filed an action alleging, among other things, that Edible Arrangements violated federal regulations by failing to disclose its relationships with its affiliates while requiring franchisees to do business with them.¹¹³ The EAIFA sought a declaratory judgment that Edible Arrangements breached their franchise agreements, violated the implied covenant of good faith and fair dealing, and violated the Connecticut Unfair Trade Practices Act.¹¹⁴ The District of Connecticut denied Edible Arrangements' motion to dismiss for lack of standing because the Court found that the EAIFA's members' individual damages would

¹⁰⁶ *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 343, 97 S. Ct. 2434, 2441 (1977).

¹⁰⁷ *NIACCF, Inc. v. Cold Stone Creamery, Inc.*, Case No. 12-20756-Civ-SCOLA, 2012 U.S. Dist. LEXIS 70256, at *1-2 (S.D. Fla. May 21, 2012).

¹⁰⁸ Subsequent to the decision issued by the Southern District of Florida in May 2012, Arthur L. Pressman of Nixon Peabody LLP assumed representation of franchisor Cold Stone Creamery in *NIACCF* and related litigation.

¹⁰⁹ *NIACCF, Inc.*, Case No. 12-20756-Civ-SCOLA, 2012 U.S. Dist. LEXIS 70256, at *1-2.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² Justin M. Klein of Marks & Klein, LLP has represented the EA Independent Franchisee Association in that litigation and in related litigation.

¹¹³ *EA Indep. Franchisee Ass'n, LLC v. Edible Arrangements Int'l, Inc.*, Case No. 3:10-cv-1489, 2011 U.S. Dist. LEXIS 78008, at *1 (D. Conn. July 19, 2011).

¹¹⁴ *Id.*

not be addressed, and permitted the EAIFA the opportunity to seek declaratory relief by proving its allegations by using experts and Edible Arrangements' documents.¹¹⁵

2. Injunctive and Declaratory Relief v. Damages

The third prong of the *Hunt* test for associational standing is not automatically satisfied whenever an association requests equitable relief rather than damages.¹¹⁶ Courts also must examine the claims asserted to determine whether they require individual participation.¹¹⁷ An organization lacks standing to assert claims of injunctive relief on behalf of its members where the fact and extent of the injury that gives rise to the claims for injunctive relief would require individualized proof.¹¹⁸ An association does not have standing to sue on behalf of its members when seeking monetary relief to compensate for its members' injuries.¹¹⁹

3. Claims

Because individual participation is almost invariably required for any claim seeking damages, courts have been reluctant to allow associational standing in cases that seek monetary relief.¹²⁰ Associational standing is particularly apt to be denied if damages are requested.¹²¹ Even where equitable relief is sought, the association lacks standing to assert claims of injunctive relief on behalf of its members where the fact and extent of the injury that gives rise to the claims for injunctive relief would require individualized proof.¹²² In contrast, where the organization seeks a purely legal ruling without requesting that the federal court award individualized relief to its members, the *Hunt* test may be satisfied.¹²³

4. Obstacles

Franchisee associations have to overcome a series of challenges from a franchisor when invoking Article III standing. The most common obstacles for a franchisee association include establishing all three elements of associational standing, jurisdiction, and the spirit of the Federal Arbitration Act.

¹¹⁵ *Id.*

¹¹⁶ *Alliance for Open Soc'y Int'l, Inc. v. United States Agency for Int'l Dev.*, 651 F.3d 218, 229 (2d Cir. 2011).

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Warth v. Seldin*, 422 U.S. 490, 515-16 (1975).

¹²⁰ *Bd. of Managers v. 72 Berry St., LLC*, 801 F. Supp. 2d 30, 34 (E.D.N.Y. 2011).

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

a. Standing

When faced with franchisee litigation premised on associational standing, a franchisor's most prominent argument is that the franchise agreement has a mandatory arbitration provision and that the association is attempting to circumvent that provision. Next, a franchisor will methodically attack each element of associational standing, with an emphasis on the third prong of the *Hunt* test, which states that "neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit."¹²⁴ Specifically, a franchisor will argue that adjudication of the dispute will require each individual association member to prove their damages. However, like the *EAIFA* case, the association can argue that individual member participation is unnecessary and that their claims can be proven based on expert testimony and other discovery. Finally, a franchisor may argue that the Federal Arbitration Act reflects an emphatic federal policy in favor of arbitral dispute resolution, and that this policy requires courts to enforce the bargain of the parties to arbitrate.¹²⁵

b. Jurisdiction

Most franchise agreements contain a forum selection clause that governs the location of where disputes between the parties should or must be resolved. Parties to a franchise agreement should understand the legal distinction between permissive and mandatory forum selection clauses. A permissive forum selection clause, such as, for example, "any dispute between the parties concerning this Agreement shall come within the jurisdiction of the courts of New York," generally confers jurisdiction on the designated forum for breach of contract, but might not prevent a party from bringing suit in a different jurisdiction.¹²⁶ In contrast, a mandatory forum selection clause, such as, for example, "any dispute arising under or in connection with the agreement or related to any matter which is the subject of the agreement shall be subject to the exclusive jurisdiction of the state and/or federal courts located in New York, NY," may preclude a successful suit from being brought in another jurisdiction.¹²⁷ A franchisor's first argument will be that the Court does not have jurisdiction over the dispute because the franchise agreement has a valid and enforceable forum selection clause.

