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W-22: TO ARBITRATE OR NOT TO ARBITRATE AND HOW TO DRAFT ACCORDINGLY

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TO ARBITRATE OR NOT TO ARBITRATE AND HOW TO DRAFT ACCORDINGLY

I. INTRODUCTION[1]

Franchisors have the ability to customize the dispute resolution process they prefer to use with franchisees in a manner that meets their risk tolerances and strategic objectives in order to grow, evolve, and protect their franchise system. One of the key threshold issues is whether to resolve disputes with franchisees by arbitration or litigation. Whichever process is ideal for the franchisor must be included in the franchise agreement.

Selecting the best dispute resolution process requires the franchisor, its general counsel, and outside counsel to consider various pros and cons of arbitration compared to litigation. To effectively do this, the franchisor and its counsel should first consider the franchise system's risk tolerance and methods by which the franchisor will enforce the terms of the franchise agreement and related agreements. Some franchisors aggressively enforce the franchise agreement terms by routinely sending default notices to franchisees, then terminating the franchisee and filing a lawsuit against them if they fail to cure the default. Other franchisors only pursue defaults that are highly material to the franchise system, such as failing to meet system standards or failing to pay royalties. Still other franchisors are less aggressive and prefer to attempt to work with franchisees to fix issues that are not in compliance with the terms of the franchise agreement. Alternatively, the franchisor may work with those franchisees to find a buyer for the franchisee's business.

A franchisor should also consider how it wants to defend any dispute brought against it by one or more franchisees. Is the franchisor concerned about precedent-setting outcomes in litigation? Does it mind that Item 3 of its franchise disclosure document contains a long list of cases? Does the franchisor wish to minimize legal fees and potential damage awards? The answers to these questions may likely change over time as the franchise system grows and new management replaces prior management. But at the time the franchisor is drafting the initial franchise agreement or modifying an existing franchise agreement, the franchisor, its senior management, and counsel should consider these baseline questions. Arbitration may be an attractive alternative to litigation for many franchise systems.

Arbitration is based on the contract terms agreed to by the parties to the franchise agreement. Essentially, both the franchisor and franchisee agree to resolve all disputes between them by arbitration pursuant to the terms of the arbitration provision in the franchise agreement and the rules of the arbitration service provider selected in the arbitration provision. The purpose of arbitration is to resolve disputes arising under the franchise agreement by a more efficient, quicker, and less expensive process than litigation.

The Federal Arbitration Act ("FAA") was passed in 1925.[2] Since then, an extensive body of case law has developed dealing with a host of issues arising under the FAA. This paper is not intended to address each of these issues in detail, although it does provide highlights of the major issues raised concerning arbitration processes and contract language.

This paper will examine the reasons to choose arbitration and reasons why a franchisor may decide to litigate rather than arbitrate disputes. It will also address other dispute resolution

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[1] The authors would like to acknowledge and thank Hannah Leiendecker, Faegre Drinker Biddle & Reath LLP, and Brianna Lockridge, Greensfelder, Hemker & Gale, P.C., for their valuable contributions.

[2] 9 U.S.C. §§ 1-16.

alternatives, as well as several related topics and common issues that every franchise lawyer should consider when drafting an arbitration provision or litigating a dispute with a franchisee.

As mentioned, arbitration is a creature of contract. This allows the parties to customize how they intend to handle any disputes arising under the contract. This is not true of litigation. However, it is important to remember that contractual provisions regarding arbitration are agreed upon when the franchise agreement is signed. If the franchisor offers twenty-year terms for each franchise agreement, there could be many court rulings during those twenty years that could affect how the arbitration provisions are interpreted when a dispute arises. Circumstances also change over a long term, which may lead the parties to change the original terms of the arbitration process contained in the franchise agreement. Unlike most terms of the franchise agreement, the parties are free to reach an agreement on alternative arbitration provisions when a dispute arises.

One note for franchisee counsel: this paper discusses the pros and cons of using arbitration from a franchisor's perspective as it is the franchisor that drafts its franchise agreement and therefore elects the dispute resolution process. In some franchise systems, the franchisor does not offer the franchisee any opportunity to negotiate the terms of the franchise agreement, including the details of the arbitration process. If the franchisee is offered the ability to negotiate the terms, franchisee counsel will also want to carefully consider the pros and cons of arbitration set forth in this paper and be prepared to negotiate each element of the process as discussed below.

Every franchisor will likely have a dispute with one or more of its franchisees at some point. How a franchisor and its franchisees resolve disputes can make a difference in the long-term success and sustainability of the franchise system. There is no right or wrong way to resolve these disputes. Each system must make an informed decision about the best dispute resolution process for that system.

II. STRATEGIC PRESSURE POINTS THAT INFLUENCE THE DECISION TO ARBITRATE OR LITIGATE

Whether a franchisor is developing a new franchise system with a new franchise agreement, or an existing franchisor is reviewing its existing franchise agreement for possible changes, at some point the franchisor will need to determine whether it prefers to use arbitration or litigation to resolve disputes with its franchisees. The following are some of the primary issues the franchisor and its counsel should consider before making this decision.

A. Reasons to Choose Arbitration as the Dispute Resolution Process

The following are the predominate reasons many franchisors elect to require arbitration to resolve disputes with their franchisees.

1. Choice of Decision Maker

In arbitration, the parties choose the person(s) who will adjudicate the issues at hand, namely the arbitrator(s). When drafting the dispute resolution section of the franchise agreement, it is important to specify the number of arbitrators – one or three – that the parties agree will decide issues arising between the franchisor and a franchisee. This is the most important distinction between arbitration and litigation.

In contrast, in litigation, a judge is appointed for each case. Neither the plaintiff nor the defendant has any say in which judge will hear the case, outside the process of seeking recusal of a judge, which is outside the scope of this paper. If there is a jury trial, the parties have some ability to select (or de-select) members of the jury pool and conduct voir dire, but they do so without much detail about each juror's background, education, knowledge of franchising or franchise law.

In an arbitration, the parties typically jointly select the one arbitrator who will hear the arbitration and render the decision or, if the agreement requires three arbitrators, each party may select one arbitrator and then those two arbitrators select the third arbitrator. The general rationale for requiring only one arbitrator is that the costs will be lower paying just one arbitrator. A main reason to require three arbitrators is the belief that a panel of three arbitrators is less likely to reach a decision that is inconsistent with the law.

Regardless of the requirement for one or three arbitrators, unless another method is identified in the franchise agreement, the designated arbitration service provider will provide the parties with a panel of approved arbitrators from which they can select their agreed upon arbitrator for the arbitration. This panel information should include detailed background of the available arbitrators, as well as their fees.[3] In selecting the arbitrator(s), each party should pay careful attention to (a) the experience of each potential arbitrator as an arbitrator, and (b) the knowledge and experience the potential arbitrator has of franchising and franchise laws.

In the early days of arbitration in franchise matters, finding an arbitrator with much knowledge or experience in franchising or dealing with franchise laws could be difficult. That is not the case today. Many of the Forum's members are experienced arbitrators and available to serve as arbitrators in a franchise dispute.[4] Regardless of the party that initiated the arbitration, both franchisor and franchisee counsel should remember that they are not required to choose their arbitrator from the list provided by the arbitration service provider. They can ask for more available arbitrators if the initial list does not include an arbitrator acceptable to both parties, or they can select their own arbitrator if they agree upon an individual arbitrator.

The franchise agreement's dispute resolution language can provide that any arbitrator used for an arbitration between the parties have a certain number of years practicing franchise law or serving as an arbitrator in a minimum number of franchise-related arbitrations.[5] The dispute resolution language may also require that the arbitrator have a certain number of years of experience in the industry in which the franchisor operates, e.g., a restaurant franchisor or a hotel franchisor. Other criteria for a knowledgeable arbitrator can also be included in this section of the franchise agreement. An arbitrator familiar with franchising and/or the franchisor's industry will not require the same education from the parties as one not experienced with the subject, and may lead to more efficient resolution consistent with the law and the parties' agreement. The more

[3] The American Arbitration Association ("AAA") considers its roster of arbitrators (and their fees) proprietary and thus it is not available to the public at large. *See* American Arbitration Association, *Why the AAA's Roster of Arbitrators is Not Publicly Available,* https://www.adr.org/sites/default/files/document_repository/Why-the-AAAs-Roster-of-Arbitrators-is-Not-Publicly-Available.pdf (last visited July 16, 2023).

[4] None of the authors of this paper serve as arbitrators in any type of disputes.

[5] The AAA is working on an initiative to develop qualification criteria as part of its efforts to establish a AAA National Franchise Panel before the end of 2023 which will include arbitrators and mediators with demonstrated expertise in the technical, business, and legal aspects of franchise disputes. Email from Svetlana Gitman, Esq., Vice President, American Arbitration Association (Aug. 7, 2023) (on file with author).

specific the arbitrator requirement language, the better the likelihood that the arbitrator(s) chosen will render a decision consistent with the law and workable within the franchisor's specific industry.

2. Choice of Forum and Provider

The franchise agreement will typically have a forum selection clause, usually requiring all disputes to be brought in state or federal courts in the county or city where the franchisor's home office is located. However, certain registration states have deemed such forum selection clauses invalid and require that franchise disputes be brought in the courts of that state.[6] Fortunately, when deciding whether arbitration must be held in the franchisor's selected forum or the state where the franchisee does business, most courts have held that the Federal Arbitration Act preempts the state franchise law.[7]

However, while many franchise disputes can be brought in federal court in the franchisor's county or city, not all disputes meet the requirements for federal jurisdiction. The dispute then must be brought in the applicable state court. Requiring arbitration as the dispute resolution process eliminates any uncertainty about whether a franchise dispute will be heard in federal court or will have to be heard by a state court judge.

The arbitration language in the franchise agreement should also be specific about which arbitration service provider must be used and clearly state that the rules of such provider apply to all arbitrations.[8] Counsel for the franchisor can provide its input as to the most efficient and knowledgeable arbitration service provider based on the experiences of the counsel's litigators. While many franchisors select the American Arbitration Association (AAA), there are a number of arbitration service providers available across the country, some of which are national providers while others are local.[9] When drafting an arbitration provision, counsel should review each potential provider's rules to determine differences.

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[6] *See infra* Section V.G.

[7] For a summary of the applicable law regarding the FAA's preemption of state law, *see infra* Section V.D.

[8] Given the length of franchise agreements, it is possible that the chosen arbitration service provider may no longer be operating when a dispute arises, so franchisors should consider that possibility when drafting.

[9] For example, JAMS, CPR Dispute Resolution, and NAM are also commonly used.

3. **Arbitration is Cheaper and Faster.**

Arbitration is often said to be less expensive and faster than litigation.[10] Reduced pre-hearing discovery is one main reason.[11] As the arbitration service providers' rules typically impose maximum timeframes for each stage of the arbitration, including the hearing and the decision, the timing of each stage of arbitration is generally shorter than the litigation process. In addition, franchisors can draft their franchise agreements to include timeframes for resolution.

There are, however, additional costs associated with arbitration that are not present in litigation. These include: (a) the arbitration service provider's administrative fees, and (b) the fees of the arbitrator(s).[12] The parties' counsel can also cause the costs to increase by using various procedural motions that are effective in a litigation matter but are not typically considered to be a part of an arbitration or are against the arbitration service provider's rules.[13] To file a procedural or dispositive motion, the party filing the motion first has to pay the fees associated with the arbitrator's decision to entertain the motion, then pay the fees associated with the arbitrator hearing and rendering a decision on the motion. To avoid this last issue, each party should be thoughtful when hiring its own attorney to represent it in the arbitration. Ensuring the attorney understands the arbitration process and the intent of arbitration to reach a faster and less expensive resolution is essential. Everyone involved in the arbitration process must understand that the strategy for an arbitration can be vastly different than a trial strategy.

One or both parties must pay the fees of the arbitration service provider and the arbitrator(s). These may include filing fees, hourly fees, administrative fees, and deposits for hearing fees. In addition, an arbitrator and/or arbitration service provider may charge cancellation fees if the parties settle within a certain time period before the arbitration hearing. Because all of

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[10] Federal court statistics show that the median length of time from filing a case to a jury or bench trial for civil cases is 35 months, as of the twelve-month period ending March 31, 2023. *See United States District Courts – National Judicial Caseload Profile (July 2023),* https://www.uscourts.gov/sites/default/files/data_tables/fcms_na_distprofile0331.2023.pdf. Although those numbers have increased since the pandemic, the median time prior to the pandemic was 26-28 months. Although it is unclear from what year these statistics were gathered, the AAA states that on average, U.S. district court cases took more than 12 months longer to get to trial than cases adjudicated by arbitration (24.2 months vs 11.6 months) and U.S. district and circuit court cases required at least 21 months longer than arbitration to resolve when the case went through appeal (33.6 months vs 11.6 months). *See* American Arbitration Association, *Measuring the Costs of Delays in Dispute Resolution*, https://go.adr.org/impactsofdelay.html (last visited July 16, 2023).

[11] For further discussion of how discovery limitations may be drafted in arbitration provisions, *see infra* Section IV.D.

[12] As noted above, an arbitrator's fees are generally unknown until the arbitration service provider provides the parties with a panel from which to choose an arbitrator. An industry magazine has reported that comprehensive data on arbitrator compensation is difficult to find and can vary significantly depending on the market, the arbitrator's expertise, and demand. *See* Deborah Rothman, *Trends in Arbitrator Compensation*, DISPUTE RESOLUTION MAGAZINE (Spring 2017). Parties have little control over what an arbitrator charges. There are no definitive rules or procedures within the AAA for disputing an arbitrator's fees. AAA R-57(b) states that "[i]f there is disagreement concerning the terms of compensation, an appropriate rate shall be established with the arbitrator by the AAA and confirmed to the parties." That appears to address the arbitrator's established rate, not the total amount billed for the arbitrator's services. Practitioners may be reluctant to raise this issue during the course of an arbitration for fear of offending the arbitrator and thus the party's success in the arbitration outcome. However, one of the authors of this paper was successful in challenging what she considered to be excessive fees of an arbitrator by submitting evidence to the AAA case manager outlining the issues after the case concluded. The AAA stated that it did not have the authority to waive an arbitrator's compensation without the arbitrator's permission.

[13] *See* Edward Wood Dunham & Michael J. Lockerby, *Shall We Arbitrate? The Pros and Cons of Arbitrating Franchise Disputes,* ABA 28TH ANNUAL FORUM ON FRANCHISING L-3 (2005).

these fees are in addition to each party's own attorneys' fees, arbitration may be cost prohibitive for some parties, in particular many small franchisees.[14] Non-payment of these arbitration fees may result in the imposition of sanctions against the non-paying party or a ruling that the failure to pay these fees results in a breach of the arbitration language or a waiver of the right to arbitrate, allowing the dispute to be heard by a court.[15]

Notwithstanding the issues raised in this section, it is sometimes true that arbitration is less expensive and can resolve a matter more quickly than litigation. It is also less formal and more flexible. Actions, or failure to act, by either party which cause the arbitration to drag on or costs to increase, should and can be effectively managed by each party's counsel and/or with the arbitrator's assistance.

4. <u>Ability to Customize or Limit Discovery and Evidentiary Process.</u>

As arbitration is a matter of contract, the details of the allowable discovery can be drafted into the terms of the arbitration provision in the franchise agreement. Generally, the discovery process can be less expansive than it is in litigation if the limits of discovery are less than rules of civil procedure allow.

The terms of the franchise agreement may limit the number of depositions the parties can take, the length of depositions, the number of document requests and/or interrogatories each party can request, and restrictions on or requirements regarding electronic discovery. The franchisor may also want to consider whether to require an arbitrator to apply specific rules of evidence unless they prefer an arbitrator have flexibility in considering evidence. If the franchise agreement dispute resolution language is not this specific, the parties can still agree to a limited discovery process and discovery schedule after the arbitration process commences.

While customized or limited discovery can lead to a more efficient process that is less costly than litigation, there are certain issues that franchisors should consider before electing arbitration as their dispute resolution process. Obtaining evidence from third parties in an arbitration may be more difficult than it is in litigation. For the arbitration hearing, if one party asks a third party to provide evidence but the third party refuses, the rules of most arbitration service providers now allow the arbitrator to issue a subpoena to such third party. If a third party refuses to appear, a party can then petition the applicable court to compel the witness to appear during the hearing or punish the witness for failing to appear. The ability to issue a subpoena is limited to the actual arbitration hearing- meaning it may be more difficult for a party to obtain evidence from a potential witness prior to the hearing. Federal courts are split on whether an arbitrator can subpoena a third party to give evidence during discovery.[16] Franchisors, franchisees, and their

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[14] *See* W. Michael Garner, *Dispute Resolution in the Twenty-First Century: The Challenge to Get ADR Right,* 40 FRANCHISE L.J. 25 (2020).

[15] *Id.; see also* Peter Halasz & Chelsea Turiano, *Franchise Arbitration: Dealing with a Party's Refusal to Share Costs,* 26 THE FRANCHISE LAW. 2 (2023).

[16] The Second, Third, Fourth, Ninth, and Eleventh Circuits have all held that the plain language of the FAA does not give arbitrators the authority to issue pre-hearing discovery subpoenas to third parties. *See, e.g.,* Life Receivables Tr. v. Syndicate 102 at Lloyd's of London, 549 F.3d 210, 215–16 (2d Cir. 2008); Hay Group, Inc. v. E.B.S. Acquisition Corp., 360 F.3d 404, 407 (3rd Cir. 2004); COMSAT Corp. v. Nat'l Sci. Found., 190 F.3d 269, 275 (4th Cir. 1999); CVS Health Corp. v. Vividus, LLC, 878 F.3d 703, 708 (9th Cir. 2017); Managed Care Advisory Grp., LLC v. CIGNA Healthcare, Inc., 939 F.3d 1145, 1160 (11th Cir. 2019). Conversely, the Sixth and Eighth Circuits authorize pre-hearing subpoenas to third parties by arbitrators. *See, e.g.,* Am. Fed'n of Tel. & Radio Artists v. WJBK-TV, 164 F.3d 1004, 1009 (6th Cir. 1999); In re Sec. Life Ins. Co. of Am., 228 F.3d 865 (8th Cir. 2000). *See also,* Paula J. Morency

respective counsel should be aware of the limits on third-party discovery and what the prevailing rule is in the federal district court in which the arbitration will occur.

