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Managing Risk in International Franchising

**AVOIDING AND MANAGING SYSTEM-WIDE
LITIGATION IN INTERATIONAL FRANCHISING**

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This paper will address how disputes with multiple franchisees across international borders can be managed or avoided. Class actions in the United States seem to have become more common. Among other matters, we examine whether class actions in litigation or arbitration will become more prevalent, including in international disputes.

1. An Explosion of System-Wide Litigation?

We first need to identify what we mean by system-wide litigation, particularly in the international context, and whether there actually has been an explosion in system-wide litigation.

1.1 What is system-wide litigation in the context of an international franchise system?

Many franchise systems over the years have faced class actions initiated by franchisees or consumers, multiple lawsuits prosecuted in multiple jurisdictions by disgruntled franchisees, and even administrative proceedings, each of which has caused franchisors to spend countless human and financial resources, endure negative publicity, and, in some cases, fundamentally change the way in which they operate. They are the types of actions that franchisors often view as having system-wide implications. The U.S. has seen the majority of these actions, primarily because of the country's longer history with franchising and the greater concentration of developed franchise systems. But as franchising becomes a more globally dominant method of distribution, as the concept of the class action becomes a more widely accepted procedural device, and as courts and arbitral tribunals attempt to open avenues for resource-strapped franchisees to seek redress against their franchisors, these types of actions will undoubtedly increase both in frequency and in size.

But international franchise systems have certain inherent characteristics that cause a loss of commonality that is essential for initiating and sustaining these types of consolidated multi-plaintiff or representative actions on a system-wide basis. Those inherent characteristics might themselves reduce, if not eliminate, the risk of litigation that is truly system-wide in the context of an international franchise system. While purely domestic franchisors may be faced with defending one or more actions maintained by all or a sizeable number of its franchisees, system-wide litigation for international franchisors is more likely to take the form of a series of unconnected lawsuits or administrative actions in multiple countries. In international franchise systems, where the franchisor directly franchises in its home country but grants master franchise rights elsewhere:

- Factors that often trigger major multi-plaintiff litigation or representative actions (for example, supply chain management, collection of rebates, management of advertising funds and the offer and sale of the franchise¹) often vary from country to country. For example, while the franchisor might control vendor relationships and marketing funds in its home country, it is more likely to delegate that responsibility to its master franchisees in other countries and, as a result, have little involvement with those matters other than reserving approval rights.

¹ See, for example, class actions filed by franchisees of the American franchisor, Quiznos Subs, in *Bonanno v. The Quiznos Master LLC*, United States District Court, Colorado, Civil Action No. 1:06-cv-2358-WYD-BNB; 2038724 *Ontario Ltd. v. Quizno's Canada Restaurant Corporation*, Ontario Superior Court of Justice, Court File No. 06-CV-311330CP; *Kalpesh Master v. The Quizno's Franchise Company*, Superior Court of New Jersey, Mercer County, Law Division, Case No. MER-L-1966-06; *Fred N. and Michana A. Westerfield v. The Quizno's Franchise Company LLC*, United States District Court, Eastern District of Wisconsin, Green Bay Division, Case No. 06-C-1210; and *Bonnie Brunet v. The Quizno's Franchise Company LLC*, United States District Court, Colorado, Civil Action No. 1:07-cv-01717-EWN-KLM.

- The franchise sales process is typically delegated to the master franchisee, making it difficult for the franchisor to have been complicit in any misrepresentations or fraud that might have been involved in the sales process. If there has been a misrepresentation or other impropriety in the franchise sales process, culpability usually lies with the master franchisee and its personnel.
- If the franchisor has granted master franchise rights, it typically has no contractual privity with and, therefore, has undertaken no direct contractual obligations to the unit franchisees. Allegations regarding the lack or sufficiency of support provided to the unit franchisees generally arise under the subfranchise agreement and represent failures of the master franchisee, not the franchisor, to comply with the unit franchise agreement.
- Depending on local law and the enforceability of governing law and dispute resolution provisions in the franchise agreement, the parties and their contracts may be subject to varying legal systems and dispute resolution mechanisms as well as a variety of laws and regulations that could easily produce inconsistent results from country to country.
- The lack of a consistent franchising methodology from country to country (for example, granting master franchises in one country while directly contracting with multi-unit developers in another) will create different operating relationships, legal relationships and resulting legal obligations.

All of these factors make it difficult for franchisees in an international franchise system to efficiently band together, on a global basis, to assert claims arising from common factual or legal bases. That loss of commonality, which is so critical to successfully mounting a broad offensive, may prove to be insurmountable roadblocks to litigation against the international franchisor which is truly system-wide.

Group proceedings, which are the hallmark of most system-wide lawsuits, arise in several contexts depending on the country in which they are implemented and generally take the form of class actions (including group litigation and representative actions), joinder or consolidation of individual claims, or administrative actions.

Class actions have long been a staple of disgruntled franchisees in the United States and are being used with increasing frequency in Australia and Canada.² In a number of jurisdictions, class actions are either unavailable or are available only with respect to limited types of claims.³ While the vehicle is also available in portions of the European Union,⁴ it has historically been fairly limited due, in part, to the anxiety in EU countries and elsewhere over what are viewed as the excesses of the U.S.-style class action, including their use to force companies to settle out of court rather than risk losing and the perception or,

² As of the date of this paper, notable class actions have been filed in Canada against high profile franchisors such as Midas, Tim Horton's, Quiznos, General Motors and Suncor based on claims such as wrongful termination and improperly inflating vendor pricing.

³ See, for example, in Korea where a recent case filed by Seoul Investment Club against Jinsung under the Securities Class Action Act of 2004 was the first case filed under that act which allows class actions by minority shareholders of a public company but only in limited circumstances.