When faced with a franchise agreement with an unfavorable or inconvenient forum selection clause, a franchisee's only recourse is to challenge its enforceability. A franchisee challenging the validity of a forum selection clause must make a "clear showing" that: (1) the incorporation of the forum selection clause into the agreement was the product of fraud or overreaching; (2) the party seeking to escape enforcement will for all practical purposes be deprived of his day in court because of the grave inconvenience or unfairness of the selected forum; (3) the fundamental unfairness of the chosen law will deprive the plaintiff of a remedy; or

¹²⁴ *Hunt*, 432 U.S. at 343.

¹²⁵ *KPMG LLP v. Cocchi*, 132 S. Ct. 23, 323 (2011).

¹²⁶ *Intellectual Property Alert*, Kramer Levin Naftalis & Frankel, LLP (Oct. 2007), available at http://www.kramerlevin.com/files/Publication/0c6cccd9-8934-4723-85f4-032cb81fe6f1/Presentation/PublicationAttachment/b71e1c42-bc06-40bb-9f98-06e79e16cccd/4883_Alert_KLIP_v2.pdf (last visited on June 8, 2012).

¹²⁷ *Id.*

(4) enforcement of the forum selection clause would contravene a strong public policy of the forum state.¹²⁸

Finally, a franchisor may argue that the Court cannot exercise jurisdiction over the dispute because the relief sought requires individual participation of the association's member, which destroys standing under Article III. However, as long as the possible representational standing does not eliminate or attenuate the constitutional requirement of a case or controversy, and the nature of the claim and of the relief sought does not make the individual participation of each injured party indispensable to proper resolution of the cause, the association may be an appropriate representative of its members, entitled to invoke the court's jurisdiction.¹²⁹

c. Sham Organization

In order to defeat associational standing, a franchisor may argue that the first and second elements of the *Hunt* test are absent. The first *Hunt* element mandates that an association's members have standing to sue in their own right and the second *Hunt* element requires that the interests an association seeks to protect are germane to the organization's purpose.¹³⁰ A franchisor will argue that a franchisee association is in fact no more than a "front" or a "sham" through which ineligible parties pursue litigation they would not otherwise be entitled to bring. In response, the association will argue that as an entity, it never signed any agreement (much less any arbitration provision) with the franchisor and demonstrate how the association regularly holds meetings, collects dues, and takes actions to materially advance the interests of the association.

C. Franchisor

As discussed, arbitration offers franchisors and franchisees a range of benefits and disadvantages. When crafting arbitration clauses, a few specific strategic considerations should be acknowledged in order to maximize the benefit of the parties' arbitration provision. For franchisors, two important strategic considerations when drafting an arbitration clause are: 1) what disputes are included and excluded by the agreement to arbitration; and, 2) whether or not to allow franchisees to bring class or consolidated claims against the franchisor.

1. To Include or Not Include?

As previously discussed, franchisors must consider which disputes they will contract to arbitrate when crafting arbitration provisions. It is common for arbitration agreements to exclude those disputes arising from, "trademark and trade dress law disputes, real estate disputes, the franchisee's liquidated indebtedness, antitrust issues, and enforcement of noncompetition provisions..."¹³¹ The primary reason for excluding these disputes from agreements sounds in preserving a franchisor's right to enforce these rights through expedited motions in court, which

¹²⁸ *Lighthouse MGA, L.L.C. v. First Premium Ins. Group, Inc.*, 448 Fed. Appx. 512, 514 (5th Cir. 2011).

¹²⁹ *Warth v. Seldin*, 422 U.S. 490, 510 (U.S. 1975).

¹³⁰ *Hunt*, 432 U.S. at 343.

¹³¹ *Fundamentals of Franchising*, 3d ed. (Barkoff, Rupert M. & Selden, Andrew C. eds.), at pp. 92-93 (2008).

are sometimes impractical in the arbitration process.¹³² This protects the franchisor from the situation where a franchisee could purposely thwart a franchisor's right to obtain an injunction for franchisee's improper use of the mark by initiating litigation in a state court to contest the enforceability of the arbitration clause.¹³³ This clause provides franchisors with an expedient alternative method to enforce their trademark rights in federal court and guard against the diminution of the mark by former franchisees.¹³⁴

Another provision franchisors often include in arbitration agreements is a prohibition on the award of exemplary or punitive damages. As discussed more fully below, to avoid the awarding of exemplar or punitive damages in arbitration, arbitration clauses should clearly and expressly state the desired prohibition. Arbitrators may award punitive damages, under some state law, unless prohibited by contract.¹³⁵ An arbitration award that is merely worded broadly, without more, has been found sufficient to allow an award of exemplary damages.¹³⁶ Therefore, the contract does not need to specifically mention punitive damages, in order for them to be awardable.¹³⁷

The FINRA Dispute Resolution Manual contains a provision regarding requests to include punitive damages as part of the award. The Manual states: "Upon a party's request, arbitrators may consider punitive damages as a remedy if a respondent has engaged in serious misconduct."¹³⁸ The Manual notes that "[i]f punitive damages are awarded, the arbitrators should clearly specify what portion of the award is intended as punitive damages. In addition, arbitrators should include in the award the basis for awarding punitive damages. If the panel needs additional information to determine the basis for awarding punitive damages, it should ask the parties to brief the issue to help determine whether both factual and legal bases exist for such an award."¹³⁹

In *Mastrobuono v. Shearson Lehman Hutton, Inc.*¹⁴⁰ the U.S. Supreme Court recognized that parties may consent to rules for allowing punitive damages, just as they may consent to

¹³² *Id.*

¹³³ Dodd, *supra*, note 9 at 126.