5. Greater Likelihood of Enforcing Class Action Waivers.

By now, most franchise agreements contain a waiver of any class actions by the franchisees. If a franchisor's franchise agreement does not contain a class action waiver, the authors strongly suggest this be added to the franchise agreement.

If the franchisor elects to use arbitration as its dispute resolution process, the language waiving any right to a class action by franchisees should be expressly set forth in the details of the arbitration process language, not in an unrelated section of the franchise agreement. Since the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion,*[17] courts have routinely upheld class action waivers in arbitration. This is one of the greatest advantages of arbitration, provided the class action waiver is written in the arbitration terms of the franchise agreement.

As the concept of arbitration is built on the principle that arbitration is based in contract and is simpler, less costly, and faster than litigation, it makes practical sense that class action waivers included in the arbitration provision of the franchise agreement would be enforced in arbitration. As we all know, class actions make litigation more complex and drawn out. This is opposite to the intent of arbitration.

6. Confidentiality and Privacy.

Unlike litigation where all filings and decisions are available to the public, arbitration is generally a confidential and private process between the parties.[18] To ensure confidentiality, franchisors should be sure to include confidentiality – of the process, the information exchanged and the outcome – within the arbitration provision in the franchise agreement.[19] As a result, other franchisees in the system, and their counsel, cannot learn about the nature of the arbitration action or the decision in the arbitration.

One exception to this is the franchisor's obligation to disclose the arbitration and the resulting award in the franchisor's franchise disclosure document ("FDD").[20] However, the reasoned award, if the franchise agreement requires one, is generally not available to the public as the opinion would be if the matter had been litigated. The exception to this is if one of the parties seeks to enforce the award in court. Although a party can ask the court for permission to

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& J. Michael Dady, *Is There Peril In Seeking Private Justice Through Arbitration – And For Whom?*, ABA 38TH ANNUAL FORUM ON FRANCHISING W-11 (2016).

[17] 563 U.S. 333 (2011).

[18] *See* AM. ARB. ASS'N COMM'L ARB. RULES AND PROCEDURES ("AAA RULES") R-45 at 30 (Sept. 1, 2022) (requiring confidentiality of arbitrator and provider and allowing parties to request a confidentiality order from the arbitrator) https://www.adr.org/sites/default/files/CommercialRules_Web_0.pdf.

[19] Hon. Robert A. Bames, *Is Your Private Arbitration In Danger of Going Public*? (July 18, 2012), https://mediate.com/is-your-private-arbitration-in-danger-of-going-public/ (noting that to keep an arbitration confidential, parties should include confidentiality in their arbitration clause).

[20] 16 C.F.R. § 436.5(c).

file the decision under seal, many courts today are not as willing as they were in the past to shield documents from the public, which counsel should consider in drafting arbitration clauses.[21]

Confidentiality can present both advantages and disadvantages for the franchisor and the franchisee. The decision in any one arbitration is likely to have no precedential value for any subsequent arbitrations. The arbitrators in any future arbitration addressing the same or similar issues as the concluded arbitration do not have to follow any reasoned decisions in any prior arbitrations. In fact, the arbitrators would not necessarily know about the decisions in prior arbitrations as they are confidential.

7. No Risk of "Runaway" Jury Award.

If a franchisor or its counsel has any concern about "runaway" jury awards in litigation with its franchisees, it should strongly consider using arbitration as its dispute resolution process. As discussed above, the decision in an arbitration is made by a single arbitrator, or, if chosen by the parties, the three-arbitrator panel. This is not to say that arbitrators always render a decision that the franchisor believes is correct or consistent with existing laws. However, the arbitrator can only render a decision on the issues presented for arbitration. Also, most arbitrators are attorneys. Although attorneys can serve on juries in some states, juries are usually comprised of non-lawyers who may be more inclined to decide a case based on factors other than the law. An arbitrator is much less inclined to decide that one party has greatly wronged the other party and therefore should be punished with an excessive damages award. In fact, the arbitration provision in the franchise agreement can also provide that the parties agree that neither party is entitled to punitive damages. Also, arbitrators depend on the parties to choose them as their arbitrator, so they have an incentive to be fair and reasonable. Jurors have no such incentive.

As an aside, if the franchisor does not elect to use arbitration to resolve disputes with its franchisees, it is prudent that the franchisor include language in the franchise agreement that prohibits either party from seeking or being awarded punitive, consequential, or exemplary damages in any litigation between them.

B. Reasons Not to Choose Arbitration as the Dispute Resolution Process.

While there are many good reasons to choose arbitration for a franchisor's dispute resolution process, there are also a number of disadvantages to the arbitration process that franchisors and franchisees should be aware of before agreeing to arbitrate any future disputes between them. As discussed above, even some of the advantages of arbitration have potential downside risks that franchisors should consider before deciding to use arbitration as the dispute resolution process. The following are reasons not to choose arbitration.

[21] *See* Pennsylvania Nat. Mut. Cas. Ins. Co. v. New England Reinsur. Corp., 840 Fed. App'x. 688 (3d Cir. 2020) (affirming district court in ordering an arbitration award unsealed because the award constituted a judicial record to which the common-law right of access applied). To guard against publication of an arbitral award, franchisors can include requirements in their arbitration clause that the losing party has a certain amount of time to pay (or comply with) the award, so there would be no need for the winning party to file the award with a court. Alternatively, the provision can require the arbitrator issue only a standard, non-reasoned award, or issue two decisions: one being a reasoned decision explaining the basis for the award, and one being a standard award that contains only the ultimate award that could be used if the winning party must seek to enforce the award in court. *See* Joshua Stein, *Arbitration Awards May Not Be As Confidential As You Think*, FORBES, Apr. 27, 2021.

1. Very Limited Opportunity to Appeal or Vacate the Arbitrator's Decision.

Typically, the greatest risk in arbitration is the limited opportunity to appeal or vacate the decision rendered by the arbitrator. Once the arbitrator provides the final decision to the parties, the parties must file the award with the relevant federal or state court within one year after the date of the final decision.[22] The court then has the authority to enforce the award as needed.

In the agreement to arbitrate any disputes set forth in the franchise agreement, the franchisor and franchisee should also agree to abide by the rules of the arbitration service provider chosen to hear any such arbitrations. Both franchisors and franchisees are cautioned to understand that arbitrators are not bound to follow existing law. For example, Rule 49(a)A of the AAA Rules states that "The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties."[23] This does not require the arbitrator to follow any existing laws or precedents. While not occurring often, arbitrators have been known to render decisions inconsistent with existing case law or by interpreting the franchise agreement in a manner not intended by the parties. Or, on rare occasions, an arbitrator may decide to resolve the dispute by issuing an award that reflects what the arbitrator believes is a good compromise for both parties.

If one or both parties believe the arbitrator's award is incorrect, they may decide to file a motion with the relevant court to vacate the award.[24] Because the purpose of arbitration is to reach a resolution of a dispute quickly and efficiently, the ability to successfully appeal or vacate an arbitrator's decision is very limited. Section 10(a) of the FAA prescribes four reasons an award may be vacated by the court.[25] These include: (1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators or either of them; (3) where the arbitrators were guilty of misconduct in the handling of the arbitration; or (iv) if the arbitrators exceeded their powers or so imperfectly executed them that a mutual, final, and definitive award upon the subject matter was not made.[26] Courts routinely follow this in their determination of whether an award should be vacated, reversed, or otherwise changed.[27] As arbitration is a creature of contract, courts have typically only considered whether the arbitrator followed the terms of the arbitration agreement and the service provider's rules to uphold an

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[22] 9 U.S.C. § 9.

[23] AAA RULES, *supra* note 18, R. 49(a) at 31.

[24] The Federal Arbitration Act authorizes parties to arbitration agreements to file certain actions in federal court, including petitions to compel arbitration and applications to confirm, vacate, or modify arbitration awards. 9 U.S.C. §§ 4, 9-11. However, those provisions themselves do not support federal jurisdiction. An action under the FAA must have an independent basis for federal jurisdiction. Hall Street Ass., L.L.C. v. Mattel, Inc., 552 U.S. 576, 581-82 (2008). If there is none, a party must file it in state court. The Supreme Court recently held that a federal court, in determining whether it has jurisdiction to decide an application to confirm, vacate, or modify an arbitral award, may only look at the application submitted to it and may not look through the application to the underlying substantive controversy between the parties, abrogating prior case law. Badgerow v. Walters, 142 S. Ct. 1310, 1315-22 (2022).

[25] 9 U.S.C. § 10(a).

[26] *Id.*

[27] For a more detailed discussion, *see* Paula J. Morency & J. Michael Dady, *Is There Peril In Seeking Private Justice Through Arbitration – And For Whom?*, ABA 38TH ANNUAL FORUM ON FRANCHISING W-11 (2016).

arbitration award, not any mistakes the arbitrator may have made following the law or interpreting the franchise agreement.[28]

Most of the arbitration service providers used today also have rules regarding the ability of a party to appeal a decision using the service provider's own internal appellate review process. This appellate process consists of a panel of different arbitrators reviewing the initial arbitration award. This panel also does not consider mistakes made by an arbitrator in following the law or the franchise agreement terms.

With the growth of franchise lawyers becoming arbitrators, this risk will hopefully diminish in the future. Most arbitration awards are fair and resolve the dispute in an efficient, quick and less costly manner than litigation. However, the risk of an arbitration award that is inconsistent with current franchise law is always present.

Franchisors considering using arbitration to resolve disputes with franchisees should consider each type of issue that may be raised in any dispute. The franchise agreement arbitration terms can carve out certain disputes from arbitration. Any dispute arising regarding the franchisor's intellectual property rights should be carved out. Having an arbitrator decide a dispute about the use of the franchisor's intellectual property could be detrimental to the franchisor's system without the ability to appeal or vacate the arbitrator's decision.

2. Discovery Limitations.

Another potential disadvantage of arbitration is the likelihood that discovery in any dispute will be greatly limited as opposed to the discovery process in litigation. As discussed above in Section II.A.4., this can be a reason to choose arbitration because limited discovery can greatly reduce the cost of the dispute resolution. However, the franchisor and its counsel must carefully consider the types of issues that will be resolved by arbitration and the discovery the franchisor and its counsel will want to pursue or defend the claims brought in any such matter.

In certain disputes arising in a franchise setting, the lack of substantial discovery may be an impediment for either the franchisor or the franchisee. If the franchisor terminates the franchisee's franchise agreement for failure to meet system standards, there may be more documents and depositions needed to prove the franchisor properly terminated the franchise agreement, including many months of audits of the business showing the failures, memos regarding how the franchisor helped the franchisee during this time, and the franchisor's operating manual setting forth the franchisor's system standards. The franchisee's counsel will likely want to review all of the franchisor's written communications regarding the franchisee to make sure the franchisor did not "target" the franchisee. Or if the franchisee has failed to pay royalties or under-reported sales and paid lower royalties, the review of many months or even years of the franchisee's financial records may not be allowed under the agreed upon discovery terms in arbitration. The franchisee's counsel may also want to review the franchisor's records relating to the franchisee's reporting of sales to the franchisor.

As discussed above, the arbitration provision in the franchise agreement can specify the number and length of depositions, discovery requests, and interrogatories each party may have in an arbitration, as well as other discovery limitations. However, this language should not be so broad as to reduce or eliminate any savings an arbitration can provide. If the agreement does not

[28] *Id.*

provide for these specifics, the discovery limitations likely will be different from arbitration to arbitration. This may cause too much uncertainty about the discovery limitations than a franchisor is comfortable dealing with in various disputes with franchisees. In those situations, the parties can ask an arbitrator to enter a scheduling order or the arbitration provider may suggest one.

3. Limited Ability to Pursue Dispositive Motions.

Because the underlying intent of arbitration is to resolve disputes more quickly and less costly than litigation, the ability of the parties to pursue dispositive motions in arbitration is limited. While arbitration eliminates the ability of a party to drag out or increase the costs of litigation by filing one motion after another, the ability to obtain meaningful early wins in an arbitration is also limited. In arbitration, depending on the arbitration service provider rules, the parties may only be entitled to file certain dispositive motions under limited circumstances. First, this ability is limited to the terms of the arbitration provisions in the franchise agreement. If the arbitration terms do not address dispositive motions, the second source to consider is the rules of the selected arbitration service provider. For example, Rule 34 of the AAA Rules provides that the arbitrator may hear a dispositive motion "only if the arbitrator determines the moving party has shown that the motion is likely to succeed and to dispose of or narrow the issues in the case."[29] Recent changes to that rule also require the arbitrator to consider the time and cost associated with the parties' briefing a dispositive motion when deciding whether to allow a party to file such a motion. The arbitrator may also assess fees, expenses and compensation incurred in connection with a dispositive motion as part of an arbitrator's decision on the motion. As a result of these limitations, there is less procedural certainty to seek relief by dispositive motion, e.g. preliminary injunction, motion to dismiss, or summary judgment, in arbitration than in litigation. Most litigators and their clients understand what is required to be successful in seeking such relief as a preliminary injunction or summary judgment. As a result, they can carefully consider the facts of a dispute and know whether it is prudent to file such motions in court. In arbitration, it is unknown whether an arbitrator or the rules under which the arbitrator is bound will allow the specific dispositive motion to even be filed in the first instance.

From at least the franchisor's perspective, the ability to quickly obtain a preliminary injunction is crucial if the franchisee is using the franchisor's trademarks, service marks or other intellectual property without a current license to do so from the franchisor. The rules of the various arbitration service providers available today typically set forth the process by which emergency relief can be obtained from the arbitration service provider.[30] However, the costs associated with this can easily exceed the cost to file a motion for a preliminary injunction in court. There can also be delays in obtaining such relief in arbitration that may not be present in court. The party seeking the preliminary injunction must first file a motion requesting the ability to file the motion for a preliminary injunction and pay the fees related to this motion. If granted, that party then files the actual motion for a preliminary injunction and pays the fees associated with the hearing and decision on this motion. This is true for all other dispositive motions as well. This is another reason to carve out any disputes relating to the franchisor's intellectual property from the arbitration requirement.

One additional thought on this issue pertains to the enforcement of a preliminary injunction or other emergency relief. If the relief is granted by a court, the court has the authority to enforce

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[29] AAA Rules, *supra* note 18, R. 34 at 26.

[30] *See id.* R-39 at 27-28.

the relief by holding contempt proceedings or levying sanctions on the party disregarding the court's order. If relief is obtained from an arbitrator, the arbitrator does not have this authority. The party obtaining the relief must first take the arbitration decision on the dispositive motion to court and ask the court to enforce the decision. This extra step can cause material delays in enforcing the relief obtained.

4. Potential for Collateral Litigation.

As discussed below in Section V, there are a number of collateral issues that can arise with arbitration provisions, such as whether the dispute is, in fact, subject to arbitration and whether an arbitrator has the authority to rule on a dispute. Depending on the language in the franchise agreement, these issues may end up in court and be decided by a judge rather than an arbitrator. This can further increase parties' costs.

III. THE LITIGATION ALTERNATIVE

In many franchise systems, the franchisor elects to use litigation as its dispute resolution process. This decision may be made based on the factors covered in Section II above, or it may be made by a general counsel or senior management of the franchisor for other reasons.

A. Why do Franchisors Opt for Litigation over Arbitration?

In many of the more mature franchise systems, the franchise agreement has required litigation as the dispute resolution process for many years, perhaps decades. This is in part due to the fact that arbitration was not routinely used in franchise agreement disputes when the original franchise agreement was drafted in the 1970s or the 1980s. In some systems of which the authors are aware, as time passed, senior management of the franchisor likely was uninclined to change the dispute resolution process to arbitration.

This may be due to a variety of reasons. The franchisor's senior management or general counsel may not have understood the benefits of arbitration. Or they were more comfortable with litigation as they had used litigation for franchise disputes, understood that process, and had been successful in litigation against franchisees. The general counsel or outside franchise counsel may have been concerned that there were not enough arbitrators available that really understood the concept of franchising and franchise laws. At the same time, they may have had a strong belief that a federal judge would be "smarter" than an arbitrator who is not a judge and, therefore, would render a better decision for the franchisor.

The franchisor may also have been concerned that franchisees would view a change from litigation to arbitration as being more "franchisor-friendly" since arbitration was still a somewhat unknown process. If the franchisor had other material changes to the then-current franchise agreement that the franchisor deemed more important than changing the dispute resolution process, the franchisor may have elected to forego any conflict with the franchisees about the dispute resolution process so it could focus on the other system changes it wanted to make in the franchise agreement.

While many franchisors have elected to use arbitration, others continue to choose litigation as their dispute resolution process between the franchisor and its franchisees. Litigation is a known process, and whether the franchisor is the plaintiff or the defendant, the general counsel and senior management understand what will occur in the litigation process, the costs associated with litigation, and the potential outcomes of most litigation.

If the franchisor and its general counsel review the reasons not to choose arbitration as its dispute resolution process discussed in Section II, they may make the decision that the reasons against using arbitration are too risky for the franchise system. First, the arbitrator's decision cannot easily be vacated or reversed. As discussed above in Section II, this is the greatest reason franchisors may choose litigation over arbitration for disputes with franchisees. Litigation provides both parties with the ability to appeal a final decision to a higher court. Arbitration does not necessarily provide that option, nor can an award be vacated unless a party can show that the decision is the result of the arbitrator's corruption, fraud, or other misconduct. The bar for successfully overturning an arbitration decision is very high. This may be too risky for the franchise system.

In addition, an arbitration decision has no precedential value, unlike a court decision. Even if the arbitration terms in the franchise agreement require a reasoned decision from the arbitrator, future arbitrators of disputes in that franchise system are not obligated to follow the reasoning of the prior arbitrator to reach the same decision. As arbitration proceedings and the decisions are confidential, future arbitrators may not be aware of a prior decision advantageous to the franchisor. By contrast, the decision in litigation does carry precedential value and can and should be referenced in subsequent decisions on the same issue. The franchisor and its general counsel may feel more comfortable with litigation as a result.

Further, if the chosen arbitrator does not have experience arbitrating franchise issues or does not have franchise law knowledge and experience in the franchise system's industry, the arbitrator may have less basis on which to render a decision that reflects the intent of the franchise agreement provision or system standard in controversy in the dispute. As shown in the AAA rules in Section II.B.(1) above, the arbitrator is not required by these rules to follow the law. Having an arbitrator who lacks background knowledge in the relevant legal areas can lead to additional expense in educating the arbitrator, which may reduce any efficiencies in arbitration. Together with the lack of precedential value of prior decisions and the very limited ability to appeal a decision, the risk of an adverse decision in arbitration may be too high for the franchisor's risk tolerance, especially if the franchisor has experienced positive results in court.