⁴ See, for example, the Netherlands' Group Actions Act of 1994, Portugal's Law 83/95 of August 31, 1995, and Spain's Civil Procedure Act 1/2000. Also, as of January 1, 2010, class actions are available to consumers in Italy to seek redress for damages caused by a party's unfair commercial practices or anti-competitive conduct. The Consumer Act of 2006, as amended by Law 99/09. Query whether franchisees will be permitted to invoke, as consumers, a franchisor's practice which is alleged to be unfair or anti-competitive.

depending on perspective, the reality that they often yield huge fees to lawyers with nominal recovery for the class members. Where class actions are available, there are key differences from the U.S. system that should provide safeguards against those perceived “excesses”:

- Larger classes should produce larger awards or larger settlements; larger awards or settlements usually yield larger fees to class counsel. But outside the U.S., there are built-in procedural mechanisms that could limit the size of the class. First, as a result of increasingly fewer restrictions in the U.S. with respect to lawyer advertising, class counsel in the U.S. have fewer barriers to soliciting prospective class members in order to generate interest in the proceedings, thereby potentially increasing the size of the class. This type of solicitation is generally prohibited in other countries.⁵ Second, class sizes in the U.S. and Canada are likely to be larger because proceedings in those countries require class members to opt out if they do not want to be included in the class; most other countries require class members to “opt in” in order to be included.⁶
- Lawyers in the U.S. are generally able to negotiate contingency or success fees with their clients which, depending on factors such as length and complexity of the case, can yield fees in the millions of dollars. The large-fee incentive often works to make the lawyers the real proponents of prosecuting the action. These types of fee arrangements are generally prohibited or heavily regulated in other countries,⁷ making it potentially less lucrative and more risky for class counsel. That, in turn, at least theoretically, acts to dissuade lawyers from taking on weaker cases.
- In the U.S., absent a statutory mandate or contractual agreement, each party is required to pay its own legal fees and costs associated with the litigation thereby limiting the exposure to the class or, more importantly, class counsel should the class be unsuccessful. However, most other countries require the loser in an action to pay the fees and costs of the winning party. The so-called “loser pays” rule can present significant risk to parties who might otherwise seek to represent a broader class. However, some countries are limiting the deterrent effect of the rule by limiting the cost awards, where a plaintiff loses, to nominal costs or no costs unless the action is found to be frivolous.⁸
- Other procedural mechanisms applicable to the conduct of trials, such as limitations on discovery, limitations on trial by jury and the unavailability of punitive damages, that exist in legal systems in countries like Japan and other countries outside the U.S. also play a role in making the use of class actions a less attractive alternative where they might otherwise be procedurally available.

Many countries have adopted procedures that, while perhaps not yet tested in the franchising context, could have application to franchise systems. For example:

⁵ Lawyer advertising is permitted in England but prohibited in most other European jurisdictions.

⁶ Henrik Lindholm & Robert Nordh, *Scandinavian Developments: The New Swedish Act on Group Actions 2* (paper delivered at the Toronto Symposium on Class Actions, September 13-14, 2002).

⁷ Some countries, such as Scotland and England, will allow limited contingency fee arrangements. Sweden will allow attorneys and group representatives to make “risk agreements” which are a function of success, but the fee is based on an hourly rate. Canada and Australia allow broader use of contingency fee arrangements.

⁸ Edward F. Sherman, *Group Litigation under Foreign Legal Systems: Variations and Alternatives to American Class Actions*, 52 DePaul Law Review 402, 2002-2003,

- Australia and Japan allow the filing of representative actions, and many Latin American countries, including Argentina, Brazil, Mexico, Ecuador, Venezuela, Colombia and Costa Rica, provide for a collective writ of protection or security which are akin to, but are much more limited than, American class actions. In these types of filings, under certain circumstances,⁹ individuals can seek protection for a broader group. But in representative actions, the court's findings are limited to the group, which requires that the members opt in; in collective writs of protection, the court's findings may bind other persons similarly situated without providing them the opportunity to opt out.¹⁰
- The European Directive on Injunctions for the Protection of Consumers' Interests, which entered into force as of December 29, 2009,¹¹ directed all EU member countries to implement a group litigation mechanism under which rights of action would be assigned to "qualified entities" that are either organizations such as consumer agencies or independent public bodies such as administrative agencies." These qualified entities are then able to file "group litigation" on behalf of a specifically defined group of people adversely affected by a defendant's conduct such as false advertising and consumer loans. In some cases, these actions are limited to injunctive relief (for example, in Germany) and, in others, only nominal damages may be permitted (for example, in France and Greece), but in all cases, the intent is to protect the collective interests of "consumers." Query whether franchisees might be considered "consumers" or whether a franchisee association or a franchisee union¹² could become a "qualified entity."¹³ (See discussion in Section 2.5 of this paper.)
- In certain EU countries such as Germany, France, Italy and England, individuals may also be able to join an on-going criminal investigation, and, if the defendant is found to have criminal liability, it may also be ordered to pay compensation to the individuals who have been harmed by the defendant's criminal activity.
- In many countries such as the U.K. and Japan, while class actions are not permitted, multiple plaintiffs may be able to have their claims procedurally joined or consolidation into one action. While this often makes it less expensive for individual plaintiffs to prosecute their claims through cost-sharing measures and procedural efficiencies, each claim stands or falls on its own merits, and different judgments can be entered with respect to individual claims.

⁹ In Australia, for example, there must be seven or more persons having claims against the same person arising out of the same, similar or related circumstances and giving rise to a substantial common issue of law or fact. Federal Court of Australia Act, 1976 §33(c)(1)

¹⁰ Similar to the *res judicata* concept in the US.

¹¹ Directive 2009/22/EC of the European Parliament and of the Council of 23 April 2009, which clarified Directive 1998/27/EC of the European Parliament and of the Council of 19 May 1998.

¹² See, for example, in Japan where several franchisees of 7-Eleven have formed a labor union and are attempting to use collective bargaining as a tool in negotiating with the franchisor.

¹³ Under Directive 2009/22/EC, a "qualified entity" could be an organization which is properly constituted according to the laws of a Member State and whose purpose is to protect the interests of consumers in certain listed Directives (currently, these Directives address things such contracts negotiated away from business premises, consumer credit, unfair terms in consumer contracts, and sale of consumer goods and associated guarantees).

We explore these procedures in more detail below. Section 1.3 of this paper expands this discussion with respect to a number of jurisdictions, and Section 2.6 of this paper discusses the typical franchise system-wide dispute resolution experience in the U.K. and other European countries.