¹³⁴ Dodd, *supra*, note 9 at 126.

¹³⁵ See *Inv. Partners, Inc. v. Glamour Shots Licensing, Inc.*, 298 F.3d 314 (5th Cir. 2002); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988).

¹³⁶ *Pyle v. Securities U.S.A., Inc.*, 758 F. Supp. 638 (D. Colo. 1991). See also *Porush v. Lemire*, 6 F. Supp. 2d 178, 185 (E.D.N.Y. 1998) ("unless the arbitration agreement provides an unequivocal exclusion of punitive damages claims from the scope of arbitration, it will be read to empower arbitrators to award punitive damages.").

¹³⁷ *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 57 (1995).

¹³⁸ FINA Manual, available at <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbtors/documents/arbmed/p009424.pdf>

¹³⁹ *Id.*

¹⁴⁰ *Mastrobuono*, 514 U.S. at 57.

other procedures involving their arbitration.¹⁴¹ In *Mastrobuono*, the arbitration clause authorized arbitration under the NASD rules, allowing arbitrators to award damages and other relief.¹⁴² The Court noted that the NASD Manual explicitly stated “[p]arties to arbitration are informed that arbitrators can consider punitive damages as a remedy,” and the Court found the arbitrators were authorized to award punitive damages.¹⁴³

Franchisors looking to include a prohibition on punitive damages in arbitration agreements should take care to clearly and expressly spell out the desired prohibition. Franchisors should do this to avoid a detrimental interpretation that could result in arbitrators awarding punitive damages.

2. Class and Consolidated Prohibitions

Franchisors should strongly consider including class and consolidated claim prohibitions in their franchise arbitration agreements. Despite what seemed like clear direction from the Supreme Court, failure to do so can result in arbitrators finding “implied” agreements to arbitrate claims on class or consolidated bases.

For example, in *FSRO v. Fantastic Sams*,¹⁴⁴ the FSRO Association filed an arbitration demand against franchisor Fantastic Sams Franchise Corporation with the AAA. In its demand, FSRO sought relief against Fantastic Sams “on behalf of its members” based upon Fantastic Sams’ allegedly making “it impossible or impractical” for its regional owners/franchisees to sell their regions on the open market. FSRO sought declaratory judgment for the benefit of all its members that Fantastic Sams be compelled to take certain steps to remedy its alleged contractual breaches of its franchise agreements.

Fantastic Sams filed a petition with the district court to compel individual arbitrations pursuant to the various FSRO members’ arbitration clauses contained in their respective franchise agreements. The district court analyzed two different types of franchise agreements: those that specifically prohibited class-wide arbitrations and those that were silent on the issue.¹⁴⁵ As to those that prohibited class-wide arbitration, the court compelled arbitration on an individual basis despite FSRO’s contention that its “associational” claim was different than the prohibited class-wide claims. In doing so, the district court recognized that associational claims brought on behalf of franchisees cannot run around specific prohibitions “against class-wide or collective action in the franchise agreements.”¹⁴⁶

¹⁴¹ *Id.*

¹⁴² *Id.* at 60-61.

¹⁴³ *Id.* at 61.

¹⁴⁴ Arthur L. Pressman, and his colleagues Gregg A. Rubenstein and Sara Farber of Nixon Peabody, LLP, have represented franchisor Fantastic Sams Franchise Corp. in the *FSRO* litigation and related arbitration proceedings..

¹⁴⁵ *Fantastic Sams Franchise Corp. v. FSRO Assoc. Ltd.*, Case No. 11-11485-NMG (D. Mass. Oct. 12, 2011).

¹⁴⁶ *Id.* see also *Champ v. The Siegel Trading Co., Inc.*, 55 F.3d 269, 275 (7th Cir. 1995) (“We find no meaningful basis to distinguish between the failure to provide for consolidated arbitration and class arbitration.”).

The district court, however, refused to stay FSRO's arbitration claim on behalf of those members whose franchise agreements were silent on the issue of class-wide arbitration. The district court relied on the First Circuit's approval of *Bazzle* in *Skirchak v. Dynamics Research Corp.*¹⁴⁷ as permitting the arbitrator to decide whether the silence of "those contracts prohibit[s] FSRO's associational claims [as] a matter of contract interpretation" ¹⁴⁸ In support of its decision, the district court relied upon three facts: (1) the arbitration provision in the agreements is broad and applies to "all controversies or claims arising from or related to the contract;" (2) the arbitration provision incorporates by reference the AAA Rules, which allow an arbitrator to determine his or her jurisdiction; and (3) the arbitration provision does not mention class arbitration at all.¹⁴⁹

Fantastic Sams appealed the district court's decision as to those franchise agreements that contained arbitration clauses silent on the issue of class or consolidated claims. Relevant to the appeal, which is currently pending before the First Circuit, were six franchise agreements that require arbitration of "[a]ny controversy or claim arising out of or relating to this Agreement or with regard to its interpretation or breach . . ." In its argument to the First Circuit, Fantastic Sams argued that FSRO's arbitration of multiple members' claims was indistinguishable from either a class or consolidated action and implicated the same concerns that informed the Supreme Court's analysis in *Stolt-Nielsen* and *Concepcion*. In support of its claim, Fantastic Sams proffered that FSRO's arbitration claim involved six franchisees and therefore sought to adjudicate issues attributable to individual franchisee's claims, destroyed the informality of arbitration because of the cost and procedure involved, and brought claims on behalf of absent FSRO members that would be bound by the arbitrator's decision, all of which implicate class concerns.