The limits on the overall arbitration process, including discovery and dispositive motions, also can be concerning to the franchisor. As mentioned above, certain issues may naturally require more discovery to prove the franchisor's claim. If the parties have agreed to limited discovery in the terms of the franchise agreement arbitration provision, this likely will not occur. Even if limitations are not included in the franchise agreement language, the arbitration service provider's rules or the arbitrator may limit the amount of discovery. If the franchisor anticipates that most of the disputes that arise with its franchisees will be related to nonpayment of fees or failure to comply with system standards, it may have concerns about this discovery limitation.

Additionally, if the franchisor or its general counsel have been successful in the past in resolving a dispute with a franchisee by winning a motion for summary judgment or other dispositive motion, they may be cautious about using arbitration given the limitations on the ability and cost related to filing any dispositive motion in arbitration. The inherent uncertainty of their ability to file a dispositive motion and be successful on such motion in an arbitration may also exceed the franchisor's risk tolerance.

One additional reason the franchisor may continue to use litigation as its dispute resolution process relates to franchisors who do not routinely take legal action against their franchisees. If the franchisor prefers to work with franchisees who repeatedly violate the terms of the franchise agreement in lieu of taking legal action against them, there often comes a time when the franchisor decides to take legal action to send a message to the franchise system that it no longer will accept any franchisee's failure to comply with certain terms of the franchise agreement. For example, if the franchisor requires that all franchisees upgrade their point-of-sale (POS) equipment as a result of new technology or changes in the business and a number of franchisees refuse to make this change to the system standard, the franchisor may decide to take action against one or more franchisees to enforce these terms.[31]

While many of the larger and well-established franchisors will not negotiate the terms of their franchise agreement, other franchisors are compelled to negotiate the terms to secure new franchisees and growth by existing franchisees. If arbitration is the chosen dispute resolution process, the strongest franchise agreement provision should contain specific details about a wide variety of arbitration process terms, as discussed in this paper. This can lead to extensive negotiation with a franchisee before reaching an agreement on the arbitration process terms. Defining the dispute resolution process in the franchise agreement as the right of either party to file a lawsuit in state or federal court in the stated jurisdiction eliminates the possibility of an extended negotiation with a prospective or existing franchisee. The franchise agreement does not need specific language about the detailed process of litigation as the civil procedure rules will apply to any litigation.

B. How to Effectively Leverage Threats of Litigation in a Franchise Dispute.

Franchisors may bring lawsuits against franchisees for a variety of reasons, including but not limited to: (i) failure to timely pay the franchisor royalties, advertising fees, and other fees or costs; (ii) failure to comply with the franchisor's system standards by operating the franchised business in a substandard way; (iii) failure to comply with systemwide changes to the system, e.g. new POS systems, new menu items, not participating in systemwide marketing campaigns, or failing to remodel the franchised location; (iv) franchisee's use of the franchisor's trademarks or other protected intellectual property in a manner inconsistent with the franchised business; or (v) franchisee's failure to comply with the post-term obligations in the franchise agreement, including the covenant not to compete.

In all these instances, there can be adverse impacts on the franchisee, especially the many small franchisees who own one or two franchises (compared to large franchisee entities that own multiple brands and locations). To attempt to gain compliance with the franchisor's system standards or franchise agreement terms without resorting to litigation, the franchisor may consider bringing some of these potential litigation issues to the franchisee's attention. The authors address these issues to suggest nonthreatening ways to use these potential impacts to the franchisee to encourage compliance. The franchisor should view litigation (or arbitration) as a last resort process, not a regular aspect of its business.[32]

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[31] Franchisors should be cognizant, however, of potential issues with respect to waiver, selective enforcement/discrimination and related arguments that franchisees may raise. *See* Karen Marchiano, Glenn Plattner & Leonard Vines, *Roadmap for the Default and Termination Process,* ABA 35TH ANNUAL FORUM ON FRANCHISING **W-13** (2012). As noted by these authors, a "new day" letter may be appropriate in these circumstances.

[32] The issues discussed in this Section III.B and the following Section III.C can also apply in the arbitration context and should be considered there as well. However, some of the differences between litigation and arbitration as outlined in this paper, including the public nature of litigation and its potential for protracted proceedings, can heighten these issues in the context of litigation.

First, the cost of litigation can be high. While the franchisee often will retain a smaller law firm and consequently have lower costs than the franchisor, the overall costs can accumulate very quickly. Less sophisticated franchisees might not realize that a failure to appear once litigation is filed by the franchisor will quickly lead to a judgment for the franchisor. It is therefore imperative that they pay a litigator to defend the case. However, smaller franchisees often do not have the available funds to pay an attorney to defend a lawsuit, especially if the case goes to trial. Or the franchisee may be liquid, but the attorneys' fees will quickly wipe out the franchisee's available funds. Franchisors should be aware of the franchisee's financial status. If any of these scenarios pertains to a franchisee not meeting system standards or franchise agreement terms, the franchisor's operations team or members of senior management may want to have a frank discussion with the franchisee about the franchisee's ongoing failures to meet the franchisor's requirements and the franchisor's intent to pursue litigation against the franchisee if the failures are not cured timely. This is especially true if the franchisor has already sent the franchisee one or more default notices without any cure.

If the franchise business has value as an ongoing business, the franchisee can be encouraged to find a buyer for the business in lieu of the franchise agreement being terminated. This not only saves the franchisee the cost of attorneys' fees, but also any liquidated damages the franchisor may be entitled to pursuant to the franchise agreement. If the franchisee agrees to this, the franchisor should have an agreement signed with the franchisee effectively staying the default for a limited period while the franchisee concludes the sale of its business to an approved franchisee/buyer. If the sale is not concluded by this time, the agreement should provide that the franchise agreement is terminated.

Many franchisees also carry bank debt on their business. It is likely that the loan agreement contains covenants that trigger a default of the loan if the covenant is breached. One such covenant may be that the franchisee is operating the franchise business in compliance with the terms of the franchise agreement. Consequently, a termination and subsequent litigation will trigger a default under the loan agreement. Unsophisticated franchisees may not be aware of this risk. Again, the franchisor's operations team or even the CFO may want to have a discussion with the franchisee about their loan covenants and explain how a termination and litigation will negatively impact them. Coming into compliance with the agreement terms and/or system standards can eliminate loan covenant issues and ultimately can be cheaper and easier than defending litigation while renegotiating its loan or dealing with the bank accelerating full payment of the loan.

Another negative consequence of litigation is the amount of time and distraction from operating the business it can cause. This is true for both the franchisee and the franchisor. The franchisee may not realize it will have to be available for depositions or some of its personnel may have to set aside time to be deposed (while being paid their wages by the franchisee). The franchisee will have to spend time collecting documents, especially financial records of the business. If the matter goes to trial, the franchisee will be required to be present in court for all of the trial. The time involved in litigation may be less consequential to a franchisee than the costs but making sure the franchisee knows how much time will be required can only help persuade the franchisee to avoid litigation by curing its defaults.

If a friendly discussion of the costs, loan impact, and time needed for litigation are not enough to convince a franchisee to cure its default(s) to avoid litigation, once the franchisor files litigation against the franchisee and the franchisee hires counsel, the franchisor's litigators may want to make one final attempt to dissuade the franchise's counsel and the franchisee from continuing with the litigation. Today there is a vast library of franchise cases that support the franchisor's right to terminate and/or bring litigation against a franchisee for failing to comply with the terms of the franchise agreement. The franchisor may even have one or more court decisions that support its case based on the same grounds as the current franchisee's defaults. While many franchisees hire a local attorney they know, some do hire from the franchisee bar within the Forum. While experienced franchisee lawyers will know the relevant precedential cases available to the franchisor's counsel, it cannot hurt to have the franchisor's attorney reach out to the franchisee's attorney to discuss the facts of the case from the franchisor's perspective, as well as discuss the cases that support the franchisor's position.

C. Impact of Litigation on Franchise Relationships and the System.

In addition to the time and costs associated with litigation for both a franchisor and franchisee, litigation between the franchisor and a franchisee can impact the overall relationship the franchisor has with its franchisees. It also can disrupt the ongoing business of the franchisor. Franchisors that elect litigation as their dispute resolution process need to be mindful of these issues.

If the franchisor has a high risk tolerance and a low tolerance for noncompliance with the franchise agreement terms and its system standards and therefore tends to litigate often with its franchisees, it likely accepts the costs of such litigation. This franchisor likely has also become used to the interruption in daily business that litigation can cause for various operating departments, such as field operations, accounting, and the legal departments. This franchisor also may have a strained relationship with its franchisees and, if applicable, the franchisee association. Fortunately, most franchisors do not use litigation as a routine part of their business or as the method to gain compliance with its system standards and agreement terms.

It is more likely to find today's franchisors using litigation in a select manner to effectively enforce the terms of their franchise agreement and system standards. If a franchisee is not paying royalties or underreporting sales and has not timely cured these defaults after notice, the franchisor may decide to either file a collection action against the franchisee, or more likely, terminate the franchise agreement and file a lawsuit under the Lanham Act[33] for a preliminary injunction requiring the franchisee to remove all the franchisor's intellectual property from the franchised location. Additionally, the franchisor will seek damages for past due royalties plus damages for the early termination of the franchise agreement. This type of litigation rarely impacts other franchisees in the system. However, in limited circumstances as discussed below, it could have a positive impact on other franchisees.

If a franchisee is not complying with the operating terms of the franchise agreement or the system standards, the franchisor must determine if it has enough evidence to prove this before it files any type of litigation against the franchisee. At this point, the legal department should be involved. Working with the field operations team, numerous operating audits must be performed and the results well documented. If, after numerous failed audits and resulting improvement plans provided by the franchisor or approved by the franchisor, the franchisee remains underperforming, the franchisor may decide to terminate the franchise agreement and file litigation against the franchisee as described above.

Well-meaning executives of the franchisor often want immediate action taken against a franchisee that is not complying with system standards or agreement terms. It is imperative that

[33] 15 U.S.C. § 1051.

the general counsel or members of the legal team stress the need for the appropriate documentation necessary to be successful in any subsequent litigation. This can include a full review of the franchisor's files for the franchisee, further operations audits and reviews of audit reports, and discussions with field operations personnel who support the franchisee. Collecting this information will take time. This is disruptive to the day-to-day business of each department involved but must be made a priority by those departments. This process is often troublesome for the executives of the franchisor, as well as the other individuals involved. However, everyone involved must understand that it is not prudent to terminate a franchise agreement and file litigation against a franchisee unless the franchisor's counsel believes the franchisor has enough proof of the franchisee's failures to be successful in court.

As mentioned above, if the franchisor sends a number of default letters to franchisees at the same time for certain failures, such as failing to update the POS system to the franchisor's new standard, it is likely that the franchisees and their association will push back, creating tension between the franchisees and the franchisor. The franchisor should consider addressing this issue in another manner – more on a one-to-one basis – to reach a less contentious and likely more successful outcome. Additionally, a franchisor should never send a default notice to a franchisee unless it intends to terminate the franchise agreement and file litigation if the franchisee does not timely cure the default. Some franchisors tend to send a number of default letters, often to the same franchisee for the same issue, but never take the next step. At some point, the franchisee is no longer threatened by the default letter since no subsequent action ever occurs. At the same time, word gets out in the franchisee community that the franchisor will not take further action against any franchisee if the franchisee does not cure a default identified in a default letter. This makes the entire default process ineffective within the franchise system.

If a franchisor does pursue termination and litigation with a franchisee that fails to cure operating issues, other franchisees in the system are rarely upset with these actions. Franchisees in the same market as the franchisee that is not following system standards will be happy with the franchisor, as poor operating standards by one franchisee will damage the brand's reputation in that market for all other franchisees. There is often a direct correlation between a franchisee's poor operations and the franchisee's failure to pay royalties. Many operating issues arise as a result of the failure of the franchisee to maintain equipment or the franchised premises, often due to a lack of funds. Surrounding franchisees will be aware of this issue and grateful for the franchisor to act against the defaulting franchisee to improve the brand's reputation in the market.

Regardless of the reason for properly terminating a franchise agreement, most franchisors face the question of what to do with the franchise location once the franchisee's agreement has been terminated. It is likely that the franchisor will not want to lose the franchise location from the system. This creates an issue that the franchisor must address before it makes the decision to terminate the agreement and file litigation. Many franchise agreements give the franchisor the right to purchase the franchised business from the franchisee upon the early termination of the agreement, typically for the then-current fair market value of the assets of the business. The franchisor must work through various issues before it exercises this right within its termination agreement.

These include, but are not limited to, the following issues. First, does the franchisor and its operations team have the capacity to step in and take over this franchised business? Many restaurant franchise systems, particularly quick service restaurants, have locations in smaller towns in more rural areas of the country. Does the franchisor have personnel that can immediately relocate to this town to manage the business? If not, it may be wise to let the location go. Second, what secured debt does the franchisee have on the assets of the business? The debt may exceed the fair market value of the assets today. In that case, is the franchisor willing to assume the balance of the bank debt, thereby effectively increasing the purchase price? Does the business use predominantly leased equipment? If so, is there a reasonable buy-out of the lease(s) or is the franchisor willing to assume the equipment leases? It may not make financial sense for the franchisor to exercise the right to purchase the business. This decision should be made before final action is taken, including filing litigation against the franchisee.

There are franchise systems in business today that have been in business for decades. Some of the original franchisees may still own franchises but have not been as successful today as they were in the past. In newer systems, there could be a number of franchisees today that just have not been able to be successful. These franchise locations may still have the ability to be successful if operated by a stronger franchisee. One method of resolving the issue of underperforming businesses or nonpaying franchisees is to offer them an alternative to termination if they do not or cannot cure the default. In this instance, the franchisor's default notice should still provide the required number of days by which the franchisee must cure the default. If the default is not cured, the franchisor reserves the right to terminate the franchise agreement and file a lawsuit against the franchisee. Alternatively, within the cure period the franchisee may elect the franchisor's offer to allow the franchisee to sell the business to another approved franchisee within a specific timeframe. The franchise agreement is effectively terminated at the end of the default cure period, with the franchisee granted a limited license to continue to use the franchisor's intellectual property and system during the time allowed to sell the business. This process eliminates the issues discussed above regarding whether a franchisor can or wishes to take over the business. The buyer in this instance will work through any debt issues with the terminated franchisee. The buyer will also bring in its own management team to operate the business. Franchisors who want to be firm about compliance with their system standards and agreement terms, but who do not want to constantly be involved in litigation with their franchisees, should be creative about alternatives like this that can be offered to a defaulting franchisee that enable the defaulting franchisee to exit the system and be replaced with a stronger financial and operational franchisee.

One final thought about the impact litigation can have on a franchise system. As mentioned, there are franchisors that do not regularly terminate franchisees' agreements and file litigation against the franchisee. This often can occur for the entire tenure of some executives who may believe it is better to work with a franchisee instead of following an uncured default with a termination. Franchisees quickly learn that demand or default letters will have no negative consequences if they do not cure the default. This can be turned around quickly with just a couple of terminations with subsequent litigation against the terminated franchisee. While most franchisors do not want any litigation in their Item 3, if they have had no litigation against franchisees to disclose for several years or longer, suddenly having one or more cases to disclose in Item 3 can quickly change the perspective of other franchisees that are not complying with the agreement or system standards. Franchisees also communicate with each other regularly so it is fair to expect that news of franchisor-initiated litigation against a terminated franchisee will be quickly spread among the entire franchise system.[34]

Franchisors who elect to use litigation as their dispute resolution process should consider the various impacts litigation can have on their relationship with franchisees and within the franchisor's operations. This is not meant to discourage franchisors from choosing litigation as

[34] As noted above, in these circumstances it may be useful to issue a "new day" letter to all franchisees.

their dispute resolution process, but rather to provide insight into issues the franchisor should be aware of before taking steps to file litigation against a franchisee.

IV. KEY ELEMENTS OF AN ARBITRATION PROVISION AND OTHER DRAFTING CONSIDERATIONS

One of the benefits of arbitration is that a franchisor can tailor its arbitration provision in a manner that not only meets its strategic objectives, including prevailing in the dispute, but also providing a process that resolves the dispute efficiently and effectively without negatively impacting the franchise system in any meaningful way. Section V below addresses the enforceability challenges a franchisor may face with its arbitration provision. This Section IV focuses on the drafting considerations.

Drafting an arbitration provision requires careful consideration of the franchisor's strategic objectives in enforcing its rights under the franchise agreement, including who they want as a decision-maker in a dispute that might be isolated in nature or may have a much broader impact on the franchise system, the venue and forum they desire to utilize in pursuing the dispute and other key points that can directly influence the outcome of a franchise dispute. Each sentence in an arbitration provision can and should cohesively support the franchisor's objectives to arbitrate a dispute efficiently and effectively. In drafting an arbitration provision, counsel should consider various points that could be challenged by a franchisee that would rather litigate the dispute, often in the franchisee's home state, with all the perceived benefits that the franchisee believes is afforded them through litigation rather than arbitration.

Consider the following sample arbitration provision:

> <u>12.A Arbitration.</u> Except as provided in Section 12.B regarding injunctive or other equitable relief, any dispute relating to this Agreement, the Franchised Business or the relationship between Franchisor and Franchisee, Franchisee's Owners or the Affiliates of either Party (the "Dispute), if not settled by negotiation or mediation, must be submitted to binding arbitration under the authority of the Federal Arbitration Act and must be determined by arbitration administered by the American Arbitration Association (AAA) pursuant to its then-current commercial arbitration rules and procedures. The arbitration must take place in the city where the Franchisor's then current corporate headquarters is located at the time of the Dispute (________, _____________, as of the Effective Date). The arbitration must be conducted by a single arbitrator. The arbitrator must follow the law and not disregard the terms of this Agreement. The arbitrator must have at least five years of significant experience in franchise law. Any arbitration must be on an individual basis, and the parties and the arbitrator will have no authority or power to proceed with any claim as a class action or otherwise to join or consolidate any claim with any other claim or any other proceeding involving third parties. If this limitation on joinder of or class action certification of claims within arbitration is held to be unenforceable, then this entire commitment to arbitrate shall become null and void and the parties shall submit all claims to the jurisdiction of the courts. A judgment may be entered upon the arbitration award in any court of competent jurisdiction. The decision of the arbitrator will be final and binding on all parties to the dispute; however, the arbitrator may not under any circumstances: (1) stay the effectiveness of any pending termination of

> this Agreement; (2) assess punitive or exemplary damages; or (3) make any award which extends, modifies or suspends any lawful term of this Agreement or any reasonable standard of business performance that Franchisor sets. Each Party will bear its own costs and expenses for the arbitration and will be responsible to pay 50% of the arbitrator's fees and costs (including arbitrator's and AAA's fees and costs); provided that the prevailing party will be entitled to reimbursement of its fees and costs under Section ___.