Proceedings akin to U.S. class actions may also be brought by a governmental agency in some countries. In Australia, for example, the Australian Competition and Consumer Commission (the “ACCC”), which is the regulatory agency charged with, among other things, overseeing compliance with the Franchising Code of Conduct and the Trade Practices Act, has been given the power to seek redress for franchisees, even those not party to the proceedings, where a large number of franchisees have been harmed by a franchisor’s actions. The ACCC recently exercised that power by initiating, on behalf of 74 franchisees, a class action proceeding against Allphones Retail Pty Limited, Australia’s largest independent mobile phone retailer, asserting that Allphones failed to pay to its franchisees certain commissions, rebates and bonus payments to which they were entitled under their franchise agreements.¹⁴

Given these disparate rights, remedies and procedures, the lack of commonality inherent in the structure of a typical international franchise system, and the multi-jurisdictional nature of parties holding various rights under the franchise system, it is unlikely that an international franchisor would face system-wide litigation in one comprehensive action. Rather, the franchise system (including the franchisor and, perhaps, its master franchisees) is more likely to be subject to attack from a variety of parties using a variety of methods in multiple jurisdictions.¹⁵

1.2 In what forum will a system-wide dispute in the U.S. be resolved?

Since the U.S. has seen the majority of system-wide franchise actions, we will examine in considerable detail the class action experience in the U.S. Most system-wide litigation in U.S. is conducted in a court, but class actions in arbitration are now appearing. For many years, many U.S. lawyers thought they could prevent class actions in arbitration by use of an arbitration clause that prohibited class actions or combined actions. As is more fully discussed below, that no longer appears to work.

(i) *Choosing the Forum/Franchisor First Strikes*

In the U.S., if the franchise agreement is silent as to where disputes will be resolved, there may be a “race to the courthouse” to be the first to file. Franchisors facing system-wide litigation can and often do launch a “pre-emptive” strike to try to choose the forum and frame the issues in a way most favorable to the franchisor.

This can take the form of a “test case” against one or more franchisees, sometimes brought in the form of a declaratory judgment action in federal court — or even a “declaratory arbitration.” For example, when MolsonCoors was formed and acquired Molson USA, the company developed a strategy for consolidating the distribution of the Molson and Coors brands. This strategy included drafting new distribution agreements which contained an arbitration clause. Although the consolidation proceeded in many states, in New York it faced a major impediment: the New York Beer Franchise Law, Section 55-c of New York’s Alcoholic Beverage Law.¹⁶ Accordingly, the company commenced a “test” arbitration

¹⁴ The ACCC has been in a long-running battle with Allphones for alleged violations by that company of the Trade Practices Act 1974, particularly in connection with the company’s on-going negotiations to secure new franchise agreements with and releases from its existing franchisees. The class action was filed by the ACCC in September 2009, and, in April 2009, the parties appear to have negotiated a settlement during the trial.

¹⁵ See discussion regarding mandatory jurisdiction and venue provisions below

¹⁶ N.Y. A.B.C.L. § 55-c.

case against a New York distributor (“Ryan”) seeking a declaratory judgment that the consolidation complied with the requirements of the New York statute. The declaratory arbitration also sought to determine a formula for calculating compensation due under that statute. The arbitrator ultimately adopted the methodology of MolsonCoors’ valuation expert. The successful outcome in Ryan was followed by a series of rulings confirming that the arbitration provision in the Molson distribution agreements supplants dispute resolution in a state judicial or administrative forum. See, e.g., *Spirit & Sanzone Distribs. Co. v. Coors Brewing Co.*, 2008 U.S. Dist. LEXIS 20064 (S.D.N.Y. Feb. 29, 2008); *Doldo Bros. v. Coors Brewing Co.*, 2008 U.S. Dist. LEXIS 17646 (N.D.N.Y. Mar. 7, 2008); *W.M. Thies & Sons, Inc. v. Coors Brewing Co.*, 2008 U.S. Dist. LEXIS 27475 (S.D. Fla. Mar. 28, 2008).

Rather than simply seeking a declaratory judgment, sometimes the franchisor will also assert claims for affirmative relief. The reason for seeking affirmative relief in addition to or instead of a declaratory judgment is that — unlike federal court jurisdiction generally — a U.S. district court’s decision whether to entertain a declaratory judgment action is discretionary.¹⁷ The affirmative relief sought might include an injunction to protect trademark rights, prevent misappropriation of trade secrets, or enforce a non-compete. Or it may include a claim for damages for unpaid royalties or the like.

If franchisees are engaged in a “royalty strike,” the federal trademark laws in particular can provide a powerful weapon for a “test case.” For example, in the case of *Precision Tune Auto Care, Inc. v. Pinole Auto Care, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,237 (E.D. Va. Oct. 15, 2001), Bus. Franchise Guide (CCH) ¶ 12,238 (E.D. Va. Jan. 15, 2002), certain franchisees had — both before and after their termination — withheld royalties while continuing to use the PRECISION TUNE® trademark. Rather than simply assert claims for breach of contract, the franchisor asserted claims under the federal trademark statute, the Lanham Act, for trademark infringement (including counterfeiting), dilution, and unfair competition. In lieu of actual damages, the trademark owner has the option under the Lanham Act of recovering the infringer’s gross profits from the infringement — trebled in case of counterfeiting and other types of willful infringement. Although the amount of unpaid royalties was only \$85,000, the franchisor obtained a damage award under the Lanham Act in excess of \$6.2 million.¹⁸

(ii) *Dismissal and Transfer from the Forum*

The winner of the “race to the courthouse” does not always have the last word on where the case will be decided. A declaratory judgment action filed as a preemptive strike may be subject to dismissal or transfer if the case serves no purpose other than to disrupt the choice of forum of the “natural plaintiffs.”¹⁹ And although the plaintiff’s choice of forum is given great weight, federal courts in the U.S. can and do grant motions to transfer venue pursuant to 28 U.S.C. § 1404(a). The factors governing the grant of discretionary venue transfer motions are as follows:

1. the convenience of witnesses (especially third party witnesses);

¹⁷ See, e.g., *Papa John’s Int’l, Inc. v. Rezko*, 2006 U.S. Dist. LEXIS 43944 (N.D. Ill. June 14, 2006); *Volvo Constr. Equip. N. Am., Inc. v. CLM Equip. Co.*, 386 F.3d 581 (4th Cir. 2004); *Mobil Oil Corp. v. Attorney Gen. of Virginia*, 747 F. Supp. 1173 (E.D. Va. 1990), *rev’d*, 940 F.2d 73 (4th Cir. 1991), *following remand*, *Mobil Oil Corp. v. Virginia Gasoline Marketers and Automotive Repair Ass’n*, 34 F.3d 220 (4th Cir. 1994), *cert. denied*, 1995 U.S. LEXIS 1029 (1995). Mr. Lockerby represented the franchisor in each of the foregoing cases.

¹⁸ Mr. Lockerby represented the franchisor, Precision Tune.