The First Circuit heard arguments on the issues presented by Fantastic Sam's appeal and on June 27, 2012, the First Circuit issued its opinion.¹⁵⁰ The Court held that Fantastic Sams was not entitled to individual arbitrations as to those franchise agreements that were silent on the issue of class arbitration. The Court found that since *Stolt-Nielsen* has not been extended to association claims and the parties had not "stipulated" to the silent nature of the arbitration agreements regarding class arbitration, Fantastic Sams was not entitled to compel the same.¹⁵¹ The Court also indicated that the broad nature of the arbitration clause supported the possibility that an arbitrator could infer the parties' intent to arbitrate claims on an aggregate basis, and that since associational claims are not inherently class claims, it was unnecessary to impose *Stolt-Neilsen* to the case at bar.¹⁵²

¹⁴⁷ 508 F.3d 49 (1st Cir. 2007).

¹⁴⁸ *Fantastic Sams*, Case No. 11-11485-NMG.

¹⁴⁹ *Id.*

¹⁵⁰ *Fantastic Sams Franchise Corp. v. FSRO Assoc. Ltd.*, Case No. 11-2300 (1st Cir. June 27, 2012).

¹⁵¹ *Id.*

¹⁵² *Id.*

Currently, the arbitration brought by FSRO against Fantastic Sams by those Regional Owners with arbitration agreements silent on the question of class or consolidated claims proceeds with the AAA.

The situation presented by the Fantastic Sam's litigation and arbitration highlights the strategic considerations that should be made when franchisors construct arbitration clauses, especially in light of recent federal court decisions, which limit *Stolt-Neilson* to those situations where parties "stipulate to" silence—a stipulation no party will ever agree to again.

VII. OTHER PRE-HEARING CONSIDERATIONS

Most commercial arbitration is triggered by a pre-dispute contract clause.¹⁵³ The arbitration clause may determine when the arbitration can be initiated, and may specify a limitations period. Some contracts require preliminary dispute resolution steps, such as good faith negotiation or mediation. Without a contract requirement, the parties may jointly initiate arbitration by executing a private arbitration agreement. If entering a private arbitration, parties can and should consider what formal or informal discovery will take place prior to the arbitration hearing. Pre-hearing considerations should begin with assessing administration and venue, calculating costs and fees, evaluating your claims and desired relief, selecting the necessary amount of arbitrators, and determining bright-line rules and procedures.

A. Affirmative Claims v. Injunctive Relief in Arbitration

Time and money are two important considerations when examining affirmative claims versus injunctive relief in the context of arbitration. For example, if a party seeks to arbitrate a petition for injunctive relief in the AAA, the party will pay a hefty filing fee and may have to wait weeks before an arbitrator will consider its petition.¹⁵⁴ On the other hand, if a party brings an order to show cause for injunctive relief in court, the party will pay a modest filing fee and may have its petition adjudicated within hours.

Additionally, arbitrators, like judges, are given broad discretion when determining whether to issue awards that include, without limitation, attorney's fees, costs, interest, specific performance, administrative fees, expenses, and "any remedy or relief that the arbitrator deems just and equitable."¹⁵⁵ In addition to the expansive power granted to arbitrators under the rules of the AAA, New Jersey, the Third Circuit and the United States Supreme Court have each endorsed such grant of power.¹⁵⁶

¹⁵³ JAMS – *Frequently Asked Questions*, available at <http://www.jamsadr.com/adr-faqs/> (last visited on June 6, 2012).

¹⁵⁴ American Arbitration Association, *Resolving Commercial Financial Disputes – A Practical Guide*, at 28 (2008).

¹⁵⁵ *Id.*

¹⁵⁶ See Revised Uniform Arbitration Act, N.J. STAT. ANN. § 2A:23B (West 2006) (empowering arbitrators to issue "subpoenas for the attendance of a witness and for the production of records and other evidence at a discovery proceeding" and to "issue a protective order to prevent the disclosure of [privileged or confidential information]"); *Johnson v. West Suburban Bank, et al.*, 225 F.3d 366, 375 (3d Cir. 2000) (holding that "arbitrators possess the power to fashion the same relief as courts"); *C&L Enterprises, Inc. v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 532 U.S. 411 (2001) (holding that "[t]he American Arbitration Association Rules and the Uniform Arbitration Act, [however,] are not secondary interpretive aides that supplement [the] reading of the contract; they are prescriptions incorporated by the express terms of the agreement itself.).

B. Parallel Injunction Litigation

A parallel injunction litigation scenario arises when a party simultaneously files a petition for injunctive relief in court and in arbitration. As previously filing a petition for injunctive relief in arbitration may not be the best option for a party who is faces immediate irreparable harm because it may take weeks to choose an arbitrator and have their petition decided. For this reason, certain franchise agreements will allow a party to file a petition for injunctive relief in court and notice for arbitration at the same time.

C. Discovery

The advent of technology brings both blessings and curses to litigation. With the birth of “e-discovery,” discovery itself has become one of the greatest costs of modern day litigation. As a result, many of the early proponents of arbitration hailed it for its limited discovery. Recently, however, arbitration participants have vocalized dissatisfaction with the ever increasing costs of discovery associated with arbitration.¹⁵⁷ One mechanism to limit the cost of arbitration associate discovery is to explicitly limit the forms and length of the discovery process. The risk associated with explicit limits on discovery is, of course, the potential that relevant evidence goes undiscovered, leading to decreased accuracy of any arbitration award. Given the strictly limited right to appellate review of arbitration proceedings, parties should be mindful of this consequence.