The ability to tailor a franchise agreement's arbitration clause means a franchisor should consider alternative provisions based on their particular priorities.

A. The Parties.

The franchisor typically wants all related parties to the dispute to be included in the arbitration, rather than pursuing different parties or defending separate lawsuits that may be venued in different forums. In an attempt to bind non-signatory parties, the arbitration provision might include the following:

> The provisions of this arbitration provision are intended to benefit and bind certain third party non-signatories and will continue in full force and effect subsequent to and notwithstanding the expiration or termination of this Agreement.

The challenge is that a court may be reluctant to enforce an arbitration provision against a non-signatory party.[35] One approach that a franchisor should consider is ensuring that any personal guarantee signed by a guarantor either includes a dispute resolution provision with an agreement to arbitrate that tracks the arbitration provision in the franchise agreement or expressly incorporates the dispute resolution provisions in the franchise agreement by reference. A franchisor should also take the same approach with owners of the franchisee who might not sign a guarantee but are individually named in an ownership addendum or some other similar document. The key is to obtain a written agreement to arbitrate from as many individuals as possible through any type of writing. Examples of this type of agreement can be as simple as a confidentiality agreement.

A franchisor should review all other agreements that a franchisee and its owners and related parties sign that are related in any way to the franchised business. The goal is to make sure that the dispute resolution provisions are consistent. Or if they are not consistent, the different dispute resolution approach should be intentional and not an oversight, while still achieving the franchisor's objectives in prevailing in any dispute and protecting its brand and franchise network. Examples of agreements to be reviewed are personal guarantees, development agreements, leases/subleases, promissory notes, technology agreements, and confidentiality agreements, among others. A franchisor's failure to give careful consideration to the dispute resolution provisions in all ancillary agreements to the franchise agreement can result in bad outcomes with unnecessary litigation costs.[36]

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[35] For a summary of the applicable law regarding enforceability of arbitration provisions against non-signatories, *see infra* Section V.E.

[36] *See* Bradford Scott-Data Corp. v. Physician Computer Network, Inc., 136 F.3d 1156, 1158 (7th Cir. 1998) (arbitration agreement in current agreement not enforceable); *see also* Suburban Leisure Ctr., Inc. v. AMF Bowling Prod., Inc., 468

B. Selection of the Arbitrator.

The franchisor has a choice to state in its arbitration provision whether the dispute should be heard by a single arbitrator or three arbitrators. A primary reason to elect a single arbitrator is the process should be less expensive, not only because the parties will be paying the fees of one arbitrator rather than three, but also three arbitrators generally will take more time discussing the issues among themselves. For example, the cost of the arbitration proceeding often is a driving factor for an emerging franchisor with a limited legal budget, especially if the types of disputes that will be arbitrated are more routine like a typical lawsuit involving contract claims or franchise disclosure violations rather than complex matters where the issues might include antitrust violations. Scheduling the arbitration with a single arbitrator also is easier than the scheduling difficulties that often arise with three arbitrators.

Although three arbitrators are more expensive, some franchisors still choose a three-person panel with the view that three arbitrators are less likely to produce a random decision that the franchisor views is inconsistent with the law or the procedure/rules agreed to in the arbitration provision. With the tendency that three arbitrators will take more time discussing the critical issues in the dispute among themselves, the parties to the arbitration believe going into the proceeding that the arbitrators will give more careful consideration and analysis to each's party's arguments. This is particularly true in a three panel proceeding where each party picks one of the arbitrators or the party has greater influence in selecting at least one of the arbitrators. In this instance the franchisor believes that its selected arbitrator will have a good understanding of the franchise business model and the roles and responsibility of the franchisor in growing, evolving and protecting its franchise system and brand for all brand stakeholders.

The arbitrator selection is a perfect example of a franchisor carefully considering its strategic objectives when drafting its arbitration clause. Here are two sample provisions:

> 1) Franchisor and Franchisee will designate their selection of a single neutral arbitrator, from among those suggested arbitrators identified by the AAA. If the Parties have not submitted their selection of arbitrators in order of preference from among the list provided by the AAA, timely within the period designated by the AAA, the arbitrator will be appointed by the AAA.
>
> 2) Except as otherwise provided in this Article __, any and all disputes between the parties (including their respective officers, directors, shareholders, members or agents), whether or not arising out of or related to this agreement, shall be submitted to a panel of three arbitrators as in accordance with the applicable AAA rules.

C. Authority of the Arbitrator.

One of the frequent franchisee challenges to an arbitration agreement is the authority of the arbitrator, including the threshold issue of who decides whether a claim will be arbitrated or litigated.[37] This part of the arbitration provision is critical for a franchisor constructing a framework

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F.3d 523, 527 (8th Cir. 2006) (arbitration agreement in ancillary agreement did not apply to franchise agreement); Franklin Wolf, Inc. v. Tes Franchising, L.L.C., No. 8:07-CV-1343-T-17MSS, 2008 WL 11335029, at *5 (M.D. Fla. Feb. 19, 2008) (arbitration provision applied despite ancillary agreements).

[37] *See infra* Section V.A.

for the arbitrator to utilize in his or her handling of the arbitration. In addition to the rules of arbitration that might apply (the sample provision above references the Federal Arbitration Act and the AAA's then-current commercial arbitration rules and procedures), in its arbitration provision the franchisor can include any other ground rules that the parties expect the arbitrator to apply. This approach provides more certainty to the arbitration proceedings. One of those threshold issues is arbitrability of a claim and who decides whether a claim will be arbitrated or litigated

Below are sample provisions addressing arbitrability/authority issues, with related key pressure points for a franchisor to consider as it tailors its arbitration clause.

Section V.A. below discusses the core issue of arbitrability, whether the arbitrator has the authority to rule on whether the dispute or various claims raised in the dispute are subject to an arbitration commitment. Franchisees will often raise this issue in the preliminary stages of the dispute as part of their overall strategy to keep the dispute out of arbitration. Rather than spend unnecessary time and money on litigating this issue, a franchisor can address the arbitrability point in the arbitration clause with either of the following provisions:

1) The arbitrator shall decide the gateway issue of arbitrability.

2) Any issue regarding arbitrability of a claim or the enforcement of this arbitration provision will be governed by the Federal Arbitration Act and the federal common law of arbitration.

In tailoring its arbitration provision, a franchisor can establish many of the ground rules that will govern the arbitration process and the responsibilities of the arbitrator during the arbitration, much like the discovery rules and court rules each party will follow in litigation before a court. One of the benefits of addressing these points in the provision itself rather than remaining silent is the certainty that comes with the parties agreeing to and knowing the key rules that will apply to the dispute, like specifically stating that the arbitrator must follow the law and not disregard the terms of the franchise agreement in rendering her decision. A similar provision might state that the arbitrator cannot make any award which extends, modifies or suspends any lawful term of the franchise agreement. A related benefit for a franchisor is that this tailored approach has a higher likelihood of getting consistent decisions on these key issues in other arbitrations regardless of who is serving as the arbitrator. This approach also should eliminate spending time and money in the early stages of the arbitration over procedural roles, which ideally results in the arbitration moving forward to a hearing in an expeditious manner.

The following provisions highlight the key points a franchisor should consider regarding the arbitrator authority and arbitration process:

1) The arbitrator must follow the law and not disregard the terms of this Agreement. The arbitrator will have subpoena powers limited only by the laws of the state in which our corporate headquarters is then located. The arbitrator may not consider any settlement discussions or offers that might have been made by either you or us. The arbitrator may not under any circumstance (a) stay the effectiveness of any pending termination of this Agreement, (b) assess punitive or exemplary damages, (c) certify a class or a consolidated action, or (d) make any award which extends, modifies or suspends any lawful term of this Agreement or any reasonable standard of business performance that we set. The arbitrator will have the right to

make a determination as to any procedural matters as would a court of competent jurisdiction be permitted to make in the state in which our corporate headquarters is then located. The arbitrator will also decide any factual, procedural, or legal questions relating in any way to the dispute between the parties, including: any decision as to whether arbitration is applicable and enforceable as against the parties, subject matter, timeliness, scope, remedies, unconscionability, and any alleged fraud in the inducement.

2) The arbitrator will base his or her decision and award on the terms and conditions of this Agreement and the law, common and statutory, governing this Agreement. The award may include money damages (including Liquidated Damages), specific performance and injunctive relief, and the arbitrator may award the prevailing party (as determined by the arbitrator) part or all of its reasonable costs and attorneys' fees for the proceeding; however, the arbitrator is not empowered to award punitive, exemplary, or other consequential damages. The arbitrator will not have authority to extend, modify or suspend any of the terms of this Agreement. A request for arbitration will not operate to stay, postpone or rescind the effectiveness of a demand for performance or a notice of termination or of non-renewal of this Agreement. The arbitrator may award interest from the date of any damages for breach or other violation of this Agreement, until paid in full, at a rate to be fixed by the arbitrator, but in no event less than 12% per annum or the maximum rate permitted by law, whichever is less.

3) If proper notice of any hearing has been given, the arbitrator will have full power to take evidence or to perform any other acts to arbitrate the matter absent any Party who fails to appear and may, if appropriate, decide the matter on documents only. The Parties to this Agreement waive the making of a record, written or recorded, of any and all arbitration proceedings. Each party waives any objection it may have to venue in those courts, waives any claim the proceedings have been brought in an inconvenient forum, and waives the right to assert that the court does not have jurisdiction over the Party.

4) The arbitrator can issue summary orders disposing of all or part of a claim and provide for temporary restraining orders, preliminary injunctions, injunctions, attachments, claim and delivery proceedings, temporary protective orders, receiverships, and other equitable and/or interim/final relief. The judgment of the arbitrator on any preliminary or final arbitration award will be final and binding and may be entered in any court having jurisdiction. Each party consents to the enforcement of such orders, injunctions, etc., by any court having jurisdiction.

D. Discovery.

One advantage of arbitration can be more limited discovery, which has the benefits of cost containment and a shorter timeframe for the dispute to be resolved. One of the common complaints that franchisors have with litigation is the ever-increasing costs of discovery and the related length of time it takes for parties to complete discovery, especially with the expanded scope of electronic discovery with complex lawsuits.

A franchisor can expressly address discovery issues in its arbitration provision by limiting the number of depositions or hours of depositions a party may take in an arbitration proceeding. The arbitration provision can also limit the number of interrogatories or requests for document production in a franchise dispute or limit the number of witnesses that a party can present at an arbitration hearing. These types of limitations typically benefit a franchisor more than a franchisee, as an experienced franchisee litigator with few or no discovery limitations might try to cause disruption to a franchisor's day-to-day business with depositions of multiple people and significant discovery requests that require the franchisor to spend an inordinate amount of time and legal fees in responding to these discovery requests. Franchisees though should be mindful of initiating that type of approach, as franchisors can reciprocate in ways that will drive up the franchisee's legal fees, often in a way that can create financial hardship on the franchisee.

Even if the arbitration provision is silent, the parties to the arbitration often will submit to the arbitrator the interrogatories, depositions, and document productions they request, with the arbitrator deciding the scope of each. In addition, JAMS and the AAA provide discovery protocols.[38] The JAMS' recommended arbitration protocols identify the relevant factors that a JAMS arbitrator should consider in determining the appropriate scope of discovery, including the nature of the dispute, any agreement of the parties, the relevance and reasonable need of any requested discovery, privilege and confidentiality and the characteristic and need of the parties (financial and human resources of the parties and financial burden imposed by discovery, among others)[39]

The JAMS and AAA protocols include provisions requiring:

1) The arbitrator will set limits on discovery depending on the needs of the parties and the case.[40]

2) That each party is entitled to one deposition of an opposing party and that each side may apply for additional depositions, if necessary.[41]

3) Production of electronic documents must come only from sources used in the ordinary course of business.[42]

Discovery disputes can be decided by a single arbitrator even when the matter is decided by a panel upon agreement by the parties.[43] Details about the scope and manner of discovery can be delegated to an arbitrator.[44]

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[38]JAMS, *Jams Recommended Arbitration Discovery Protocols for Domestic, Commercial Cases* (Jan. 6, 2010) at 5, https://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Arbitration_Discovery_Protocols.pdf.

[39] *Id.* at Exhibit A.

[40] *Id.* at 5.

[41] *Id.* at 6.

[42] *Id.* at 5.

[43] *Id.* at 7.

[44] *See* AAA RULES, *supra* note 18, R. 23 at 22-23. *See* Section V.A for a more fulsome discussion of delegation.

E. **Right to Appeal.**

A common reason that some franchisors prefer to litigate rather than arbitrate is a very limited or no opportunity to appeal the arbitrator's decision, although the second sample provision below does include the right to appeal to a second arbitration panel.[45] The biggest risk of no appeal rights is the losing party having to live with a bad decision. The impact of a bad decision against a franchisor likely will have an impact far beyond that specific arbitration with that specific franchisee party, as other disgruntled franchisees who believe they have grounds that resulted in the award to the initial franchisee will almost certainly consider their options regarding filing arbitration to pursue similar claims.

The following are sample provisions containing appellate rights:

1) The decision and award of the arbitrator will be conclusive and binding upon all Parties to the arbitration. Judgment upon any award(s) rendered by the arbitrator may be entered in any court having jurisdiction. If the award is upheld by a court of competent jurisdiction in a proceeding by either Party to enforce the award or to challenge the award, the Party challenging the award or resisting its enforcement must pay, to the extent permitted by law, all reasonable costs, legal fees, and expenses incurred by the Party defending the award or seeking its enforcement, with interest on the award from its issuance as determined by the court.

2) (a)The award shall be in writing and shall be accompanied by a reasoned opinion. Within thirty days after receipt of the award (which shall not be binding if either party requests a new hearing as provided herein), either party, by notifying the AAA and the other party, may appeal the decision of the initial arbitration panel by requesting a hearing de novo before a second panel of three arbitrators, constituted in accordance with the Commercial Arbitration Rules of the AAA. None of the arbitrators who served on the original panel shall serve on the second panel. The second panel shall conduct a hearing de novo and may adopt the initial award as its own, modify the initial award, or substitute its own award for the initial award. The award of the panel tribunal shall be binding upon both Franchisor and Franchisee upon the confirmation of the award by a court of competent jurisdiction. Each party shall bear its own costs and expenses in connection with the arbitration. The administrative fees and arbitrators' fees shall be allocated equally between the parties.

   (b) A party shall not have the right to appeal an award under subparagraph (a) of this section unless the party: (i) fully cooperated in the exchange of information and discovery as ordered by the arbitration panel in the initial arbitration; (ii) attended all evidentiary hearings after due notice in the initial arbitration; and (iii) paid all administrative fees, arbitrators' compensation, and other

[45] The United States Supreme Court held in 2008 that parties cannot contractually expand the grounds for vacating and modifying an arbitral award. Hall Street Ass., L.L.C. v. Mattel, Inc., 552 U.S. 576, 584 (2008). The court left open the possibility that parties can seek heightened judicial review through (1) enforcement under the judge's case management power under Federal Rule of Civil Procedure 16; (2) enforcement under state law; or (3) enforcement under common law. *Id*. at 588-92.

charges assessed or allocated to the party by the AAA in the initial arbitration.

Both JAMS and the AAA include optional appellate procedures. JAMS allows parties to appeal to three neutral members 14 days after a final award.[46] The appeal panel uses the same standard of review that a first-level appellate court would use in the jurisdiction that would apply to the appeal.[47] The parties receive a decision within 21 days of the oral argument, or if they agree to no argument, the submission of the briefs.[48]

In comparison, the AAA's Optional Appellate Arbitration Rules provide for an appeal to an appellate arbitral panel that applies a standard of review greater than that allowed by existing federal and state statutes. The rules allow parties to appeal on the grounds that the underlying award is based on (1) an error of law that is material and prejudicial, or (2) determinations of fact that are clearly erroneous.[49] However, the parties must agree to use these optional rules.[50] The parties could do this in the franchise agreement or at the beginning of a case.

F. Venue.

Many franchisors include arbitration in their franchise agreements so they can require that the arbitration will take place in the city or county where the franchisor is located. This type of provision is generally enforceable, although certain states with franchise laws have attempted to restrict forum selection provisions. The most common type of state law or regulation that may invalidate a franchise agreement provision is one that prohibits a franchisee from bringing a claim in the franchisee's home state. For example, in Illinois, "[a]ny provision in a franchise agreement that designates jurisdiction or venue in a forum outside of this State is void, provided that a franchise agreement may provide for arbitration in a forum outside of this State."[51] Some courts have held these types of statutes are preempted by the FAA and therefore void.[52] Other states have attempted to limit out of state arbitration clauses by taking the position that out of state arbitration is unfair or inequitable under the state franchise laws or rules.[53]

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[46] JAMS, *JAMS Optional Arbitration Appeal Procedure* (Jun. 2003) at 3–5, https://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Optional_Appeal_Procedures-2003.pdf.

[47] *Id.* at 5.

[48] *Id.*

[49] American Arbitration Association, Optional Appellate Arbitration Rules (Nov. 1, 2013, Rule A-10 at 8-9, https://www.adr.org/sites/default/files/AAA-ICDR_Optional_Appellate_Arbitration_Rules.pdf.

[50] *Id*. at Rule A-1.

[51] 815 ILL. COMP. STAT. ANN. § 705/4. ***See also*** GA. CODE ANN. § 10-1-623 ("Any provision of a franchise or other agreement, under which the parties determine, agree to, control, restrict, establish, limit, or direct the venue in which a cause of action under this article shall be brought, shall be void.").

[52] Bradley v. Harris Rsch., Inc., 275 F.3d 884, 889 (9th Cir. 2001) (CAL. BUS. & PROF. CODE § 20040.5 preempted by the FAA); *see also* KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp., 184 F.3d 42 (1st Cir. 1999) (Rhode Island Franchise Investment Act's bar of all but in-state arbitration forum violates the FAA and was preempted).