¹⁹ See, e.g., *Hyatt Int’l Corp. v. Coco*, 302 F.3d 707, 712 (7th Cir. 2002) (“as other courts have noted, the Declaratory Judgment Act ‘is not a tactical device whereby a party who would be a defendant in a coercive action may choose to be a plaintiff by winning the proverbial race to the courthouse.’”), *quoting Terra Nova Ins., Co., Ltd. v. Acer Latin Am., Inc.*, 931 F. Supp. 852, 854-55 (S.D. Fla. 1996).

2. the convenience of the parties (although shifting the burden of inconvenience from one party to another is generally not grounds for transfer); and
3. the “interests of justice,” which may include ease of access to sources of proof as well as other factors.

See 28 U.S.C. § 1404(a).

The plaintiff’s choice of forum and the presence of a forum selection clause are factors that, under Section 1404(a), may weigh against transfer. See, e.g., *Stewart Org. v. Ricoh Corp.*, 487 U.S. 22, 29 (1988) (“[t]he presence of a forum selection clause such as the parties entered into in this case will be a significant factor that figures centrally in the district court’s analysis.”); *P&S Business Machines, Inc. v. Canon USA, Inc.*, 331 F.3d 804, 807 (11th Cir. 2003) (“Thus, while other factors might ‘conceivably’ militate [in favor of] a transfer ... the venue mandated by a choice of forum clause rarely will be outweighed by 1404(a) factors.”) (quoting *In re Ricoh Corp.*, 870 F.2d 570, 573 (11th Cir. 1989)). Notwithstanding such precedents, courts do regularly ignore both the plaintiff’s choice of forum and the presence of a forum selection clause and transfer cases pursuant to Section 1404(a).

(iii) **“Lessons Learned” in Litigation:
Practice Pointers for Avoiding Venue Transfers**

Lawyers have learned lessons on how to avoid venue transfers and keep the cases in the forum in which the suit was filed.

- ☑ **Have an express waiver of the right to seek a venue transfer in the franchise agreement.** With or without such a provision, the likelihood of a venue transfer is greater if the chosen forum is not particularly convenient for either the franchisor or the franchisee. That may be the case if the chosen forum is the state in which the franchisor is incorporated if that state is not a place where witnesses and/or documents are located.
- ☑ **Specify the forum in terms of the franchisor’s principal place of business or place of incorporation at the time the dispute arises.** A forum that may have been convenient for the franchisor at the time the franchise agreement was signed may no longer be convenient if — as the result of a corporate relocation, merger, or acquisition — the franchisor’s headquarters has moved. One way of avoiding this problem is to require dispute resolution in the state in which the franchisor is incorporated or has its principal place of business at the time the dispute arises.
- ☑ **To avoid the perception that the forum selection clause is one-sided and therefore “unfair” if not unenforceable, have the forum vary depending upon which party sues first.** In other words, if the franchisee sues first, the required forum is the state in which the franchisor is incorporated or has its principal place of business; if the franchisor is the plaintiff, the required forum is the franchisee’s “home turf.”
- ☑ **If the chosen forum is a federal court, have a “failsafe” provision in case the federal court lacks subject matter jurisdiction.** It is hornbook law that subject matter jurisdiction cannot be conferred by consent. To the contrary, the subject matter jurisdiction of the federal courts may be challenged at any time during the course of the litigation — even *sua sponte* by the court itself. If the forum

selection clause is therefore unenforceable, the franchisee would then have the opportunity to choose the forum — unless the franchise agreement provides that, if the chosen federal court lacks diversity or federal question jurisdiction, the chosen forum is the state court where the franchisee is incorporated or has its principal place of business. Such a provision will also address the situation in which no diversity jurisdiction is present, for example, because the franchisee and franchisor are citizens of the same state.

For purposes of establishing diversity jurisdiction, a corporation is deemed to reside in both the state in which it is incorporated and the state in which it has its principal place of business. 28 U.S.C. § 1332(c)(1). Franchisees seeking to avoid diversity jurisdiction often join non-diverse defendants — such as other franchisees — for that very purpose.

It *may* be possible nevertheless to remove to federal court on grounds of fraudulent joinder and perhaps even to realign the parties to obtain complete diversity. For an example of fraudulent joinder, the plaintiff in *Victor L. Phillips Co. v. Volvo Construction Equipment North America, Inc.*, Case No. 02-2144-JAR, 2002 U.S. Dist. LEXIS 11355, Bus. Franchise Guide (CCH) ¶ 12,236 (D. Kan. May 17, 2002),²⁰ had brought suit in state court seeking a declaratory judgment under the Kansas Outdoor Power Equipment Dealer Act against both Volvo Construction and one of its Kansas dealers. Volvo Construction had removed the case to federal court. The federal court denied the plaintiff's motion to remand, holding that the plaintiff had improperly joined the dealer for the purpose of defeating diversity jurisdiction. That result was atypical, however. More often than not, the case may be remanded back to state court — with the franchisor facing liability for the franchisee's attorneys' fees associated with the remand. 28 U.S.C. § 1447(c).

(iv) *Arbitration vs. Litigation*

For many years, the conventional wisdom has been that franchisors prefer arbitration to litigation and that franchisors should seek to avoid jury trials at all costs. As a result, some franchise agreements require arbitration of most if not all disputes. Many franchisors have found arbitration to be a preferable means of ADR — especially if the alternative form of dispute resolution is one of the so-called “Judicial Hellholes®” identified by the American Tort Reform Association.²¹ Still, there are considerable drawbacks to arbitration from the standpoint of franchisors.

Many franchisors have assumed that they should favor arbitration because so many trial lawyers and franchisee associations oppose it. For example, the American Franchise Association (“AFA”) (www.franchisee.org) has developed a list of “The Twelve Worst Franchise Agreement Provisions” and posted a copy on its Web site.²² With respect to these so-called “worst provisions” — including arbitration clauses — the AFA admonishes prospective franchisees: “***Do not sign a franchise agreement until you get these provisions changed!***” (emphasis in original). According to the AFA:

While arbitration is a faster and presumably cheaper, it has major disadvantages to franchisees. Arbitration is private, with the resulting decisions not creating any precedents. In addition, the ability of a franchisee to obtain documents from the franchisor and to take depositions is severely limited.

²⁰ Mr. Lockerby represented the defendant in this litigation.

²¹ See www.atra.org/reports/hellholes.

²² See www.franchisee.org/Buying%20a%20Franchise.htm#12%20worst.