D. Motion Practice

It is also common for parties to engage in dispositive motion practice during arbitration proceedings in an effort to narrow issues and help bring proceedings to their conclusions as expeditiously as possible. Typical motions include motions to dismiss for failure to state a claim, motions for judgment on the pleadings, and motions for summary judgment. Parties are not always permitted to bring motions as of right, and instead arbitrators in those instances, have the right to hear and grant such motions.¹⁵⁸ The AAA commercial rules are seemingly silent on whether or not parties have a right to bring dispositive motions. Rules 30 and 31, however implicitly authorize the same, as they “obligate arbitrators to ‘conduct the proceedings with a view to expediting the resolution of the dispute’ and give arbitrators the authority to focus the presentation of evidence on issues that, in the discretion of the arbitrator may readily decide the case.”¹⁵⁹

Parties considering dispositive motion practice during arbitration should be careful to time motions appropriately. As discussed, arbitration offers its participants the flexibility to focus on certain issues and to design procedures and schedules that make arbitration as effective and cost efficient as possible. Without adequate discovery such motions can detract from the benefits offered by arbitration. On the other hand, where discovery isn’t essential to adjudication of the action, arbitration allows parties to expedite motion practice where they may otherwise

¹⁵⁷ Drahozal & Quentin R. Wittrock, *supra*, note 32 at 103-104.

¹⁵⁸ Alfred G. Ferris & A. Lee Biddle, *The Use of Dispositive Motions in Arbitration*, *Dispute Resolution J.* 3 (Aug./Oct. 2007) (comparing the AAA’s Employment and Construction Rules).

¹⁵⁹ *Id.*

have to wait in litigation. Overall, parties should use the flexibility of arbitration to maximize the potential benefits of targeted dispositive motion practice.

E. Parallel Mediation

Depending on the agreement, mediation can occur and either suspends activity in arbitration until mediation concludes, or both processes may continue on parallel tracks.¹⁶⁰ Under the AAA rules, at any point in the arbitration process, the parties may agree to conduct a mediation conference under the Commercial Mediation Procedures in order to facilitate an agreement.¹⁶¹ Having parallel arbitration and mediation can have some advantages. “The fact that discovery devices are available if parties are proceeding with a parallel mediation and arbitration might incentivize parties to pursue both devices, even if mediation were otherwise more suitable.¹⁶² Normally, parties who lack access to documents and information in the possession, custody or control of the adverse party are mediating at an information disadvantage.¹⁶³

F. Costs

Generally, parties to arbitration are responsible for paying their own costs, expenses, and legal fees.¹⁶⁴ The FAA does not include a fee provision, nor does it award the prevailing party its fees or costs. Certain state statutes do allow for an award of fees to the prevailing party.¹⁶⁵ Some state consumer protection acts also contain prevailing party fee provisions.¹⁶⁶ Overall, issues regarding fee awards tend to be hotly contested disputes that center on whether or not it is in the arbitrator or court’s jurisdiction to make such an award pursuant to either contract or statute.¹⁶⁷ Additionally, there has been extensive litigation nationwide regarding whether or not arbitration fee and cost awards must be “reasonable” and what “reasonable” under the circumstances means.¹⁶⁸ For this reason it is critical for franchisors to give thought to how franchise documents, containing arbitration clauses, are drafted and what choice of law they apply to any cost or fee provision, given various states’ franchise statute fee provisions.

¹⁶⁰ See e.g. FINRA Mediation Rules (available at <http://www.finra.org/ArbitrationAndMediation/Mediation/Rules/>).

¹⁶¹ See AAA Rules, R-8. Mediation.

¹⁶² Jill Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, 21 OHIO ST. J. ON DISP. RESOL. 329, 378 (2006).

¹⁶³ *Id.*

¹⁶⁴ Dodd, *supra*, note 9 at 127 (“The American rule (followed by every state but Alaska is that each party to a litigated or arbitrated matter is responsible for its own costs, expenses, and legal fees unless those expenses are allocated in advance by contract, court rule, or substantive statute that must be followed by an arbitrator or judge.”)

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* (“The question of whether fees and costs to be awarded must be reasonable, and the definition of the prevailing party, have been extensively litigated, with widely varying results across various U.S. jurisdictions as these tend to be highly fact specific.”)

G. Consequences and Strategy of Non-Payment

Situations occasionally arise where one party chooses not to or is financially unable to pay for the costs of the arbitration. Choosing not to pay for the costs of arbitration can be a strategic decision that counsel should carefully consider and tactically employ. By refusing to pay for the costs of arbitration a franchisor or franchisee can force the arbitration into suspension and eventually termination. In other words, when a party decides that they do not want to resolve the at-issue dispute through arbitration, non-payment offers them a potential “exit strategy” to traditional litigation in the court system.¹⁶⁹

H. Awards and Decisions

Arbitrators have the authority to award “any relief permitted by the underlying substantive federal or state laws at issue, unless the scope of the arbitrator’s jurisdiction is otherwise circumscribed by [an] arbitration agreement.”¹⁷⁰ In light of the arbitrator’s power, franchisors may include any number of provisions aimed at limiting the impact of an adverse decision.¹⁷¹ For example, a franchisor may limit or prohibit punitive damages, consequential damages, and caps on compensatory damages.¹⁷²

Parties may define whether a written decision is required and whether it will include the arbitrator’s rationale/basis or simply state his/her conclusions or monetary award.¹⁷³ Such a provision may be desirable because under the FAA and most state laws, an arbitrator is not obligated to state the basis for the decision.¹⁷⁴ Just as the FAA does not require an arbitrator to publish his reasoning or conclusions, it does not require that a party publicize a settlement agreement.¹⁷⁵ Indeed, parties will not typically publicize an agreement to settle because franchise disputes are often driven by one party’s or both parties’ desire for confidentiality.¹⁷⁶ As part of the settlement agreement, the parties may request that the arbitrator formally dismiss the

¹⁶⁹ See e.g., *Cinel v. Christopher*, 203 Cal. App. 4th 759 (2012).