[53] *See, e.g.*, WASH. REV. CODE ANN. § 46.96.240 ("It is the public policy of this state that venue provided for in this section may not be modified or waived in any contract or other agreement, and any provision contained in a franchise

G. Exceptions to Arbitration (Injunctive Relief).

One final point that a franchisor should consider in drafting an arbitration provision is the nature and types of claims that the franchisor desires to exclude from the agreement to arbitrate. The principal exception is permitting a party to seek injunctive relief to prevent irreparable harm. Rather than make any exception apply only to instances where the franchisor is seeking injunctive relief, the exception should be mutual where either party can pursue that relief. These exceptions should reflect situations where arbitration is not best suited for the type of relief that is needed to protect the party seeking the relief. For a franchisor, this form of relief is necessary in instances where a franchisee's conduct is causing or threatens to cause irreparable harm to the brand. A common example is where a terminated franchisee continues to operate the business (often refusing to discontinue use of the franchisor's trademarks and other proprietary material) and continue to service customers of the brand.[54] Another example might be where a franchisee is not taking the necessary steps to protect customer information where the harm may impact the entire brand and all brand stakeholders.

A franchisor may have other arbitration exceptions depending on the nature of the franchise business and may even include an exception if the amount in dispute exceeds a designated dollar threshold. An example of injunctive relief based on the nature of the business is a health and safety concern where a franchisee is undercooking hamburger or improperly refrigerating chicken at a fast casual restaurant. When a franchisor encounters this situation with a franchisee, it needs the right to seek immediate injunctive relief from a court rather than go through the procedural steps of initiating an arbitration for relief.

Sample provisions to consider:

1) Exceptions. Notwithstanding Sections ____(a) Mediation) and ___(b) (Arbitration), the parties agree that the following Disputes will not be subject to arbitration or mediation: (i) any action for equitable relief, including seeking preliminary or permanent injunctive relief, specific performance, declaratory relief, other relief in the nature of equity to enjoin any harm or threat of harm to such party's tangible or intangible property, brought at any time, including prior to or during the pendency of any arbitration proceedings initiated hereunder; (ii) any action in ejectment or for possession of any interest in real or personal property; (iii) any action which by Applicable Law cannot be arbitrated; or (iv) our decision in the first instance to issue a notice of default and/or notice of termination, or undertake any other conduct with respect to the franchise relationship that might later result in a dispute or controversy between us.

2) Exception to Arbitration. Notwithstanding the provisions of section ___ above, if the amount in controversy in any dispute between Franchisor and Franchisee exceeds $200,000 in the aggregate, Franchisor shall have the

agreement that requires arbitration or litigation to be conducted outside the state of Washington is void and unenforceable.").

[54] Sashital v. Seva Beauty, LLC, No. 20 C 4692, 2021 WL 1222895, at *5 (N.D. Ill. Mar. 31, 2021) (request for injunctive relief "appear[ed] to fall cleanly within the 'exceptions to arbitration' clause in the Franchise Agreements); Rescuecom Corp. v. Chumley, 522 F. Supp. 2d 429, 451 (N.D.N.Y. 2007) (claims for injunctive relief excepted from franchise agreement).

> right to require that the matter be adjudicated in either the Court of _________ County, ____ or the United States District Court for the ________ District of ________, in lieu of arbitration. If an arbitration demand has already been filed in connection with such a dispute, Franchisor shall have the right to remove the matter to such court.

V. Enforceability Challenges and Other Issues Most Commonly Litigated with an Arbitration Provision

A. <u>Arbitrability.</u>

Arbitrability refers to the issue of whether an arbitrator has the authority to rule on a dispute. The issue of arbitrability most often arises when one party disputes the enforceability of the parties' arbitration agreement or the agreement containing an arbitration clause. The question is whether the subject matter of a party's claim is to be determined by the courts or through arbitration. It is usually the first issue raised in opposition to arbitration to prevent the dispute from reaching an arbitrator.

A common argument that parties use to oppose arbitration is that the arbitration agreement is unenforceable because the entire franchise agreement is unenforceable or invalid. However, parties can compel arbitration to resolve this issue if the franchise agreement it contains a well-drafted delegation provision. A franchise agreement containing an arbitration clause that clearly and unmistakably delegates authority of deciding arbitrability to an arbitrator – often referred to as the "delegation clause" or "delegation provision" – is strong evidence that the parties intended to assign the issue of arbitrability to an arbitrator rather than the courts.[55]

The U.S. Supreme Court set significant precedent on the issue of arbitrability in *Rent-A-Center, West, Inc. v. Jackson*.[56] In *Rent-A-Center*, the plaintiff argued that the arbitration agreement at issue was unconscionable under state law but the court enforced the arbitration clause because it delegated to the arbitrator "any dispute relating to the . . . enforceability or formation of [the] Agreement, including but not limited to any claim that all or any part of [the] Agreement is void or voidable."[57] The court ultimately held that the agreement's delegation of authority to the arbitrator to decide whether the agreement was valid was severable from the rest of the agreement, such that a challenge to the validity of the delegation provision itself was required before a court could intervene.[58] The court further noted that the contract being an arbitration agreement "makes no difference" because "[a]pplication of the severability rule does not depend on the substance of the remainder of the contract."[59] Consequently, under the court's

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[55] In the absence of a delegation clause, "courts presume that the parties intend courts, not arbitrators, to decide what we have called disputes about 'arbitrability.'" BG Grp., PLC v. Republic of Argentina, 572 U.S. 25, 34 (2014). But "courts presume that the parties intend arbitrators, not courts, to decide disputes about the meaning and application of particular procedural preconditions for the use of arbitration," such as "waiver, delay, or a like defense to arbitrability," and "the satisfaction of 'prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate.'" *Id*.

[56] Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63 (2010).

[57] *Id.* at 63.

[58] *Id*. at 68.

[59] *Id*. at 69.

severability rule, if a party does not specifically challenge a delegation clause or provision and instead challenges the franchise agreement as a whole, it can be required to arbitrate even when the franchise agreement is otherwise found unenforceable.[60]

The delegation provision at issue in *Rent-A-Center* granted the arbitrator "exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability, or formation of [the] agreement."[61] In analyzing the delegation provision's language, the court noted that the parties delegated the "gateway" question of enforceability to an arbitrator.[62] Despite the court's decision in *Rent-A-Center*, opponents of arbitration have continued to focus on arbitrability as a way to challenge the enforcement of arbitration agreements. For advocates of arbitration, courts applying *Rent-A-Center* generally do not require such specific language in delegation provisions.

For example, in *Clayborne v. Golden Krust Franchising, Inc.*,[63] the franchisee argued that the issue of the franchise agreements' validity was not compelled to an arbitrator based on the franchise agreements' specific language. The franchisee pointed out that the agreements stated that issues concerning the validity of the franchise agreements' provisions "will be submitted" to arbitration, but they did not state that arbitration "shall be the exclusive forum" to adjudicate such issues.[64] The court noted that other courts have required arbitration even where the agreement used "will" instead of "shall."[65] The court ultimately held that while the franchise agreements' arbitration provisions did reserve something for resolution in court, the issue of the franchise agreements' validity was reserved for the arbitrator, even though it used "will" instead of "shall."[66]

Similarly in *Doctor's Associates v. Kirksey,*[67] a franchisor filed a petition to compel arbitration which the franchisee opposed. The agreement provided in part that "any disputes concerning the enforceability or scope of the arbitration clause shall be resolved under the Federal Arbitration Act[.]"[68] The franchisee argued that its claims did not fall within the scope of the arbitration clause because it addressed "threshold issues" of arbitrability.[69] The court held that, based on the plain language of the clause and incorporation of the American Arbitration Association (AAA) and the American Dispute Resolution Center rules, there was clear and

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[60] Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 448-49 (2006) ("It is true, as respondents assert, that the Prima Paint rule permits a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void. . . . [R]egardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator.").

[61] *Rent-a-Center, West, Inc., supra* n. 56 at 64.

[62] *Id*. at 63.

[63] No. 0:22-CV-62018, 2023 U.S. Dist. LEXIS 23948, at *9 (S.D. Fla. Feb. 10, 2023).

[64] *Id*.

[65] *Id*.

[66] *Id*.

[67] No. 3:18-cv-963 (JCH), 2018 U.S. Dist. LEXIS 197515, at *14 (D. Conn. Nov. 19, 2018).

[68] *Id*. at *15.

[69] *Id*.

unmistakable evidence that the franchise agreement delegated disputes over the scope, enforceability, and validity of the franchise agreement's arbitration clause to the arbitrator.[70]

As evidenced by the holding in *Doctor's Associates v. Kirksey*, the incorporation of arbitration provider rules that grant an arbitrator the power to decide issues of arbitrability also supports the inference of the parties' intention to arbitrate.[71] Including the rules set forth by either the AAA or JAMS in arbitration agreements has also proven successful for advocates of arbitration when arbitrability is being challenged, particularly in the federal circuit courts.[72] Incorporation of such rules is frequently found by courts as "clear and unmistakable evidence" of the parties' intent to delegate questions of arbitrability to the arbitrator.[73] However, parties must be careful not to merely cross reference the AAA or JAMS rules because courts have consistently held that such cross-reference is not clear and unmistakable evidence that the parties delegated the issue of arbitrability to the arbitrator.[74]

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[70] *Id*. at *16.

[71] *Id*.

[72] First Circuit: Awuah v. Coverall N. Am., Inc., 554 F.3d 7 (1st Cir. 2009). Second Circuit: Metro. Life Ins. Co. v. Bucsek, 919 F.3d 184, 191 (2d Cir. 2019). Third Circuit: Richardson v. Coverall N. Am., Inc., 811 F. App'x 100 (3d Cir. 2020). Fourth Circuit: Simply Wireless, Inc v. T-Mobile US, Inc., 877 F.3d 522 (4th Cir. 2017), *abrogated on other grounds by* Henry Schein, Inc. v. Archer & White Sales, Inc., 139 S. Ct. 524 (2019); Willcock v. My Goodness Games, Inc., Case No. PWG-16-4020, 2017 WL 2537010 (D. Md. June 12, 2017). Fifth Circuit: Maravilla v. Gruma Corp., 783 F. App'x 392 (5th Cir. 2019). Sixth Circuit: Blanton v. Domino's Pizza Franchising, LLC, 962 F.3d 842 (6th Cir. 2020); Fruit Creations, LLC v. Edible Arrangements, LLC, Case No. 3:20-cv-00479, 2020 WL 5095460 (M.D. Tenn. Aug. 27, 2020). Seventh Circuit: Kuznik v. Hooters of Am., LLC, Case No. 1:20-cv-01255, 2020 WL 5983879 (C.D. Ill. Oct. 8, 2020); Allscripts Healthcare, LLC v. Etransmedia Tech., Inc., 188 F. Supp. 3d 696 (N.D. Ill. 2016). Eighth Circuit: Giddings v. Media Lodge, Inc., 320 F. Supp. 3d 1064 (D.S.D. 2018) (citing Fallo v. High-Tech Inst., 559 F.3d 874 (8th Cir. 2009)). Ninth Circuit: Esguerra-Aguilar, Inc. v. Shapes Franchising, LLC, Case No. 20-cv-00574-BLF, 2020 WL 3869186 (N.D. Cal. July 9, 2020) (citing Brennan v. Opus Bank, 796 F.3d 1125 (9th Cir. 2015)). Tenth Circuit: Dreamstyle Remodeling, Inc. v. Renewal by Andersen, LLC, Civ. No. 19-1086 KG/JFR, 2020 WL 2065276 (D.N.M. Apr. 29, 2020) (citing Belnap v. Iasis Healthcare, 844 F.3d 1272 (10th Cir. 2017)). Eleventh Circuit: AMC Pinnacle, Inc. v. Jeunesse, LLC, Case No: 6:18-cv-1102-Orl40DCI, 2018 WL 6267314 (M.D. Fla. Nov. 30, 2018) (citing Terminix Int'l Co., LP v. Palmer Ranch Ltd. P'ship, 432 F.3d 1327 (11th Cir. 2005)). Federal Circuit: Qualcomm Inc. v. Nokia Corp., 466 F.3d 1366 (Fed. Cir. 2006), abrogated on other grounds by Henry Schein, Inc. v. Archer & White Sales, Inc., 139 S. Ct. 524 (2019). D.C. Circuit: Sakyi v. Estée Lauder Cos., Inc., 308 F. Supp. 3d 366 (D.D.C. 2018).

[73] *See, e.g*., Tel. Invs. USA, Inc. v. Lumen Techs., Inc., No. 22-cv-2260, 2022 U.S. Dist. LEXIS 129162, at *12 (N.D. Ill. July 20, 2022); Falls v. Soulbound Studios, LLC, No. 2:21-cv-00961-SVW-JPR, 2021 U.S. Dist. LEXIS 185545, at *8 (C.D. Cal. July 6, 2021); Blanton v. Domino's Pizza Franchising LLC, 962 F.3d 842, 846 (6th Cir. 2020); Simply Wireless, Inc v. T-Mobile US, Inc., 877 F.3d 522, 527 (4th Cir. 2017); Belnap v. Iasis Healthcare, 844 F.3d 1272, 1284 (10th Cir. 2017); Cooper v. WestEnd Capital Mgmt., L.L.C., 832 F.3d 534, 546 (5th Cir. 2016); Brennan v. Opus Bank, 796 F.3d 1125, 1130 (9th Cir. 2015); Chevron Corp. v. Republic of Ecuador, 795 F.3d 200, 207–08 (D.C. Cir. 2015); Fadal Machining Centers, L.L.C. v. Compumachine, Inc., 2011 W.L. 6254979, at *2 (9th Cir. 2011); Fallo v. High-Tech Inst., 559 F.3d 874, 878 (8th Cir. 2009); Qualcomm Inc. v. Nokia Corp., 466 F.3d 1366, 1373 (Fed. Cir. 2006); Terminix Int'l Co. v. Palmer Ranch Ltd. P'ship, 432 F.3d 1327, 1332-33 (11th Cir. 2005); Contec Corp. v. Remote Sol., Co., 398 F.3d 205, 208 (2d Cir. 2005); Apollo Comput., Inc. v. Berg, 886 F.2d 469, 473-74 (1st Cir. 1989).

[74] Takiedine v. 7-Eleven, Inc., No. 17-4518, 2019 U.S. Dist. LEXIS 29201, at *27 (E.D. Pa. Feb. 22, 2019). *See also* Richardson v. Coverall N. Am., Inc., Civ. No. 18-532, 2018 U.S. Dist. LEXIS 167240, at *10-11 (D.N.J. Sept. 27, 2018) (holding that a cross-reference to the AAA rules in a franchise agreement was not clear and unmistakable evidence that the parties delegated the issue of arbitrability to the arbitrator); Meadows v. Dickey's Barbecue Rests., Inc., 144 F. Supp. 3d 1069, 1078-79 (N.D. Cal. Nov. 12, 2015) (finding no clear and unmistakable evidence that franchisees intended an arbitrator to decide questions of arbitrability even though the AAA rules were incorporated in the arbitration provision because the franchisees were "far less sophisticated" than the franchisor-defendant).

Even broad language is sufficient to compel arbitration. In *Parrella v. Orange Rabbit, Inc.,* [75] a franchisor moved to vacate an arbitration award in favor of the franchisee. In its discussion of the arbitrability of the agreement, the court noted that "[w]hen an arbitration agreement includes '[b]road language expressing an intention to arbitrate all aspects of all disputes,' that language supports 'the inference of an intention to arbitrate arbitrability.'"[76] The arbitration agreement at issue defined arbitrable issues broadly, and the franchise agreement defined "Dispute" as "any dispute, claim or controversy arising out of or relating to this Agreement or any agreed breach hereof, including any claim that this Agreement or any part hereof is invalid, illegal or otherwise voidable or void."[77] The contract further stated that any "Dispute between us (and/or our affiliated entities) and you (and/or your affiliated entities) that is not resolved through mediation will be resolved through binding arbitration."[78] The court found that the franchise agreement "contemplate[d] issues 'related to' the agreement and claims the agreement itself is 'invalid' or 'void' would be decided by the arbitrator suggest[ed] a delegation of arbitrability questions."[79] On the issue of arbitrability, the court ultimately held that both the franchise agreement's broad definition of arbitrable issues and incorporation of rules granting the arbitrator authority to decide arbitrability were evidence of the parties' clear and unmistakable intent to delegate questions of arbitrability to an arbitrator.[80]

The continued trend favoring the enforcement of arbitration agreements was further evidenced by the U.S. Supreme Court's unanimous decision in *Henry Schein, Inc. v. Archer & White Sales, Inc.,*[81] where the court struck down the "wholly groundless" exception which was previously used by those opposing arbitration to combat delegation provisions in arbitration agreements. Under the "wholly groundless" exception, courts find arbitration agreements unenforceable when the claims at issue are deemed "so plainly outside the arbitration provision that a contrary argument is wholly groundless."[82] A split developed among federal circuits in applying the exception, with the Fifth, Sixth, and Federal circuits adopting the exception,[83] and the Tenth and Eleventh circuits rejecting it.[84] In 2019, the U.S. Supreme Court resolved the circuit

75 No. 20-CV-9923 (RA), 2021 WL 4462809 (S.D.N.Y. Sept. 29, 2021).

76 *Id*. at *8 (citing Metro. Life Ins. Co. v. Bucsek, 919 F.3d 184, 191 (2d Cir. 2019)).

77 *Id*. at *9.

78 *Id*.

79 *Id*.

80 *Id*.

81 139 S. Ct. 524, 531 (2019).

82 Evans v. Building Materials Corp. of America, 858 F.3d 1377, 1382 (Fed. Cir. 2017).

83 Douglas v. Regions Bank, 757 F.3d 460 (5th Cir. 2014) ("The Qualcomm test is an attractive one and most accurately reflects the law – that what must be arbitrated is a matter of the parties' intent."); Turi v. Main Street Adoption Serv., LLP, 633 F.3d 496 (6th Cir. 2011) ("A dispute that plainly has nothing to do with the subject matter of an arbitration agreement, for example, would not give the arbitrator the authority to decide the arbitrability of this wholly unrelated claim.").