Consistent with the conventional wisdom that arbitration is “unfair” to franchisees, the U.S. Congress in 2001 enacted the “Motor Vehicle Contract Franchise Arbitration Fairness Act.” This enactment made arbitration provisions in motor vehicle franchise agreements unenforceable. See 15 U.S.C. § 1226. For the past few years, Congress has been considering various legislative proposals to make arbitration clauses in all franchise agreements unenforceable.²³

The fact of the matter, however, is that franchisors and their counsel are by no means unanimous in viewing arbitration as a preferred method of dispute resolution. The “pros” and “cons” of arbitration — from the perspective of franchisor counsel — are examined at length in a paper presented at the ABA Forum on Franchising, Edward Wood Dunham and Michael J. Lockerby, “Shall We Arbitrate? The Pros and Cons of Arbitrating Franchise Disputes” (ABA Forum on Franchising October 2005) (hereinafter “Shall We Arbitrate?”). Depending upon the choice of forum otherwise available to the franchisor, arbitration may or may not be faster than litigation. As set forth in the “Shall We Arbitrate?” paper, whether arbitration is less expensive than litigation is certainly questionable. Arbitration may reduce the likelihood of punitive damage awards and help avoid the phenomenon of the “runaway jury.” The drawbacks of arbitration, however, can include the following:

1. Obtaining meaningful judicial review of any arbitration award — even one of a “runaway arbitrator” — is extremely difficult.²⁴
2. Franchisee claims that might be dismissed as a matter of law in federal court can result in substantial damage awards in favor of the franchisee in arbitration.²⁵
3. One of the perceived advantages of arbitration — avoiding class actions by franchisees — may no longer be available following the Supreme Court’s 2003 decision in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003).

In *Bazzle*, the parties disagreed as to whether the arbitration agreement was truly silent about class arbitration or whether its terms actually prohibited class arbitration. The Supreme Court’s decision in *Bazzle* raised as many questions as it answered. It resulted in a four-member plurality opinion authored by Justice Breyer, a dissenting opinion authored by Justices Rehnquist (joined by Justices O’Connor and

²³ See Michael J. Lockerby and Kimberly J. Shur, “Arbitration Fairness Act of 2007: A Trial Lawyer’s Dream, A Client’s Nightmare,” *Franchise World* (International Franchise Association November 2007) (www.foley.com/publications/pub_detail.aspx?pubid=4619).

²⁴ In one of the cases discussed in “Shall We Arbitrate?” the arbitrators awarded preliminary injunctive relief without requiring either a showing of irreparable harm or the posting of an injunction bond. The arbitrators’ award of preliminary injunctive prevented the respondent in the arbitration, a Pentagon contractor, from using alleged “trade secrets” that in fact had been posted on the Internet by a third party. The arbitration award also purported to require the respondent to default on a contract that was essential for homeland security. In fact, in subsequent proceedings to confirm the arbitration award, the petitioner admitted that it sought to force the respondent to default for the purpose of taking over the contract. The dispute over confirmation resulted in simultaneous proceedings before the American Arbitration Association, the U.S. District Court for the Eastern District of Virginia, and the U.S. Court of Appeals for the Fourth Circuit (three separate appeals, which were consolidated, in addition to a petition for writ of mandamus). In view of the limited scope of judicial review of arbitration awards, however, these efforts to avoid confirmation of the arbitration award were unavailing. *Arrowhead Global Solutions, Inc. v. DataPath, Inc.*, 166 Fed. Appx. 39; 2006 U.S. App. LEXIS 2786 (4th Cir. Feb. 3, 2006). (Following entry of the arbitration award at issue, Mr. Lockerby represented the plaintiff-appellant in subsequent efforts to avoid confirmation.)

²⁵ See Michael J. Lockerby, “Who Says Arbitration Is Good for Franchisors?” sidebar to “Revisionist History? Kicking the Tires of J. Michael Dady’s Market Withdrawal Cases (PDF),” *Franchise Law Journal* (Spring 2002) (www.foley.com/files/tbl_s31Publications/FileUpload137/3984/lockerbyrevisionisthistory.pdf).

Kennedy), a separate dissent authored by Justice Thomas, and a fourth opinion by Justice Stevens dissenting in part and concurring in part. The *Bazzle* plurality, joined by Justice Stevens in the judgment only, remanded the case for an arbitrator to decide whether the contract was truly silent. Following *Bazzle*, the two leading purveyors of ADR services — the American Arbitration Association (“AAA”) and JAMS — each adopted new rules governing class arbitrations.

Effective October 8, 2003, the AAA adopted Supplementary Rules for Class Arbitrations (www.adr.org/sp.asp?id=21936). The AAA’s Web site states that “[t]he AAA administers Class Arbitrations for cases where (1) the underlying agreement specifies that disputes arising out of the parties’ agreement should be resolved by arbitration and (2) the agreement is silent with respect to class claims, consolidation, or joinder of claims.” See www.adr.org/sp.asp?id=28763. The AAA’s Policy on Class Arbitration (July 14, 2005) states:

The Association is not currently accepting for administration demands for class arbitration where the underlying agreement prohibits class claims, consolidation or joinder, unless an order of a court directs the parties to the underlying dispute to submit any aspect of their dispute involving class claims, consolidation, joinder or the enforceability of such provisions, to an arbitrator or to the Association.

(www.adr.org/sp.asp?id=28779). Like the Federal Rules of Civil Procedure, the AAA Supplementary Rules for Class Arbitrations contain a procedure for class certification. Supplementary Rule 4 (“Class Certification”)²⁶ is virtually identical in substance and form to Federal Rule of Civil Procedure 23 (“Class

²⁶ Rule 4 states as follows:

(a) Prerequisites to a Class Arbitration

If the arbitrator is satisfied that the arbitration clause permits the arbitration to proceed as a class arbitration, as provided in Rule 3, or where a court has ordered that an arbitrator determine whether a class arbitration may be maintained, the arbitrator shall determine whether the arbitration should proceed as a class arbitration. For that purpose, the arbitrator shall consider the criteria enumerated in this Rule 4 and any law or agreement of the parties the arbitrator determines applies to the arbitration. In doing so, the arbitrator shall determine whether one or more members of a class may act in the arbitration as representative parties on behalf of all members of the class described. The arbitrator shall permit a representative to do so only if each of the following conditions is met:

- (1) the class is so numerous that joinder of separate arbitrations on behalf of all members is impracticable;
- (2) there are questions of law or fact common to the class;
- (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class;
- (4) the representative parties will fairly and adequately protect the interests of the class;
- (5) counsel selected to represent the class will fairly and adequately protect the interests of the class; and
- (6) each class member has entered into an agreement containing an arbitration clause which is substantially similar to that signed by the class representative(s) and each of the other class members.