¹⁷⁰ Dodd, *supra*, note 9 at 130.

¹⁷¹ Jennifer L. Gehrig, *Arbitration: A Franchisee’s Perspective*, 22 FRANCHISE L.J. 112 (2003).

¹⁷² *Id.* Although a franchisor may include similar provisions throughout the franchise agreement, there is a risk in doing so; namely, a court may invalidate the agreement as a whole, concluding that the franchisor has overreached, rather than severing the prohibit clause. *Id.* (citing *Hooters of Am., Inc. v. Phillips*, 39 F. Supp. 2d 582 (Dist. S. Car, Florence Division. 1998).

¹⁷³ Dodd, *supra*, note 9 at 130.

¹⁷⁴ *Id.* (citing Federal Arbitration Act, 9 U.S.C. § 9; see, e.g., CAL. CIV. PROC. CODE § 1283.4; N.Y. C.P.L.R. § 7507; WASH. REV. CODE § 7.04A.190; see also *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 203 (1956)). See generally 2 DOMKE ON COMMERCIAL ARBITRATION § 34:7 (3d ed. 2003); R.D. Hursh, *Annotation, Necessity That Arbitrators, in Making Award, Make Specific or Detailed Findings of Fact or Conclusions of Law*, 82 A.L.R.2d 969 (Supp. 2011). Disputants may at the outset of a proceeding request that the arbitrator provide the basis for any award in a separate letter that is not incorporated into the award itself, if desired or permitted under the arbitration agreement or statute. See *Operations Mgmt. Int’l, Inc. v. City of Forsyth*, 654 S.E.2d 438 (Ga. Ct. App. 2007)

¹⁷⁵ *Id.* at 128.

¹⁷⁶ *Id.* Some franchise laws require the franchisor to disclose certain settlements.

proceedings in light of the confidential settlement agreement, and specify the tribunal and means for enforcement.¹⁷⁷

Section 9 of the FAA provides that a court may confirm an arbitration award as a final judgment if the arbitration clause provides that "a judgment of the court shall be entered upon the award made pursuant to the arbitration."¹⁷⁸ Whether an arbitration clause must explicitly provide for judicial confirmation of an award before the award can be confirmed under section 9 of the FAA is up for debate.¹⁷⁹ Contrary to a majority of circuits, at least two have held that an arbitration agreement stating that the arbitrator's decision shall be "final and binding" did not satisfy the requirements of section 9.¹⁸⁰ Therefore, to eliminate any possibility that a federal court would decline to enforce an award, the arbitration clause should explicitly provide that both parties consent to confirmation of the award as a final judgment.

VIII. POST-HEARING

A. Appellate Rights Post-Arbitration

Franchisors and franchisees should keep their eyes wide open to the reality that judicial review of an arbitration award is much more limited than appellate review of litigation.¹⁸¹ In fact, the court's power of review of arbitration awards is "among the narrowest known to the law."¹⁸² Errors in arbitrator's factual findings or interpretation of the law, unless showing a manifest disregard of the law, do not justify review or reversal on the merits.¹⁸³

1. Challenges Under the FAA

The grounds for challenging an arbitration award, under the FAA, are narrowly limited, reflecting the voluntary contractual nature of commercial arbitration.¹⁸⁴

¹⁷⁷ *Id.*

¹⁷⁸ Jennifer L. Gehrig, *Arbitration: A Franchisee's Perspective*, 22 *FRANCHISE L.J.* 112, 114 (2003) (quoting 9 U.S.C. § 9).

¹⁷⁹ *Id.* (citing Erika Van Ausdale, *Confirmation of Arbitral Awards: The Confusion Surrounding Section 9 of the Federal Arbitration Act*, 49 *DRAKE L. REV.* 41, 44 (identifying split among the circuits over whether explicit language providing for judicial confirmation is not mandated by the FAA).

¹⁸⁰ *Id.*

¹⁸¹ See generally *Bernhardt v. Polygraphic Co. of America*, 350 US 198 (1956).

¹⁸² *Dominion Video Satellite, Inc. v. Echostar Satellite, LLC*, 430 F.3d 1269, 1275 (2005).

¹⁸³ *Denver v. Rio Grande W. R.R. v. Union Pac. R.R.*, 119 F.3d 847 (10th Cir. 1997). To add insult to injury, the losing party may not only get stuck with a poorly reasoned decision, the adversely affected party may also be sanctioned by the court for appealing the faulty arbitration ruling. *B.L. Harbert Int'l, LLC v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006); *Cuna Mutual Ins. Co. v. Office & Prof. Employees Int'l Union, Local 39*, 443 F.3d 556 (7th Cir. 2006); *Rueter v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 440 F. Supp. 2d 1256 (N.D. Ala. 2006). For instance, in *Harris v. Sandro*, a California appellate court sanctioned plaintiff \$11,062 for filing a "frivolous appeal" of a binding arbitration award, observing that the merits of the controversy submitted to arbitration were not subject to judicial review. 96 Cal. App. 4th 1310 (Cal. App. 2d Dist. 2002).