84 Jones v. Waffle House, Inc., 866 F.3d 1257, 1268 (11th Cir. 2017) ("We agree that the wholly groundless exception has no place in this analysis."); Belnap v. Iasis Healthcare, 844 F.3d 1272, 1286 (10th Cir. 2017) ("[W]e decline to adopt the "wholly groundless" approach.").

split in *Henry Schein, Inc.*, where the court determined that the exception was "inconsistent with the statutory text and with [its] precedent."[85]

The importance of having a well-drafted delegation clause that clearly and unmistakably gives the arbitrator authority to decide questions of arbitrability is evidenced by the continued challenges to these clauses, even during a time when arbitrability is commonly determined to be decided by the arbitrator. If the parties want an arbitrator to have authority to decide all issues, they should define the arbitrator's authority as broadly as possible to include all issues relating to the enforceability, validity, unconscionability, or scope and not just merely cross-reference the AAA or JAMS (or other arbitration service provider) rules.

B. Unconscionability.

Arbitration is a creature of contract, so a party can challenge the enforcement of an arbitration agreement by arguing any grounds used to dispute the enforceability of a contract. One of those grounds is unconscionability, which is an equitable doctrine that ensures that contracts, "particularly contracts of adhesion," do not impose terms that are overly harsh, unduly oppressive, so one-sided as to shock the conscience, or unfairly one-sided."[86] Generally, the party challenging the validity of an arbitration clause has the burden of proving unconscionability.[87]

In determining unconscionability, courts require a finding of both substantive and procedural unconscionability.[88] However, while both must be present, the two elements do not need to hold the same weight, as most courts apply a sliding scale approach.[89] Substantive unconscionability focuses on whether the terms of the agreements are so one-sided that they unfairly benefit one of the parties to the agreement. Courts weigh various factors to assess substantive unconscionability, but they generally consider the commercial reasonableness of the contract terms, the purpose and effect of the terms, the allocation of the risks between the parties,

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[85] *Id*. at 531 ("In sum, we reject the 'wholly groundless' exception. The exception is inconsistent with the statutory text and with our precedent. It confuses the question of who decides arbitrability with the separate question of who prevails on arbitrability. When the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract.").

[86] Sanchez v. Valencia Holding Co., LLC, 61 Cal. 4th 899, 910-11, 190 Cal. Rptr. 3d 812, 353 P3d 741 (Cal. 2015).

[87] Chin v. Advanced Fresh Concepts Franchise Corp., 194 Cal. App. 4th 704, 708 (Cal. Ct. App. 2011).

[88] *See generally* Bridge Fund Cap. Corp. v. Fastbucks Franchise Corp., 622 F.3d 996, 1004 (9th Cir. 2010); Fensterstock v Educ. Fin. Partners 611 F 3d 124, 134-36 (2d Cir. 2009); Edwards v Hovensa LLC, 497 F 3d 355, 362 (3d Cir. 2007).

[89] Golden Gate Nat'l Senior Care, LLC v. Beavens, 123 F. Supp. 3d 619, 631 (E.D. Pa. 2015) ("where the procedural unconscionability is very high, a lesser degree of substantive unconscionability may be required" (quoting Quilloin v. Tenet HealthSystem Philadelphia, Inc., 673 F.3d 221, 230 (3d Cir. 2012)); Nagrampa v MailCoups Inc., 469 F.3d 1257, 1280 (9th Cir. 2006) (internal quotations and citations omitted) ("In California, the 'prevailing view' is that procedural unconscionability and substantive unconscionability need not both be present to the same degree: Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation . . . in proportion to the greater harshness or unreasonableness of the substantive terms themselves.") (quoting 15 Williston on Contracts § 1763A, at 226-27 (3d ed. 1972)). In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability required to conclude that the term is unenforceable, and vice versa. *See also* Mercuro v Superior Court, 116 Cal. Rptr. 2d 671, 676 (Cal. Ct. App. 2002) ("Given Countrywide's highly oppressive conduct in securing Mercuro's consent to its arbitration agreement, he need only make a minimal showing of the agreement's substantive unconscionability.").

and public policy concerns.[90] Procedural unconscionability refers to how the contract was negotiated and the circumstances of the parties at that time.[91] In determining procedural unconscionability, the court analyzes the existence of "oppression" and "surprise" over the party bringing the claim.[92] While many courts follow similar rules in determining the existence of unconscionability in arbitration agreements, it is a state law issue so the standard may vary by jurisdiction.

Recently, a franchisee successfully established unconscionability of an arbitration agreement in *Streedharan v. Stanley Industrial & Automotive, LLC*.[93] In *Streedharan*, the plaintiff argued that the arbitration agreement in the franchise agreement was procedurally unconscionable because it was a contract of adhesion, in that the agreement was presented to him on a "take-it-or-leave-it basis," where he had no opportunity to negotiate its terms, and it was drafted by the defendant franchisor who held superior bargaining power.[94] The court found that the arbitration agreement had some degree of procedural unconscionability because it was a contract of adhesion.[95] The franchisee further argued that the arbitration agreement was substantively unconscionable because there was a one-way statute of limitations clause; it limited damages that can be recovered; it imposed costs on the franchisee not permitted in court; the JAMS rules referenced limited discovery; the Ohio choice-of-law clause attempted to strip away nonwaivable rights; and the New York forum selection clause imposed significant hardships on the weaker party.[96] The court ultimately found that the one-way statute of limitations, the forum selection provision, the incorporation of JAMS rules regarding fee sharing, and the limit on available remedies were all unconscionable provisions within the arbitration agreement.[97] Thus, the court held that the arbitration agreement within the franchise agreement was "permeated with unconscionability and should not be enforced."[98]

Unconscionability may also exist where provisions in a contract are facially unequal. In *Takiedine v. 7-Eleven, Inc.*, a franchisee successfully challenged the arbitration provision (or, as the court called it, the "no arbitration" agreement) in his franchise agreement with 7-Eleven.[99] The court found that the arbitration provision was procedurally unconscionable because it was presented to the franchisee on a "take it or leave it" basis; the parties were in vastly different bargaining positions with the franchisor holding the power; and the franchisee was under extreme

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[90] Dan Ryan Builders, Inc. v. Nelson, 230 W. Va. 281, 283 (2012).

[91] Fuentes v. Empire Nissan, Inc., 90 Cal. App. 5th 919, 929 (Cal. Ct. App. 2023).

[92] Nagrampa v MailCoups Inc., 469 F 3d 1257, 1280 (9th Cir. 2006).

[93] No. 5:22-cv-0322-MEMF (KSx), 2022 U.S. Dist. LEXIS 176754 (C.D. Cal. Sept. 27, 2022).

[94] *Id*. at *41.

[95] *Id*. at *43.

[96] *Id*.

[97] *Id*. at *55.

[98] *Id*. at *56.

[99] No. 17-4518, 2021 WL 3223070 (E.D. Pa. July 29, 2021).

financial compulsion.[100] The court also determined that the arbitration provision was substantively unconscionable. It completely prevented the franchisee from litigating his claims anywhere, either in a court or arbitration, which "completely [shut] and lock[ed] down any avenue for relief" for the franchisee because claims were handled by a Franchise Selection Committee.[101] After determining that the arbitration provision was both procedurally and substantively unconscionable, the court held that the arbitration agreement was unconscionable under Pennsylvania law and that the FAA did not preempt Pennsylvania's unconscionability defense.[102]

Even when a franchise agreement provides for the severability of its provisions, a court might not sever unconscionable parts of an arbitration provision. For example, in *Escobar v. National Maintenance Contractors, LLC*,[103] the Ninth Circuit reversed an Oregon district court's ruling on severability, holding that severance was inappropriate because the arbitration agreement was too permeated with unconscionable provisions.[104] While the district court agreed with the plaintiffs' claims that the forum selection clause in the franchise agreements was unconscionable because it denied the low-income Washington- and Oregon-based plaintiffs the ability to arbitrate, it severed the unconscionable provisions.[105] The lower court reasoned that severability was appropriate because the franchise agreement provided for severability and the offending provisions were not sufficiently pervasive to render the entire franchise agreement unconscionable.[106] On appeal, however, the Ninth Circuit reversed because the arbitration agreement was too permeated with unconscionable provisions.[107] The court further held that it could not sever unconscionable provisions that would require the court to rewrite aspects of the contract.[108] The Ninth Circuit ultimately concluded that the entire arbitration agreement was substantively unconscionable and unenforceable.[109]

Unconscionability challenges to arbitration provisions are not always determined by the court. The importance of directing the unconscionability allegation at the delegation provision specifically was demonstrated in *Fatt Katt Enterprises, Inc. v. Rocksolid Granit (USA), Inc*.[110] In *Fatt Katt Enterprises*, a franchisor terminated the franchise agreement due to the franchisee's alleged breach of certain sections, and the franchisee filed suit seeking a declaration that the arbitration provision and restrictive covenants were unenforceable. The franchisor moved to stay

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[100] *Id*. at *6.

[101] *Id*. at *8.

[102] *Id*.

[103] Nos. 21-35765, 21-35780, 2022 U.S. App. LEXIS 35276, at *6-7 (9th Cir. Dec. 21, 2022).

[104] *Id*. at *6.

[105] *Id*.

[106] *Id*.

[107] *Id*.

[108] *Id*. at *7.

[109] *Id*.

[110] No. 1:17-CV-1900-MHC, 2018 U.S. Dist. LEXIS 8119 (N.D. Ga. Jan. 11, 2018).

or dismiss the action and to compel arbitration.[111] The franchisee opposed the motion arguing that the franchise agreement containing the arbitration provision was substantively and procedurally unconscionable.[112] The court found that although the franchisee argued that "the arbitration provisions [were] unconscionable," and claimed that it "d[id] not contend that the entire Franchise Agreement [was], in whole, unconscionable," the franchisee's arguments of substantive and procedural unconscionability were not specifically directed at the delegation provision.[113] The court noted that the crux of the franchisee's argument that the franchise agreement was substantively unconscionable was directed to the restrictive covenants, and the argument that the franchise agreement was procedurally unconscionable was clearly directed at the franchise agreement as a whole; neither argument specifically addressed the delegation clause.[114] Citing *Rent-a-Center*, the court held that the franchise agreement clearly delegated unconscionability challenges to an arbitrator because the arbitration provision provided that "all disputes and claims relating to the agreement or any other claims relating to the making, interpretation, or performance of either party under the agreement" must be settled by arbitration, and thus, the franchisee's unconscionability claim had to be decided by an arbitrator.[115]

C. <u>Waiver.</u>

Generally, waiver is the intentional relinquishment or abandonment of a known right.[116] Waiver, in the context of arbitration, may be inferred where a party fails to seek arbitration, or its conduct in litigating a matter evidences its intent to litigate rather than arbitrate the claims at issue. Such an inference to litigate may preclude a party from later asserting that the case should be arbitrated. The question of whether a party has waived its right to arbitration is fact-specific and determined on a case-by-case basis. However, courts are generally reluctant to find a waiver. This reluctance derives from the strong presumption in favor of arbitration and against waiver found in the FAA.[117]

The more that parties engage in the litigation process without seeking to compel arbitration, the greater the likelihood that courts will find that they waived their right to compel arbitration. This risk of waiver was heightened in 2022 when the U.S. Supreme Court set a significant precedent in *Morgan v. Sundance, Inc.*[118] by eliminating the requirement that a party show prejudice on a claim of waiver.

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[111] *Id*. at *5.

[112] *Id*. at *12.

[113] *Id*.

[114] *Id*. at *14-15.

[115] *Id*. at *15.

[116] *See* Dones v. Life Ins. Co. of N. Am., 55 Cal. App. 5th 665, 677-78 (Cal. Ct. App. 2020).

[117] In re Bath Junkie Franchise, Inc., 246 S.W.3d 356, 367 (Tex. Ct. App. 2008).

[118] 142 S. Ct. 1708, 1712 (2022).

To mitigate the risk of waiver, parties should clearly express their intent to compel arbitration at the start of litigation, limit litigation activity that is inconsistent with their right to arbitrate, and promptly move to compel arbitration.

In *Morgan*, the Supreme Court held that federal courts may not adopt an arbitration-specific rule conditioning a waiver of the right to arbitrate on a showing of prejudice by the delay in seeking arbitration.[119] The Supreme Court reasoned that the FAA's "policy favoring arbitration" served only to treat "arbitration contracts like all others" and not to foster arbitration.[120] Following *Morgan*, several district courts have held that *Morgan* rejected the precedent set on the prejudice requirement previously enforced by various courts.[121] In general, that prior precedent, seemingly based on what the Supreme Court referred to as "the liberal national policy favoring arbitration," required a party who opposed arbitration to show that it was prejudiced by the other party's delay in seeking arbitration.

The Second Circuit recently recognized that *Morgan* "fully support[ed]" its determination, in a pre-*Morgan* decision applying the three-part test, that a movant had not waived its right to arbitrate because its conclusion rested "not merely" on a lack of prejudice to the non-movant but also on the fact that the movant had not "engaged in litigating any substantial merits questions" before seeking arbitration."[122] Following this conclusion, the U.S. District Court for the Southern District of New York held that pre-*Morgan* decisions are still "good law to the extent they discuss grounds for or against waiver independent of prejudice."[123] The Second Circuit's waiver analysis considers "the time elapsed from when litigation was commenced until the request for arbitration" and "the amount of litigation to date, including motion practice and discovery."[124] In the Second Circuit, courts generally find a party has waived arbitration when it "engages in protracted litigation, such as extensive pre-trial discovery and substantive motions over the course of several months before seeking arbitration."[125]

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[119] *Id*. at 1712-14 (rejecting Eighth Circuit's rule finding waiver where a party knew of the right to arbitrate, "acted inconsistently with that right," and "prejudiced the other party by its inconsistent actions.").

[120] *Id*. at 1713 (citing Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 218-21 (1985)).

[121] Vollmering v. Assaggio Honolulu, LLC, No. 2:22-CV-00002, 2022 WL 6246881, at *12 (S.D. Tex. Sept. 17, 2022), report and recommendation adopted, No. 2:22-CV-00002, 2022 WL 6250679 (S.D. Tex. Oct. 6, 2022); Gaudreau v. My Pillow, Inc., No. 6:21-CV-1899-CEM-DAB, 2022 WL 3098950, at *6 (M.D. Fla. July 1, 2022); McBurnie v. Acceptance Now, LLC, No. 3:21-CV-01429-JD, 2022 WL 17342195, at *2 (N.D. Cal. Nov. 30, 2022).

[122] Nicosia v. Amazon.Com, Inc., No. 21-2624, 2023 U.S. App. LEXIS 1259 at *4 n.2 (2d Cir. Jan. 19, 2023) (quoting Nicosia v. Amazon.com, Inc., 815 F. App'x 612, 614-15 (2d Cir. 2020)).

[123] Boustead Sec., LLC v. Leaping Grp. Co., Ltd., No. 20-CV-3749, 2023 US Dist. Lexis 25208 (S.D.N.Y. Feb. 14, 2023).

[124] LifeTree Trading Pte., Ltd. v. Washakie Renewable Energy, LLC, 764 F. App'x 105, 107 (2d Cir. 2019) (quoting Louisiana Stadium & Expo. Dist. v. Merrill Lynch, Pierce, Fenner & Smith Inc., 626 F.3d 156, 159 (2d Cir. 2010)); Johnson v. Ensite USA, Inc., No. 21-CV-4437, 2022 U.S. Dist. LEXIS 27058, at *4 (S.D.N.Y. Feb. 15, 2022) ("In determining whether [the] [d]efendant has waived its right to arbitration, the [c]ourt considers such factors as '(1) the time elapsed from the commencement of litigation to the request for arbitration [and] (2) the amount of litigation (including any substantive motions and discovery)[.]'").

[125] Boustead Sec., LLC v. Leaping Grp. Co., Ltd., No. 20-CV-3749, 2023 U.S. Dist. LEXIS 25208, at *4-5 (S.D.N.Y. Feb. 14, 2023).

Recently, the U.S. Court of Appeals for the Ninth Circuit in *Armstrong v. Michaels Stores, Inc.*[126] found the defendant did not waive its right to arbitrate. The Ninth Circuit concluded that "the party asserting waiver must demonstrate: (1) knowledge of an existing right to compel arbitration and (2) intentional acts inconsistent with that existing right."[127] Ninth Circuit courts find inconsistent acts when the movant "makes an intentional decision not to move to compel arbitration" and "actively litigates the merits of a case for a prolonged period of time in order to take advantage of being in court."[128] In its waiver analysis, the *Armstrong* court also noted that "seeking a decision on the merits of a key issue in a case indicates an intentional and strategic decision to take advantage of the judicial forum."[129] The court ultimately held that the defendant did not waive its right to arbitrate because he repeatedly reserved its right to arbitration, did not ask the district court to weigh in on the merits, and did not engage in any meaningful discovery.[130]

In *Warrington v. Rocky Patel Premium Cigars, Inc.*, [131] the U.S. Court of Appeals for the Eleventh Circuit considered "whether a party had substantially invoked the litigation machinery prior to demanding arbitration." The court noted that a party "[a]cting in a manner inconsistent with [its] arbitration rights and then changing course mid-journey smacks of outcome-oriented gamesmanship played on the court and the opposing party's dime."[132] It further noted that the key is "fair notice" to the opposing party and the district court of a party's intent to exercise its arbitration rights.[133] The *Warrington* court affirmed the lower court's denial of the motion to compel arbitration, holding that the defendant evinced a clear intent to litigate the matter at issue before asserting his right to arbitrate because he initially filed suit in state court to enforce his rights under the agreement, then he attempted to force plaintiff's federal action down to the state court to be joined with his action there all before seeking to compel arbitration.[134]

As demonstrated by the court's waiver analysis post-*Morgan*, time is a significant factor that courts weigh when deciding when a party has waived its right to arbitration. Thus, parties who want to arbitrate should seek arbitration at the commencement of litigation. After a suit is filed, the probability of waiving arbitration increases as the litigation progresses, especially where there has been no attempt to compel arbitration. The *Morgan* decision has heightened the significance of timely moving to compel arbitration. Even if parties have communicated their intent to compel arbitration, their intent is not confirmed until they move to compel arbitration.[135]

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[126] 59 F.4th 1011 (9th Cir. 2023).

[127] *Id*. at 1014.

[128] *Id*. at 1015 (quoting Newirth ex rel. Newirth v. Aegis Senior Cmtys., LLC, 931 F.3d 935, 941 (9th Cir. 2019)).

[129] *Id*.

[130] *Id*. at 1016.

[131] No. 22-12575, 2023 US App Lexis 3083 (11th Cir. Feb. 08, 2023).

[132] *Id*. at *4.

[133] *Id*.

[134] *Id*.

[135] *See, e.g.*, In re Mirant Corp., 613 F.3d 584, 591 (5th Cir. 2010).