(b) Class Arbitrations Maintainable

An arbitration may be maintained as a class arbitration if the prerequisites of subdivision (a) are satisfied, and in addition, the arbitrator finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class arbitration is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include:

- (1) the interest of members of the class in individually controlling the prosecution or defense of separate arbitrations;

Actions”).²⁷ The “Class Determination Award” of the arbitrator(s) is subject to judicial review. *See* Supplementary Rule 5.

The JAMS Class Action Procedures adopted in the wake of *Bazzle* have since been amended, effective May 1, 2009. *See* www.jamsadr.com/rules-class-action-procedures. Like the AAA, JAMS “will not administer a demand for class action arbitration when the underlying agreement contains a class preclusion clause, or its equivalent, unless a court orders the matter or claim to arbitration as a class action.” JAMS Class Action Rule 1(a). The JAMS Class Action Procedures expressly incorporate by reference the class action certification procedures of Federal Rule 23(a)²⁸ and (b)²⁹. Like a AAA

(Footnote Cont’d)

- (2) the extent and nature of any other proceedings concerning the controversy already commenced by or against members of the class;
- (3) the desirability or undesirability of concentrating the determination of the claims in a single arbitral forum; and
- (4) the difficulties likely to be encountered in the management of a class arbitration.

²⁷ *See* Fed. R. Civ. P. 23:

(a) Prerequisites.

One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

- (1) the class is so numerous that joinder of all members is impracticable,
- (2) there are questions of law or fact common to the class,
- (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
- (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Types of Class Actions.

A class action may be maintained if Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

²⁸ *See* JAMS Class Action Rule 3(a):

(a) The Arbitrator shall determine whether a class should be certified.

determination of class certification, a JAMS determination of class certification is “subject to immediate court review.” JAMS Class Action Rule 3(c).

Although many manufacturers and franchisors chose arbitration as a method of dispute resolution for the express purpose of avoiding class actions, many agreements that pre-date *Bazzle* are in fact silent on the issue. Amending such agreements to expressly prohibit class action arbitration may be easier said than done. Many dealer, distributor, and franchise agreements have a relatively long term. In the hospitality industry, for example, terms of 20 years are not uncommon. State franchise and dealer “relationship” laws may often restrict the timing, notice, and grounds for—in addition to terminations and nonrenewals—amendments and “substantial changes in competitive circumstances.”

In the wake of *Bazzle*, there is a split among the Circuits as to whether a class action arbitration can proceed if arbitration agreement is silent on the issue. The Seventh Circuit, for example, left in place pre-*Bazzle* precedents holding that a class action arbitration cannot proceed when the arbitration agreement is silent on the issue. *Employers Ins. Co. of Wausau v. Century Indem. Co.*, 443 F.3d 573, 580 (7th Cir. 2006). The Second Circuit, in contrast, held otherwise in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 548 F.3d 85 (2d Cir. 2008). The Supreme Court accepted a *cert.* petition in *Stolt-Nielsen* and heard oral argument on December 9, 2009.

On April 27, 2010, the Supreme Court issued its long awaited decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 559 U. S. ____ (2010). Imposing class arbitration on parties who have not agreed to authorize class arbitration, the Supreme Court held, is inconsistent with the Federal Arbitration Act, 9 U.S.C. §1 *et seq.* In reversing the Second Circuit’s decision in *Stolt-Nielsen*, the Supreme Court cited one of the few statutory grounds for vacating arbitration awards. Section 10(a)(4) of the FAA, the Supreme Court observed, permits vacatur “[w]here the arbitrators exceeded their powers.” 9 U.S.C. § 10(a)(4). Under prior Supreme Court precedents, Section 10(a)(4) is satisfied “only when [an] arbitrator strays from interpretation and application of the agreement and effectively ‘dispense[s] his own brand of industrial justice.’” *Major League Baseball Players Ass’n v. Garvey*, 532 U. S. 504, 509 (2001) (*per curiam*).

In *Stolt-Nielsen*, the Supreme Court found that requiring class action arbitration was inconsistent with “the basic precept that arbitration ‘is a matter of consent, not coercion.’” (quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989)). Unlike *Bazzle*—where the parties disagreed as to whether the arbitration agreement was silent on the issue of class actions—in *Stolt-Nielsen* the parties stipulated that they had reached no agreement on the issue. The rationale of the Supreme Court’s decision in *Stolt-Nielsen*, however, was *not* based solely on this stipulation. Rather, the Supreme Court announced a broader principle that “an implicit agreement to

(Footnote Cont’d)

In making that determination, the Arbitrator shall consider the criteria enumerated in this Rule 3 and any law that the Arbitrator determines applies to the arbitration. The Arbitrator also shall determine whether one or more members of a class may act in the arbitration as representative parties on behalf of all members of the class described. The Arbitrator shall permit a class member to serve as a representative only if the conditions set forth in **Federal Rules of Civil Procedure, Rule 23(a)** are met.

(emphasis added).

²⁹ See JAMS Class Action Rule 3(b):

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, in addition to the criteria set forth in the **Federal Rules of Civil Procedure, Rule 23(b)**.

(emphasis added).

authorize class action arbitration is not a term that the arbitrator may infer solely from the fact of an agreement to arbitrate.”

While answering one question that the Supreme Court left unanswered in *Bazzle*, the Supreme Court’s decision in *Stolt-Nielsen* may well lead to additional litigation over questions of arbitrability. For one thing, the Supreme Court did not address the grounds upon which the arbitration decision had been vacated at the district court level: “manifest disregard of the law,”³⁰ — a basis for setting aside arbitration awards that is not found anywhere in the FAA itself. And will the FAA always govern the question of whether the parties intended to arbitrate class action disputes? Or will the answer sometimes be found in substantive law at the federal and state level — potentially state laws invalidating class action waivers on public policy grounds? Regardless of how the courts answer these and other questions, the Supreme Court’s decision in *Stolt-Nielsen* may provide further impetus for ongoing congressional efforts to limit the enforceability of arbitration clauses altogether.

(v) **“Lessons Learned” in Litigation:
Practice Pointers for Franchise Agreement Arbitration Provisions**

Since class actions in arbitration are now possible, lawyers also have learned lessons on how to draft an arbitration clause.

☑ **“Carve out” certain exceptions to mandatory arbitration.** If the franchisor decides that arbitration is its preferred method of dispute resolution, the franchisor should consider including in the franchise agreement a “carve-out” provision in the arbitration clause. At a minimum, such a carve-out provision should permit the franchisor to obtain preliminary injunctive relief in court to protect its intellectual property — thereby avoiding the pitfalls of obtaining and enforcing preliminary injunctions in arbitration.