¹⁸⁴ *Delta Mine Holding Co. v. AFC Coal Props.* 280 F.3d 815 (8th Cir. 2001), *cert denied*, 537 U.S. 817 (2002).

There is a heightened standard for judicial review under the FAA as well as under most state arbitration statutes. Arbitration awards may only be set aside where (1) the award was procured by fraud, corruption, or undue means; (2) there was evident partiality or corruption in the arbitrators, or either of them; (3) the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.¹⁸⁵

2. Private Agreements Regarding Further Review

Prior to 2008, there was a circuit split and confusion to whether parties, in dealing with the risk of having an arbitration decided neither by law nor the record, could add a provision to their standard arbitration agreements to provide for a heightened standard of judicial review beyond that of the FAA.¹⁸⁶ The U.S. Supreme Court has subsequently held that the FAA provides the exclusive grounds for review and modification of an award and that parties are not free to provide for a heightened standard of judicial review beyond that of the FAA.¹⁸⁷ Only 9 U.S.C. § 10 provides the statutory grounds to vacate an award.¹⁸⁸ The Court's decision in *Hall Street* prized the finality of the arbitration process over the parties' autonomy in shaping the process.¹⁸⁹

Certain alternative dispute resolution institutions, such as the AAA, do not provide for any appeals procedure and offers only the option of non-binding arbitration.¹⁹⁰ On the other hand, JAMS provides an Optional Arbitration Appeal Procedure where if all parties have agreed to the Procedure, any party may appeal an arbitration award that has been rendered pursuant to the applicable JAMS Arbitration Rules and has become final.¹⁹¹ While FAM recognizes that arbitration awards are typically final and non-appealable, if the franchise agreement provides for the right of one party to appeal a FAM arbitration award or if both parties in dispute agree to appeal a FAM arbitration award, FAM is prepared to handle such an appellate procedure in the

¹⁸⁵ See 9 U.S.C. § 10(a); see also *Bazzle*, 351 S.C. 244, *vacated, remanded*, 539 U.S. 444.

¹⁸⁶ For brief discussion See 22 Franchise L.J. 112, 115 (2002).

¹⁸⁷ *Hall St. Assocs., LLC v. Mattel., Inc.*, 552 U.S. 576, 584 (2008). Whether the FAA preempts state law that permits contractually expanded review is an open question. For discussion, see 78 Fordham L. Rev. 1813, 1850.

¹⁸⁸ See *Citigroup Global Mkts. Inc. v. Bacon*, 562 F.3d 349 (5th Cir. 2009) (error to vacate an award on the basis of a manifest disregard of the law.)

¹⁸⁹ *Hall St. Assocsc.*, 552 U.S. at 584.

¹⁹⁰ *AAA Non-Binding Arbitration Rules*, http://www.adr.org/aaa/faces/rules/searchrules/rulesdetail?doc=ADRSTG_010623&_afLoop=750688350733769&_afWindowMode=0&_afWindowId=1apem2pfm5_1#%40%3F_afWindowId%3D1apem2pfm5_1%26_afLoop%3D750688350733769%26doc%3DADRSTG_010623%26_afWindowMode%3D0%26_adf.ctrl-state%3D1apem2pfm5_53 (last visited on June 7, 2012).

¹⁹¹ *JAMS Optional Dispute Resolution Procedures*, at 2 (June 2003), http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Optional_Appeal_Procedures-2003.pdf (last visited on June 7, 2012).

same manner as a new FAM arbitration involving three arbitrators and subject to the FAM Arbitration Guidelines.¹⁹²

B. Confirmation of the Award

Where there is review, an appellate court reviews *de novo* a district court's confirmation of an arbitration award.¹⁹³ Review of the award itself, however, is exceedingly deferential.¹⁹⁴ Vacatur of an arbitration award will be permitted only on very narrow grounds.¹⁹⁵ Under section 9 of the FAA, "a court 'must' confirm an arbitration award 'unless' it is vacated, modified or corrected 'as prescribed' in sections 10 and 11."¹⁹⁶

Confirmation of foreign arbitration awards is governed by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (known as the New York Convention)¹⁹⁷ and federal law implementing the Convention.¹⁹⁸ Section 207 of the FAA provides: "Within three years after an arbitral award falling under the Convention is made, any party to the arbitration may apply to any court having jurisdiction under this chapter for an order confirming the award as against any other party to the arbitration. The court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention."¹⁹⁹ The seven grounds for refusing to confirm an award are set out in Article V of the Convention.²⁰⁰ These defenses are construed narrowly, and the party opposing recognition or enforcement bears the burden of establishing that a defense applies.²⁰¹

C. The Consideration of Limited Appellate Rights for Franchisors and Franchisees

Franchisors and franchisees need to be aware of the limited appellate rights that come with arbitration. While arbitration may be preferred due to the lack of formal appeals process and lower costs that come with it, there are consequences. The tradeoff becomes between cost savings and control of arbitral decisions.²⁰² As a result of *Hall Street*, state courts are confirming

¹⁹² Rule 2.5, *FAM Arbitration Guidelines*, <http://www.franarb.com/pdf/ARBGDL.pdf> (March 17, 2011) (last visited on June 7, 2012).