Whether a party waives its right to arbitrate by engaging in limited court proceedings typically depends on the specific facts and circumstances of the case, including the language of the parties' arbitration agreement and the type of proceedings in which the party has engaged. When a party wishes to arbitrate the claims at issue, the party should immediately communicate its intent to arbitrate in order to preserve its arbitration rights. Courts typically consider "whether a party has informed its adversary of the intention to seek arbitration even if it has not yet filed a motion to stay the district court proceedings."[136] If a party must file an answer before moving to compel arbitration, it should include arbitration as an affirmative defense or defense as a safeguard to prevent waiving its right to arbitrate[137] as courts have held that failure to raise arbitration as an affirmative defense shows a party's intent to litigate rather than arbitrate.[138]

In addition to asserting the right to arbitrate as soon as possible, a party that intends to arbitrate must avoid "consistently and actively" participating in litigation.[139] When waiver is determined based on a party's active participation in litigation, the waiving party likely acted inconsistent with the intent to arbitrate on multiple occasions. In *Hurley v. Deutsche Bank Trust Company Americas*, [140] the court found waiver where the defendant "responded to actions taken by [the] [p]laintiffs… [and] filed multiple dispositive and non-dispositive motions… including motions to dismiss, motions for summary judgment, and a motion to change venue.

In *McCoy v. Walmart, Inc.*,[141] the court found a party waived its right to arbitrate because it "took several actions that were inconsistent with its right to arbitrate," including filing two motions to dismiss. The *McCoy* court emphasized that "[e]ven a single attempt to seek 'immediate and total victory' on the merits can waive arbitration."[142] However, where a party seeks dismissal solely on jurisdictional grounds, waiver is less likely to be found, especially where the party asserts the right to arbitrate within the motion.[143] Additionally, some circuits have held that seeking the dismissal of a frivolous claim or using a motion to dismiss to sort out arbitrable and non-arbitrable claims may be consistent with the intent to arbitrate.[144]

The probability of waiving the right to arbitrate is significantly heightened when a party files a motion for summary judgment. The Second Circuit has stated that any motion for summary judgment would constitute waiver of the right to compel arbitration.[145] The Seventh Circuit has

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[136] Ehleiter v. Grapetree Shores, Inc., 482 F.3d 207, 222 (3d Cir. 2007).

[137] Hilti, Inc. v. Oldach, 392 F.2d 368, 371 (1st Cir. 1968).

[138] Johnson Assocs. Corp. v. HL Operating Corp., 680 F.3d 713, 718 (6th Cir. 2012).

[139] 610 F.3d 334, 339 (6th Cir. 2010).

[140] *Id*.

[141] 13 F.4th 702, 704 (8th Cir. 2021).

[142] *Id*. at 704 (quoting Hooper v. Advance Am., Cash Advance Ctrs. of Mo., Inc., 589 F.3d 917, 922 (8th Cir. 2009)).

[143] *See, e.g.*, McCoy, 13 F.4th at 704. *See also* Dumont v. Saskatchewan Gov't Ins. (SGI), 258 F.3d 880, 886–87 (8th Cir. 2001).

[144] *See, e.g.*, Khan v. Parsons Glob. Servs., Ltd., 521 F.3d 421, 427 (D.C. Cir. 2008).

[145] Sweater Bee by Banff, Ltd. v. Manhattan Indus., Inc., 754 F.2d 457, 465 (2d Cir. 1985) (dictum).

similarly stated that a motion for summary judgment is an "[e]specially telling" factor in assessing whether a party waived a right to arbitration.[146] The District of Columbia Circuit has held that "filing a motion for summary judgment based on matters outside of the pleadings is inconsistent with preserving the right to compel arbitration; if the motion is accompanied by a motion to compel arbitration in the alternative, the movant takes the risk that the district court will choose to rule on the motion for summary judgment, thereby preventing the movant from subsequently seeking arbitration."[147]

Whether filing a non-dispositive motion alone will result in waiver is less clear and ultimately depends on the particular circuit's precedent. However, the *Morgan* court's removal of the prejudice requirement may make waiver by filing a non-dispositive motion more probable. The Eighth Circuit found that where a party joined a request to transfer venue to another judicial district, a "preference for litigation" over arbitration was clear.[148] However, both the Seventh Circuit and the Fifth Circuit have held that "a motion to transfer venue does not constitute waiver of the right to arbitrate."[149] If a non-dispositive motion is filed in addition to engaging in other litigation activities, it is more likely to result in waiver.

It is important to note that the decision of whether waiver has occurred is typically decided by a court rather than an arbitrator. As the Eighth Circuit stated, "when the relevant conduct happens in court, waiver is for the judge, rather than an arbitrator, to decide."[150]

D. <u>Statutory Preclusion.</u>

Another challenge raised by parties opposing arbitration is that the right to arbitrate violates a state statute or rule. Franchisees often point to state franchise statutes that prevent franchise agreements from requiring potential claims to be resolved through arbitration because doing so forces franchisees to waive their right to a jury trial.[151] For advocates of arbitration of franchise disputes, the trend overwhelmingly disfavors such preclusion.

The trend favoring arbitration usually results from courts relying on the FAA and its preemptive effect on state laws. Section 2 of the FAA is the basis of the U.S. Supreme Court's

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[146] St. Mary's Med. Ctr. of Evansville, Inc. v. Disco Aluminum Prods. Co., 969 F.2d 585, 589 (7th Cir. 1992) (citing Sweater Bee by Banff, Ltd. v. Manhattan Indus., Inc., 754 F.2d 457, 465 (2d Cir. 1985)).

[147] Khan v. Parsons Glob. Servs., 521 F.3d 421, 428 (D.C. Cir. 2008).

[148] Sitzer v. Nat'l Ass'n of Realtors, 12 F.4th 853, 856 (8th Cir. 2021).

[149] Sharif v. Wellness Int'l Network, Ltd., 376 F.3d 720, 727 (7th Cir. 2004).

[150] McCoy v. Walmart, Inc., 13 F.4th 702, 704 (8th Cir. 2021). *See also* Sitzer, 2021 U.S. App. LEXIS 27244, at *2-3 (discussing the various types of waiver and who gets to decide them); N&D Fashions, Inc. v. DHJ Indus., Inc., 548 F.2d 722, 728 (8th Cir. 1976).

[151] *See, e.g.*, Minn. R. 2860.4400(J) ("It shall be unfair and inequitable for any person to . . . require a franchisee to waive his or her rights to a jury trial or to waive rights to any procedure, forum, or remedies provided for by the laws of the jurisdiction.").

expansive decisions preempting state laws.[152] *AT&T Mobility LLC v. Concepcion*[153] is a landmark decision on this topic. In *AT&T Mobility*, the parties' agreement mandated arbitration of any disputes that arose between the parties but specifically prohibited class arbitration.[154] Opposing the exclusion of class arbitration under the agreement, Concepcion filed suit and the Ninth Circuit found that the arbitration provision was unconscionable under California's *Discover Bank* rule, which provided that class-action waivers in consumer contracts of adhesion were unconscionable in cases where a party with superior bargaining power was alleged to have cheated large numbers of consumers out of individually small sums of money. However, the U.S. Supreme Court held that because the California statute "st[ood] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress [with regard to the FAA]," the FAA preempted the statute."[155] The Supreme Court noted that "the overarching purpose of the FAA… is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings," and "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[156]

The Supreme Court's holding ultimately impacted similar state statutes restricting arbitration agreements, especially given the court's prior decision in *Citizens Bank v. Alafabco, Inc.*,[157] which found that because the FAA "'provides for the enforcement of arbitration agreements within the full reach of the Commerce Clause,' it is perfectly clear that the FAA encompasses a wider range of transactions than those actually in commerce – that is, 'within the flow of interstate commerce.'" As a result, numerous courts have rejected arguments that state franchise statutes preclude arbitration.[158]

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152 Section 2 of the FAA states, in part, that agreements to arbitrate "in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

153 563 U.S. 333 (2011).

154 *Id*.

155 *Id*. at 352.

156 *Id*. at 344.

157 539 U.S. 52, 56 (2003) (quoting Perry v. Thomas, 482 U.S. 483, 490 (1987) and Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 272 (1995)).

158 *See, e.g.*, Bradley v. Harris Research, 275 F.3d 884 (9th Cir. 2001) (holding that FAA preempted out-of-state venue restriction in California franchise statute); KKW Enters. v. Gloria Jean's Gourmet Coffees Franchising Corp., 184 F.3d 42 (1st Cir. 1999) (holding that FAA preempted out-of-state venue restriction in Rhode Island franchise statute); Doctor's Assocs. v. Hamilton, 150 F.3d 157 (2d Cir. 1998) (holding that FAA preempted out-of-state venue restriction in New Jersey franchise statute); Mgmt. Recruiters Int'l, Inc. v. Bloor, 129 F.3d 851, 856 (6th Cir. 1997) (holding that validity of Washington franchise statute "would be in serious doubt as a result of the preemptive effect of the FAA" if it "imposed an absolute requirement of in-state arbitration notwithstanding the parties' agreement to arbitrate" elsewhere); Alphagraphics Franchising v. Whaler Graphics, 840 F. Supp. 708 (D. Ariz. 1993) (holding that FAA preempted out-of-state venue restriction in Michigan franchise statute); Saturn Distrib. Corp. v. Williams, 905 F.2d 719, 724 (4th Cir. 1990) (holding that the FAA preempted a Virginia law that made it unlawful for automobile manufacturers and distributors to fail to include a particular clause in franchise agreements); Perry v. Thomas, 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987) (holding that the FAA preempts statute allowing actions for the collection of wages notwithstanding existence of an arbitration agreement); Southland Corp. v. Keating, 465 U.S. 1 (1984) (holding that the FAA preempts state statute requiring judicial forum for claims under state Franchise Investment Law).

But not all courts hold that the FAA preempts state franchise laws, especially when the arbitration agreement specifically references the franchisee's right to file a lawsuit under those state laws. In *Chorley Enterprises Inc. v. Dickey's Barbecue Restaurants, Inc.,*[159] the Fourth Circuit held that the FAA did not preempt a Maryland statute that required franchisors to include a provision in their franchise agreement that preserved the franchisee's right to litigate certain claims. The court ultimately held that some of the disputed claims had to be litigated while the others could proceed through arbitration, reasoning that the franchisor "was not forced to do anything" because "[i]t could have simply declined to do business in Maryland" or "filed a declaratory action challenging the [state's] position before including the Maryland Clause in its agreements."[160] The court noted that the "FAA preemption prevents states from carving out wholesale exceptions to arbitration [but] does not prevent private parties from agreeing to litigate, rather than arbitrate, specific claims." In support of its holding, the court reiterated that "the parties were free under Maryland Franchise Law to either arbitrate or litigate the [f]ranchisees' claims."

Ultimately, the trend favoring the FAA's preemption of state franchise laws remains dominant.[161] The Nevada Supreme Court's decision in *U.S. Home Corporation v. The Michael Ballesteros Trust* further confirms this trend in holding that "[t]he Supreme Court has made unmistakably clear that, when the FAA applies, it preempts state laws that disfavor arbitration."[162]

E. <u>Who is Bound.</u>

It is well-settled that signatories to an agreement to arbitrate are bound by it. As signatories on a franchise agreement, the franchisor and franchisee should be bound by any arbitration provision in the agreement.[163] If the franchisee signs the arbitration agreement individually and on behalf of an LLC or other self-formed corporation, both the individual and entity would be bound.[164]

Parties may also be able to enforce the terms of an arbitration agreement against non-parties, depending on applicable state law. Section 2 of the FAA states that franchise agreements will be enforceable "save upon such grounds as exist at law or in equity for the

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[159] 807 F.3d 553, 558 (4th Cir. 2015).

[160] *Id*.

[161] *See* Kindred Nursing Ctrs. v. Clark, 137 S. Ct. 1421 (2017) (holding that Kentucky's "clear-statement rule," requiring an explicit statement in a power of attorney that the attorney-in-fact has authority to waive the principal's right to a jury trial, disfavors arbitration agreements, and thus, the rule was preempted by the FAA); Doctor's Assocs., Inc. v. Desai (In re Patwari), No. 08-26178 (JKS), 2016 Bankr. LEXIS 1139, at *15 (Bankr. D.N.J. Apr. 7, 2016) (finding that the FAA preempts the New Jersey Franchise Practices Act).

[162] United States Home Corp. v. Ballesteros Tr., 134 Nev. 180, 188 (2018) (citing AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 341 (2011)).

[163] Arthur L. Pressman & Justin M. Klein, *The Strategy of Arbitration*, ABA 35TH ANNUAL FORUM ON FRANCHISING W-10, at 8 (2012) ("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").

[164] *Id.*

revocation of any contract."[165] The FAA does not "alter background principles of state contract law regarding the scope of agreements (including the question of who is bound by them)."[166]

The Supreme Court has held that the "traditional principles of state law" that apply under the FAA "include doctrines that authorize the enforcement of a contract by a nonsignatory."[167] Nonsignatories to franchise agreements can therefore be liable through state-law doctrines like assumption, piercing the corporate veil, alter ego, incorporation by reference, third-party beneficiary theories, waiver and estoppel." [168]

This has important implications for franchise systems that may involve parties that benefit from, but are not signatories to, the franchise agreement. At least one court has applied the existing Supreme Court precedent to hold non-signatories bound by a franchise agreement under a third-party beneficiary theory. In *Torres v. Simpatico, Inc.*, the relevant franchise system contained both "master (regional) franchisors" and "various individuals associated with the franchise system."[169] The court held that non-signatory master franchisors were third-party beneficiaries, and thus bound to unit-level franchise agreements and the arbitration provisions within them. It also held that the "owners, operators, agents, officers, or employees" of the master franchise agreement were similarly bound.[170]

Franchisors and franchisees should think critically about how nonparties may or may not be bound to franchise agreements as third-party beneficiaries. The best practice is to try, whenever possible, to have all relevant parties sign the relevant franchise agreements.

F. **What is Covered.**

Another important consideration for any arbitration agreement is what disputes are covered. The Supreme Court has made clear that the scope of an arbitration agreement should be decided "with a healthy regard for the federal policy favoring arbitration," and "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration."[171] Any doubts as to whether something should be arbitrated must be resolved in favor of coverage.[172] Courts are disinclined to treat arbitration clauses as severable from the contract in which it appears and will thus lean in favor of applying the clause to all disputes.[173]

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[165] 9 U.S.C. § 2.

[166] Arthur Andersen LLP v. Carlisle, 556 U.S. 624, 630 (2009).

[167] GE Energy Power Conversion France SAS, Corp. v. Outokumpu Stainless USA, LLC, 140 S. Ct. 1637, 1643–44 (2020).

[168] *Id.*

[169] 995 F. Supp. 2d 1057, 1060 (E.D. Mo. 2014), *aff'd*, 781 F.3d 963 (8th Cir. 2015)

[170] *Id.*

[171] Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24–25 (1983).

[172] AT&T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 650 (1986).

[173] Granite Rock Co. v. Int'l Bhd. Of Teamsters, 130 S. Ct. 2847, 2857 (2010).

Parties to franchise agreements have wide latitude to shape the agreements according to their preferences. They can specify with whom they will arbitrate, the issues subject to arbitration, the rules by which they will arbitrate, and the arbitrators who will resolve their disputes."[174]

The parties can agree to carve out certain disputes from an arbitration clause.[175] Often, a franchise agreement will exclude disputes to seek injunctive or declaratory relief.[176] These carve outs often specifically refer to the right to go to court to seek injunctive relief for trademark or other intellectual property infringement or declaratory relief involving interpretation of the franchise agreement.[177] Parties can specify a particular jurisdiction to consider those disputes. These types of carve outs allow franchisors to move quickly and seek immediate relief in response to potential infringement or other urgent matters.

Arbitration agreements can also address joinder of multiple parties.[178] Parties can agree that similar actions brought by separate parties can be joined in arbitration. This can prevent confusing and inefficient parallel actions. Parties can also avoid class or mass arbitration with effective drafting.[179] The Supreme Court has made clear that consent to arbitrate between individuals is meaningfully different from consent to arbitrate a class action.[180] As a result, courts "may not infer consent to participate in class arbitration absent an affirmative 'contractual basis for concluding that the party *agreed* to do so."[181]

In any dispute regarding what is covered, courts will determine whether the parties have a valid agreement to arbitrate.[182] If they do, the case will go to arbitration. It is then up to the arbitrator to determine what the arbitration contract means, including the scope of the arbitration clause and which disputes are covered. The arbitrator can apply common law contract principles to resolve those disputes.

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[174] Lamps Plus, Inc. v. Varela, 139 S. Ct. 1407, 1416 (2019).

[175] Pressman & Klein, *supra* n. 163, at 11.

[176] *Id.* at 12 (noting that "[t]ypically, 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.").

[177] *Id.*

[178] Pressman & Klein, *supra* n. 163, at 13 ("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.").

[179] *See, e.g.*, Bar-Ayal v. Time Warner Cable Inc., No. 03 CV 9905 KMW, 2006 WL 2990032, at *16 (S.D.N.Y. Oct. 16, 2006) (upholding class limitation in arbitration agreement).

[180] Lamps Plus, Inc. v. Varela, 139 S. Ct. 1407, 1416 (2019).

[181] *Id.*

[182] Bazzle v. Green Tree Fin. Corp., 539 U.S. 444, 452 (2003); Pressman & Klein, *supra* n. 163, at 11.

G. Forum Selection And Venue Clauses.

Parties to a franchise agreement typically can select the venue for their arbitration. Forum selection clauses help franchisors control the costs associated with arbitration by limiting the travel costs and other burdens associated with an out-of-state arbitration.[183] Those same provisions, however, tend to burden franchisees who have often have to travel away from the franchise for the arbitration.[184]

If, after the franchise agreement has been executed, one or more parties wants to waive the venue clause, they can do so.[185] Most courts allow a party to waive a term in an agreement either affirmatively or through action that is inconsistent with an intent to enforce his or her rights under the agreement.[186]

H. Payment of Arbitration Fees.

The default rule is that parties to an arbitration are responsible for paying their own costs, expenses, and legal fees.[187] Parties contemplating arbitration should anticipate paying a variety of costs. These include administrative fees, such as filing and hearing fees, as well as the expenses and compensation to the arbitrator(s). Parties may incur additional costs from room rentals, abeyance fees, and, of course, the legal fees associated with preparing for the arbitration.[188] The total amount of costs depends on a variety of factors, including the total scope of the arbitration, how efficiently the parties move the case forward and the arbitrator's hourly or daily rate.[189]

The FAA does not award a prevailing party fees or costs.[190] There are two exceptions to this default rule. First, the parties may agree to a cost-shifting or cost-splitting provision in the arbitration clause of the franchise agreement. The AAA allows for this kind of cost recovery.[191] It

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[183] C. Griffith Towle, Andrew Beilfuss, James Shrimp, *Effective and Failed Strategies to Compel/Avoid Arbitration*, ABA 41ST ANNUAL FORUM ON FRANCHISING W-2, at 22 (2018).