☑ **Beware of “carve-outs” that are so one-sided as to jeopardize enforceability of the arbitration clause.** Some franchisors have broad carve-outs that preserve their flexibility to litigate many types of disputes. One example is the following:

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

Too many exceptions to compulsory arbitration, however, can create a complicated clause that may also strike a court as unbalanced and unfair — jeopardizing the franchisor’s ability to enforce the franchisee’s obligation to arbitrate.

³⁰ See 559 U. S. at ___, n. 3 (“We do not decide whether “manifest disregard” survives our decision in *Hall Street Associates, L. L. C. v. Mattel, Inc.*, 552 U. S. 576, 585 (2008), as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. § 10.”). The Supreme Court’s prior decision in *Hall Street* was the subject of an April 3, 2008 *Legal News Alert* entitled “[Supreme Court Limits Scope of Judicial Review of Arbitration Awards.](#)”

- ☑ **Do not agree to “carve-outs” that, as a practical matter, eviscerate the arbitration clause.** Especially if the franchisor has carved out from the arbitration clause the right to seek preliminary injunctive relief in court to protect intellectual property, the franchisee may demand a *quid pro quo*. For example, the franchisee may want the right to obtain preliminary injunctive relief in court to prevent termination or nonrenewal of the franchise agreement. As a practical matter, such a carve-out may eviscerate the arbitration clause. Most if not all of the merits of the parties’ dispute may be related to termination or nonrenewal. Although not a final decision on the merits, the preliminary injunction decision often prompts a final resolution of the parties’ dispute, and a franchisee that has obtained a preliminary injunction against termination or nonrenewal has little incentive to cooperate in an expeditious final resolution in arbitration.

Even without such a carve-out, a franchisee may be able to obtain a preliminary injunction against termination or nonrenewal pending the outcome of the arbitration. There is authority to the effect that the federal courts have the inherent power to preserve the status quo pending arbitration.³¹ This same authority would entitle a franchisor to preliminary injunctive relief to protect its intellectual property pending the outcome of the arbitration. Many of these cases were decided before the American Arbitration Association and other ADR providers amended their rules to specifically provide for preliminary injunctive relief. Whether such cases would be decided the same way today is therefore subject to debate.

- ☑ **Require arbitration on a franchisee-by-franchisee basis and specifically disclaim class action arbitrations.** Now that class actions are in fact arbitrable, the presence of an arbitration clause is no barrier to system-wide arbitration. As a result, the franchise agreement should require arbitration on a franchisee-by-franchisee basis and specifically disclaim class action arbitrations. One of the impediments to doing so, of course, however, is that franchise agreements may have a relatively long term and — by virtue of state franchise “relationship” laws — the franchisor’s right to amend and/or “substantially change the competitive circumstances” may be severely limited. Even if the franchisor can impose such a provision, its enforceability may be questionable.

1.3 What is the venue for international dispute resolution proceedings?

Class actions are a U.S. phenomenon, but like other good and bad things in the states, somehow these tactics tend to creep into other jurisdictions.

³¹ See, e.g., *Guinness-Harp Corp. v. Jos. Schlitz Brewing Co.*, 613 F.2d 468, 472 (2d Cir. 1980): Applying the federal policy of the Arbitration Act, a federal court is entitled to adjudicate “issues relating to the making and Performance of the agreement to arbitrate,” *Prima Paint Corp. v. Floor & Conklin Mfg. Co.*, 338 U.S. 395, 404, 87 S. Ct. 1801, 1806, 1807, 18 L. Ed.2d 1270 (1967) (emphasis added), and it is empowered to grant specific performance of the agreement to arbitrate. Here maintenance of the status quo pending arbitration relates in a substantial way to the performance of the agreement. Guinness is therefore entitled to specific performance of its arbitration agreement, including the status quo provision.

(footnotes omitted).

(i) ***Litigation***

Whereas the U.S. has highly developed and widely used class action procedures and jurisprudence comprising franchising decisions, this is generally not the case in other jurisdictions. Those that do permit class actions, rarely find that they are used in franchise disputes. The type of cases which are usually litigated through class action tend to be personal injury, accidents and disasters, bad effects of pharmaceutical products or medicines, asbestos, environmental causes, action by shareholders of a major company. As a result, system wide litigation outside of the U.S. tends to comprise a series of independent parallel actions. The position is best illustrated by considering a selection of jurisdictions.

England. Under part 19.6 of the English Civil Procedure Rules (“CPR”), a representative action may be brought by or against one or more persons who have the same interest in a claim as representatives of any other persons who have that interest. The order can only be binding on persons represented or who have opted in.

The High Court will examine whether the group or class of claimants have the same interest, and whether the relief sought would be equally beneficial for the members of the class. If the damage suffered is significantly different between the members the court may not allow it .

Under CPR 19.1, a Group Litigation Order (“GLO”) can be made for claims which give rise to common or related issues of fact or law.

The GLO is the commonest form of group or collective claim in the UK. It is regulated by CPR 19.10-15. It can be used where a number of different claims give rise to “common or related issues of fact or law” (r.19.10). The interests of the Claimant do not have to be identical. A GLO can be made by the court in a single case with multiple Claimants, or in multiple cases with multiple Claimants.

A party to the proceedings may apply for a GLO to be ordered, or a Court may order a GLO of its own initiative. The GLO regime allows a Court to manage the various individual claims covered by the GLO in a more effective and co-ordinated way than if the individual claims were brought and progressed separately. So, for example, the GLO may require the establishment of a “group register”, or enable a Court to select particular claims as “test” claims. However, any judgment, and in particular the assessment of damages, will still take into account the individual circumstances of each member of the GLO.

GLOs have never really taken off in the U.K. This is because of lack of funding options, the risk of adverse cost awards and the possibility that costs may outweigh benefit.

India. In India, Rule 1 of Order 1 of the Civil Procedure Code allows plaintiffs to be joined in one suit if they are seeking a remedy in respect of the same act(s) or transactions. Rule 8 of Order 1 allows one person to sue or defend on behalf all who have the same interest with the permission of the court. For a representative suit, all members of the alleged class must have a common interest, a common grievance and the relief must be beneficial to all. There are no reported cases involving franchising.