¹⁹³ *Martel v. Ensco Offshore Co.*, 449 Fed. Appx. 351, 353 (5th Cir. 2011).

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ *Hall St. Assocs.*, 552 U.S. at 582.

¹⁹⁷ June 10, 1958, 21 U.S.T. 2517.

¹⁹⁸ 9 U.S.C. §§ 201-208.

¹⁹⁹ 9 U.S.C. § 207.

²⁰⁰ *Id.*

²⁰¹ *Ministry of Def. & Support v. Cubic Def. Sys.*, 665 F.3d 1091, 1095-1096 (9th Cir. Cal. 2011).

²⁰² See Drahozal & Wittrock, *supra*, note 32 at 104.

more arbitration awards.²⁰³ There is a slim likelihood of achieving a reversal of an arbitration decision, so the real value of the right to appeal is strategic, in that it leaves the proceedings open and the ultimate outcome uncertain to create an opportunity to negotiate an out-of-court solution.²⁰⁴

The biggest problem for a party seeking review of an arbitration decision often is not the limited review under the FAA, but rather the lack of a record concerning both the proceedings and the arbitrator's reasoning process.²⁰⁵ Any party in arbitration can make arrangements and pay for a court reporter for a stenographic record.²⁰⁶ The record must be provided to the arbitrator and made available to the other parties for inspection to be constituted as the official record of the proceeding.²⁰⁷ Therefore, the need for a record in arbitration should be anticipated at the outset of the proceedings.²⁰⁸

In the decision between litigation and arbitration, the limited appellate review is of significant importance. With litigation, parties risk bad case law with precedential value. With arbitration, they risk non-binding decisions.

IX. CONCLUSION

Generally, arbitration offers franchisors and franchisees a cost-effective and expeditious dispute resolution forum. Nevertheless, even with its advantages, parties should consider the process outlined in the dispute resolution procedure provision before executing an agreement. With an understanding of the procedural obstacles and benefits, and with the acknowledgement that courts generally and liberally enforce such agreements, parties should carefully consider the arbitration provision they are agreeing to before signing on the dotted line.

²⁰³ Michael H. LeRoy, *Are Arbitrators Above the Law? The "Manifest Disregard of the Law" Standard*, 52 B.C. L. Rev. 137, 183 (2011).

²⁰⁴ Arbitration v. Litigation: The Right to Appeal and Other Misperceptions Fueling the Preference for a Judicial Forum, 35-36 (2006), available at <http://law.bepress.com/cgi/viewcontent.cgi?article=5934&context=expresso>

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 39 (citing AAA Commercial Rules, R-26).

²⁰⁷ *Id.*

²⁰⁸ *Id.*

Arthur L. Pressman

Arthur L. Pressman has practiced franchise law and assisted franchise industry clients for more than 25 years. He is a partner at Nixon Peabody LLP, a global law firm, and resident in its Boston offices. Arthur actively tries franchise cases throughout the country. Among his recent cases are the successful defense of Little Caesar Enterprises, Inc. in a \$600M claim by a franchisee over ownership of Little Caesar's Hot-N-Ready® program (Pinnacle Pizza Co., Inc. v. LCE Enterprises, Inc., USDC/South Dakota, aff'd, 8th Circuit 2010) and the successful defense of Dunkin Brands, Inc. in a high profile jury trial of a \$13M fraud and contract claim by a former franchisee (Barkan v. Dunkin' Donuts, Inc., USDC/RI, aff'd, 1st Circuit 2010). From 2004 to 2007, Arthur was a faculty member at Babson College, co-teaching an MBA level course entitled "Franchising: Pathway to Wealth Creation," and in 2012-2013 is a faculty member of Boston University School of Law, teaching a seminar in representing clients in civil litigation, and a course on professional responsibility. For many years, Arthur has been named one of the top 100 franchise lawyers in the United States by Franchise Times magazine, and was selected as "Lawyer of the Year" among Boston franchise lawyers in 2011 by *The Best Lawyers in America*. *Chambers USA: America's Leading Lawyers for Business* has selected Arthur as one of the top 10 franchise lawyers in the United States in 2010 and 2011, calling him "a tremendous litigator and a fantastic counselor and adviser—his results speak for themselves." (2010 ed.). Since 2009, Arthur has also been the Board chair of South Coastal Counties Legal Services, Inc. which provides free civil legal services to over 4,000 elderly, working poor or poverty level clients throughout Cape Cod, the Islands and southeastern Massachusetts.

Justin M. Klein

Justin M. Klein is a partner in the law firm of Marks & Klein, LLP. Mr. Klein focuses his practice in the areas of franchise law, commercial litigation and general business law. He represents privately held and publicly traded businesses, individuals and charitable institutions in national and international transactions, litigation, arbitration and mediation. He completed his undergraduate studies at the University of Wisconsin, Madison and obtained his law degree from the New York Law School. Mr. Klein has been appointed lead counsel in multiple franchisee class action matters. He is a frequent lecturer and author on franchise and other business law topics, and has been quoted by the national media on developments in the franchise and business industry. He has also been designated to speak on behalf of the New Jersey Economic Development Authority Entrepreneurial Training Institute on franchising. Mr. Klein has been recognized as a leading franchise attorney by International Who's Who, SuperLawyers and the Franchise Times. Recently, he was designated as a "New Leader of the Bar" – 40 Under 40 by the New Jersey Law Journal in the practice of franchise law. He is admitted to practice law in New Jersey, New York, and numerous federal courts and Courts of Appeals throughout the United States.