[184] *Id.*

[185] *Id*. at 24.

[186] *Id.*

[187] Pressman & Klein, *supra* n. 163, at 26.

[188] American Arbitration Association, *Costs of Arbitration* (2023), https://www.adr.org/sites/default/files/document_repository/AAA228_Costs_of_Arbitration.pdf.

[189] *Id.*

[190] Pressman & Klein, *supra* n. 163, at 26.

[191] *Costs of Arbitration, supra* n. 188.

is important to note, however, that courts around the country have struck down cost-shifting provisions in franchise agreements as unconscionable.[192]

Second, the applicable claims may involve cost-shifting statutes. Several state consumer protection laws include prevailing fee provisions.[193] For example, Wisconsin's unfair competition statute allows "reasonable attorneys fee[s]."[194] The prevailing party in an arbitration arising from violations of these kinds of statutes may be able to recover fees and costs.

Franchisors must think critically about how arbitration clauses in franchise documents are drafted. Fee shifting provisions and choice-of-law provisions may have significant impacts on the fees ultimately owed at the end of an arbitration.

VI. EFFECTIVE USE OF MEDIATION AND OTHER EARLY DISPUTE RESOLUTION ALTERNATIVES TO CONTROL YOUR OWN DESTINY

It is safe to assume that most franchisors and franchisees dislike being involved in arbitration or litigation with each other. Even if arbitration proves to be faster, more efficient, and less expensive as discussed above, it is still time-consuming and requires the parties to focus on things other than operating and growing their businesses, which is costly in and of itself.

Including a requirement that the parties meet and/or mediate before engaging in arbitration (or litigation) allows the parties another opportunity to control their own destiny rather than having an arbitrator or judge decide it for them. Franchisors and franchisees should both understand the substantial risks of arbitration or litigation, not only in the outcome but also the impact on the parties' relationship and the impact on the franchise system, such as setting unfavorable precedent.

For these and other reasons, mediation and other pre-suit dispute resolution alternatives have become a more acceptable approach to resolving disputes as parties recognize that arbitration and litigation can also fracture the franchisor-franchisee relationship, often beyond repair.[195] These alternatives, if successful in resolving the dispute, also avoid the potential ramifications of disclosure in Item 3 of the Franchise Disclosure Document.

Franchisors may want to consider a tiered or (the more adversarial term) "escalation clause" dispute resolution approach in their franchise agreements as a way to try to resolve disputes before engaging in arbitration or litigation. These clauses, if carefully drafted, can be enforceable and require the parties to use certain steps in sequential order before the parties

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192 *See, e.g.*, Scovill v. WSYX/ABC, 425 F.3d 1012, 1021 (6th Cir. 2005) (affirming ruling that cost-shifting provision in arbitration agreement was unconscionable); Zaborowski v. MHN Gov't Servs., Inc., 601 F. App'x 461, 463 (9th Cir. 2014) (same).

193 Pressman & Klein, *supra* n. 163, at 26.

194 WIS. STAT. § 100.20.

195 Arthur L. Pressman, *What Franchise Litigators Can Learn From Transactional Lawyers about Mediation*, 24 THE FRANCHISE LAW. 3, at 7-8 (2021) (noting that pre-suit mediation clauses "present a potential for early settlement that did not exist without them. Mediation now appears as an event triggered by mandatory contract language, not as a white flag waved by the party (or lawyer) who has the nerve to bring it up first. Having an event at the beginning of a dispute that addresses settlement removes the fear of looking weak to a client or adversary – it is on the calendar because transactional lawyers put it there. They put it there not as a roadblock to resolution but as an opportunity for resolution.").

resort to the "final" step of arbitration or litigation. These can include executive-level or key decision-maker meetings, negotiation, mediation, and other types of alternative dispute resolution methods such as Early Dispute Resolution, which combines mediation and collaborative law methods.[196] Some franchisors impose time requirements for each level of the dispute resolution process. This may be helpful to encourage the parties to resolve disputes quickly and not allow issues to linger.

Before including such provisions in a franchise agreement, the parties must understand that some alternative dispute resolution mechanisms (such as mediation or informal attempts to resolve their disputes) that result in a mutually agreed-upon resolution to their dispute are not binding unless the terms are documented in a written agreement signed by all parties. There is no award by an arbitrator that can be enforced in court, nor a judgment entered by a judge. Therefore, the parties must go into the process with the mindset of following through in good faith and not just "checking a box."

Franchisors and franchisees have numerous options and resources available for early dispute resolution. Some are free of charge, while others are not.

A. Pre-filing Negotiation Among Key Decision-Makers or Similar Resolution Procedures.

One provision that has emerged in some franchise agreements is a clause that allows or requires a meeting between the parties' business representatives when a conflict first arises. Although one might assume that the parties have talked to each other regarding a dispute, sometimes they have not or the issues might not have been fully addressed by the appropriate persons on each side. Although some franchise agreement provisions may include a meeting of executive-level persons, the parties may want participants in this meeting to be those who have both the factual knowledge and authority to resolve the dispute. Although that may be and often is an executive, there may be others in the organization who have or can be given the authority to resolve disputes. Having participants who can agree on a resolution during the meeting is important, similar to mediation where mediators and courts often require someone with decision-making authority to be present. Sometimes the delay in having to go back and talk to others within the organization (whether franchisor or franchisee) can disrupt the resolution process. Although some may consider including attorneys in this meeting, parties often desire to meet with each other first without counsel present to encourage open and frank discussions without the hint of adversity that counsel's presence may convey and to keep the dispute internal to the parties. Thus, franchisors should consider whether franchise agreements should require parties only to participate and whether to protect these discussions as confidential settlement discussions that are not subject to discovery.

One of the advantages of a pre-filing negotiation or meeting of the parties is that it can avoid the cost of other alternative dispute resolution methods. As to the location of these

[196] *See* ERD Institute, *Early Dispute Resolution*, https://edrinstitute.org (last visited July 20, 2023). EDR stands for Early Dispute Resolution. According to its website, it is a rigorous and comprehensive process for fairly and rapidly resolving disputes within 30-60 days from inception. The EDR Institute is a non-profit organization that provides training on its procedures and protocols. One of the authors of this paper has completed the training. The organization was founded by Forum member Peter Silverman. According to him, the EDR Institute has partnered with the AAA to provide training to neutrals. The EDR Institute also has been working to get the program established in various courts. Under the EDR process, lawyers obtain sufficient information regarding disputes to enable them to confidently forecast the expected value of a case and determine reasonable settlement ranges. EDR has four steps: (i) initial dispute assessment, (ii) information and document exchange, (iii) risk-benefit analysis, and (iv) final resolution. *See id.*

meetings, franchisors frequently require them to be held at their headquarters or office locations, but they may want to consider whether a neutral location or the franchisee's location will aid in resolution, particularly if franchisees have to incur travel expenses to the franchisor's location. Virtual meetings are another option, although parties may prefer face-to-face meetings.

Another alternative is an ombudsman program. Some franchise systems, particularly larger ones where executive-level meetings may be cumbersome or create too many obstacles for success, have created such programs. The ombudsman may be employed or provided by the franchisor, or she may work for a third party. The International Franchise Association ("IFA") ombudsman program offers "franchisees and franchisors the services of a confidential and neutral third party to de-escalate disputes in an amicable and expeditious fashion."[197] This is a free program open to members and non-members. If the dispute is not resolved with the IFA ombudsperson, then the parties may request a referral to the IFA's alternative dispute resolution panel or a mediator with franchise experience.

Other alternatives for resolving disputes include using the franchisee association or influential or trusted franchisees who have the confidence of both the franchisor and franchisee. Franchisee associations can help manage disputes that have the potential of threatening the larger franchise system.

B. Early Mediation

Franchisors may also want to consider a provision in their franchise agreement that requires mediation as a second step if direct negotiations do not resolve the parties' differences. Franchisors should consider the types of disputes that they normally have within their systems, and whether mediation is an appropriate dispute resolution method for such disputes. If they choose mediation as a prerequisite to arbitration or litigation, they should consider the timing of mediation. As discussed above, parties now are more willing to engage in early mediation in hopes of resolving disputes before costly and time-consuming arbitration or litigation ensues. If so, the parties may want to voluntarily exchange documents to aid in the resolution process. Franchisees may be wary if the franchisor demands that they provide documents before mediation as it may be viewed as a way for franchisors to collect evidence for future arbitration or litigation. However, if exchanging documents will help the parties understand their positions, it may be useful for either party to suggest doing so.

Early mediation can be more challenging, however, because parties are more entrenched in their positions and have less information about the other side's position at the beginning of the dispute. A skillful mediator with franchise experience can be helpful to overcome this dynamic.

1. Enforcement of Mediation as a Condition Precedent to Arbitration or Litigation.

Franchisors are increasingly including mandatory mediation provisions in their franchise agreements. Parties can seek to enforce pre-suit dispute resolution requirements by filing a motion to dismiss or a motion to stay the proceeding pending completion of the required steps. If properly drafted, arbitrators or courts usually will enforce mediation provisions in a franchise

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[197] *See* International Franchise Association, *IFA Facilitative Ombudsman Program*, https://www.franchise.org/ifa-facilitative-ombudsman-program#:~:text=A%20facilitative%20ombudsman%20program%20is,in%20mediation%20and%20conflict%20resolution (last visited July 20, 2023).

agreement as a condition precedent to arbitration or litigation. In general, a condition precedent "is either an act of a party that must be performed or an uncertain event that must happen before the contractual right accrues or the contractual duty arises."[198] Conditions precedent are generally disfavored and will not be read into a contract unless they are required by plain, unambiguous language.[199]

Courts have held that a contractual provision that requires mediation as a condition precedent to arbitration is enforceable. For example, in *Golden State Foods Corporation v. Columbia/Okura LLC*,[200] the court found that mediation provisions that explicitly stated that "[a]ny Claim arising out of or related to the Contract … shall … be subject to mediation as a condition precedent to arbitration or the institution of legal or equitable proceedings by either party" and the arbitration provisions' mandate that claims not resolved in mediation must be decided by arbitration "could not be more clear: mediation is a condition precedent to arbitration and arbitration is the sole forum for adjudicating disputes."

Other courts examining the issue have concluded that the Federal Arbitration Act's policy in favor of arbitration does not override the parties' contractual agreement. For example, in *Perdue Farms, Inc. v. Design Build Contracting Corporation,*[201] the court affirmed the district court's denial of a motion to dismiss or stay arbitration and to compel arbitration. The court held that the failure to comply with the condition precedent of mediation rendered the arbitration clause unenforceable.[202]

Whether mediation was actually requested and rejected is an issue of fact. For example, one court held that simply advising the other party of the terms of a mediation provision in the contract while attempting to resolve the dispute and informing the other party that hopefully mediation "would not be necessary" was insufficient to trigger the contract's requirement to submit a request for mediation.[203] The court then awarded the prevailing party its attorneys' fees.

If the contract contains a mediation condition precedent, a party's failure or refusal to mediate can have several consequences. First, it may be deemed a waiver of the condition precedent by the breaching party. That could allow the non-breaching party to proceed with

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198 *See, e.g.*, Platt Pac., Inc. v. Andelson, 6 Cal. 4th 307, 313, 24 Cal. Rptr. 2d 597, 862 P.2d 158 (1993).

199 Golden State Foods Corp. v. Columbia/Okura LLC, No. CV 13-8150 RSWL VBKX, 2014 WL 2931127, at *5 (C.D. Cal. June 26, 2014); Effects Assocs., Inc. v. Cohen, 908 F.2d 555, 559 n.7 (9th Cir.1990) (internal citation omitted).

200 No. CV 13-8150 RSWL VBKX, 2014 WL 2931127, at *6.

201 263 F. App'x 380, 383-384 (4th Cir. 2008).

202 *Id*. *See also* HIM Portland, LLC v. DeVito Builders, Inc., 317 F.3d 41, 44 (1st Cir. 2003); Kemiron Atl., Inc. v. Aguakem Int'l, Inc. 290 F.3d 1287, 1291 (11th Cir. 2002); Begley v. Fullana-Morales, 546 F. Supp.3d 103, 105-07 & n.3 (D.P.R. 2021); R&F, LLC v. Brooke Corp., No. 07-2175-JWL, 2008 WL 294517, at *2-3 (D. Kan. Jan. 31, 2008); In re Pisces Foods, LLC, 228 S.W.3d 349, 351-354 (Tex. Ct. App. 2007).

203 MB America, Inc. v. Alaska Pacific Leasing Co., 367 P.3d 1286, 1289-91 (Nev. 2018) (noting that the agreement incorporated the mediation rules of the American Arbitration Association, which required certain procedural steps to initiate mediation, which, read together with the parties' contract, demonstrated that the party failed to properly submit a request for mediation).

arbitration (or litigation).[204] Second, it may be equated with an unsuccessful effort to mediate, which means the condition precedent is satisfied and the non-breaching party can proceed with arbitration (or litigation).[205]

If a party has failed to comply with the mediation condition precedent, the non-breaching party may consider filing a motion to compel specific performance of the mediation clause.[206] Also, some states have statutes specifically addressing motions to compel mediation. For example, Texas has a statute that allows a party to file a motion to refer a case to mediation.[207] Parties can also file a motion relying on those cases where courts ordered mediation as a condition precedent to arbitration.[208] The non-breaching party may also consider bringing a motion to dismiss the claim or to stay the arbitration pending mediation, combined with a motion to compel mediation.

2. Drafting Considerations.

As shown above, careful drafting is important as courts have refused to enforce pre-litigation ADR requirements in cases where the provisions were ambiguous. In drafting the franchise agreement, franchisors should consider the following:

1. Does the clause contain an unequivocal commitment to commence and participate in the alternative dispute resolution process?

2. Does the clause clearly define reasonable time limits for invoking each step of the process? Does the clause include a waiver if these steps are not met?

3. Does the clause clearly define the steps that each party must take to effect the process?

4. Does the clause sufficiently define the extent of the process so that the parties know exactly when they have the right to proceed to arbitration (or litigation)? The terms should be sufficiently clear such that the agreement is not deemed an unenforceable "agreement to agree."

5. Does the clause identify or define by job title the person required to participate in the negotiation/meeting and the mediation?

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[204] DeValk Lincoln Mercury, Inc. v. Ford Motor Co., 811 F.2d 326, 335-337 (7th Cir. 1987).

[205] Gerber v. Riordan, 535 F. Supp. 2d 860, 861-62 (N.D. Ohio 2008).

[206] ***See, e.g.***, Wagner Constr. Co. v. Pac. Mech. Corp., 41 Cal. 4th 19, 29 (2007) (noting that compelling arbitration "is in essence a suit in equity to compel specific performance of a contract."); Advanced Bodycare Sols., LLC v. Thione Int'l, Inc., 524 F.3d 1235, 1240-41 (11th Cir. 2008) (recognizing that agreements to mediate "might be specifically enforceable in contract or under other law").

[207] TEX. CIV. PRAC. & REM. CODE §§ 154.021(a), 154.023.

[208] ***See, e.g.,*** Barr v. Frannet, LLC, No. 3:07-CV-1222 M, 2008 WL 59295, at *3 (N.D. Tex. Jan. 3, 2008); Mann v. Brooke Franchise Corp., Case No. 07-CV-2056-CM, 2007 WL 3379723, at *1 (D. Kan. Aug. 20, 2007).

6. Does the clause define how the mediator (or other expert) will be chosen? If external procedures are incorporated, such as the AAA, carefully review those rules in conjunction with the franchise agreement clause.

7. Does the clause state who will pay the costs of the mediation, including the parties' travel and the fees of the mediator and/or mediation service?

8. Does the clause state what will happen if one party fails to pay the mediation expenses?

9. Does the clause identify where the parties' negotiation/meeting and mediation will be held?

10. Does the clause define which issues are subject to alternative dispute resolution (does it apply to all disputes or are there carve-outs)?

11. Does the clause apply to all agreements between the parties?

12. Does the clause address how the parties should clarify what issues are in dispute?

13. Does the clause address the confidentiality of issues, documents, and parties?

14. Does the clause identify the consequences of any failure to comply with the clause?

15. Does the clause include terms tolling the running of the statute of limitations for the disputed claim during the pre-suit negotiation and mediation process?

VII. CONCLUSION

Both arbitration and litigation can be effective dispute resolution processes for any franchise system. Franchisors should carefully consider the pros and cons of each process before concluding which process is appropriate for the franchise system. If a franchisor elects arbitration as its dispute resolution process, careful attention must be paid to the terms of the arbitration provision in the franchise agreement. Because arbitration is a creature of contract, it is essential that the franchisor's franchise agreement reflect exactly what the franchisor wants to occur if a dispute arises between the franchisor and a franchisee. If the franchisor elects litigation as its dispute resolution process, it should also consider if it wants to require other dispute resolution processes, such as mediation, prior to the commencement of litigation. These terms should also be carefully crafted into the franchise agreement.

BIOGRAPHIES

Dawn Johnson is co-leader of Greensfelder, Hemker & Gale, P.C.'s Franchising & Distribution industry group. As a litigator, she has represented franchisors for 25 years, focusing on dispute resolution in all aspects of the franchise relationship. She serves as an associate editor for the ABA Forum on Franchising's *The Franchise Lawyer*.

Kathryn Kotel is the founding member of Kotel Law, PLLC. She provides project-based legal services to franchisors, including developing or revising franchise compliance programs, drafting form agreements, negotiating the sale or purchase of units, and assisting with operational issues. Ms. Kotel was Special Counsel for CKE Restaurant Holdings, Inc. from June 2022 to June 2023.

Brian Schnell leads the Faegre Drinker Biddle & Reath franchise practice and has devoted more than 30 years to finding practical and creative solutions for clients. He counsels both emerging and mature franchisors in a variety of industries on all aspects of their franchise programs. As the first male to receive the IFA Women's Franchise Committee Crystal Compass in 2009 based on his leadership in franchising, he is known for his passion and commitment to making a difference for clients.