China. In China, representative action is possible under PRC Code of Civil Procedure (adopted on April 9, 1991, revised on October 28, 2007) (“Civil Procedure”). Pursuant to Article 53 of Civil Procedure, where one party or both parties to an action comprise of two or more persons with a common or similar category of action, the claims may be combined in a joint action if the people's court deems it appropriate and all parties agree with it.

If the persons constituting a party to a joint action have common rights and obligations with respect to the object of the action, the act of procedure of one member, if recognised by the others of the party, shall be binding on the other members. If the individual members of one party do not have common rights and obligations with respect to the object of the action, an act of procedure of one member of the party shall have no binding force on the other members of the party.

Pursuant to Article 54 of Civil Procedure, if one party to a joint action consists of many persons, a representative may be chosen by and from the party to conduct the case. The procedural acts of such a representative shall be effective in relation to all members of the party, but any modification or waiver of the claims of the action or confirmation of the claims of the other party or entry into a compromise shall be subject to approval by the representative's whole party.

Pursuant to Article 55 of Civil Procedure, where the objects of an action are of the same category and members of one party are numerous and of an uncertain number at the time the action is initiated, the people's court may issue a public notice stating the case particulars and the claims of the action and advise claimants to register at the people's court within a specified period.

Claimants who register with the people's court may select a representative to conduct their case. If a representative is unable to be determined through the selection process, the people's court may decide on a representative after consultation with the registered claimants.

The procedural acts of such a representative shall be effective in relation to all members of the party, but any modification or waiver of the claims of the action or confirmation of the claims of the other party or entry into a compromise shall be subject to approval by all the claimants represented.

The judgments and rulings of a people's court shall be effective on all claimants registered with the court in relation to an action. These same judgments and rulings shall also apply to other claimants who are not registered, but who initiated legal proceedings during the relevant period of the action.

It is possible that Chinese law firms may collect contingency fees from their clients if the same is provided in their agreements.

If the franchisee breaches any of its obligations under the franchise agreements, it would normally be liable for such breaches. PRC courts mainly focus on the provisions stipulated in the franchise agreement if any dispute between the franchisee and franchisor arises during the performance of franchise agreement.

Class actions are common in China and there are examples. In December 2009, 10 franchisees brought a civil lawsuit before the Court of Xu Hui District in Shanghai, in which these plaintiffs claimed that the quality of product (a kind of cooling spray used in vehicles) provided by the franchisor did not meet the PRC standards related to such product and the effects advertised by the franchisor. The Court decided that the agreements between the franchisees and franchisor should be terminated and that the franchisor reimburse the payment by the franchisees for such product to the franchisees respectively.

In April 2009, 4 franchisees brought a civil lawsuit before the Second Intermediate Court of Shanghai, in which these plaintiffs who claimed that the franchisor deprived the franchisees of the management power to their restaurants and intended to merge these franchisees. This lawsuit is still pending in the Court. In China, representative action is possible under Articles 54 and 55 of its Civil Procedure Law.

Australia. In Australia, class actions (or representative proceedings as they are formally known) can be started by a representative applicant where there are seven or more people who have claims which arise out of the same or related circumstances and that give rise to a substantial issue of fact or law. Australia uses the opt-out model and so every person in the described class is assumed to be part of the action.

In 1992, the Federal Court of Australia Act 1976 (the “Act”) was amended to include Part IVA to allow class actions to be brought in the Federal Court. Victoria also introduced a class action scheme which is essentially identical to the Federal Court scheme and is under Part 4A of the Supreme Court Act 1986. In other States and the Territories, there are representative procedures available but they are not, strictly speaking, “class actions”. They involve “same interest” procedures which traditionally have been narrowly interpreted but their scope has broadened in recent years.³²

The key provisions of the Act are contained in section 33, which addresses the procedural issues that must be followed as well as the rights of the parties in class actions. The Australian Competition and Consumer Commission (“ACCC”) has the power to bring class actions on behalf of persons under s 87(1B) of the Trade Practices Act. A recent example of a class action against a franchisor is the *Allphones Retail Pty Ltd* case in which the franchisor and its current and former directors and executives were sued on behalf of certain current and former franchisees.³³

Brazil. The first Brazilian statute dealing specifically with class action procedure was enacted in 1985³⁴. This statute, known as the Public Civil Action Act. In 1990, the legislature enacted the Consumer Code.³⁵ The Consumer Code made it clear that its class action rules are available to solve controversies in environmental, antitrust, torts, tax, and any other branch of the law. The Public Civil Action Act and the Consumer Code complement each other and amount, in effect, to a code of class action procedure.³⁶

Article 5 of Brazil’s Constitution specifically relieves popular action plaintiffs of court costs if they lose their case. If the plaintiff litigates frivolously, they will have to pay the defendant’s costs but not its counsel expenses. The authors are not aware of any reported franchisee class action in Brazil.

Japan. Japan does not have U.S. style (opt-out type) class action procedures. By contrast, in Japan, those who wish to benefit from a collective action for individual damages must affirmatively declare their position by opting into the collective action. More specifically, persons or entities which wish to seek their claim in collective way may either file a joint lawsuit together with other persons or entities that wish to seek the same sort of claims, or join a pending lawsuit with which they share common interests by appointing the plaintiff as a party to stand on their behalf. Those that join a pending lawsuit may be said to be an “opt-in-type” class action. Hereinafter, we refer to the two types as a “Collective Action”, collectively.

In addition, Japan has recently introduced the “Consumer Organization Lawsuit System” which enables a consumer organization certified by the Prime Minister of Japan to demand an injunction against the business operator which conducts such acts as prohibited by the Consumer Contract Act (Act No. 61 of 2000) on behalf of consumers. The target of this new system is consumer contracts entered into between consumers and business operators, and does not include franchise agreements, where franchisees execute

³² *Carnie v Esanda Finance Corp Ltd* (1995) 182 CLR 398.

³³ The ACCC also brought further action against Allphones in late 2009 and the parties agreed an undisclosed out of court settlement thought to be in the region of AUD \$1m-3m

³⁴ See Lei da A_ç_ao Civil P´ublica, Lei n. 7,347, de 24 de julho de 1985

³⁵ See C´odigo de Prote_ç_ao e Defesa do Consumidor

³⁶ American Journal of Comparative Law, vol 51

franchise agreements for the purpose of business even if franchisees are individuals. Therefore, it would not be applicable to franchise agreement related law suits.

The Civil Procedure Code of Japan (No. 109 of 1996) is the core statute of civil litigation procedure. All the provisions applicable to ordinary civil suits are applicable to the Collective Action, subject to certain special provisions applicable only to "opt-in-type" class action.

In general, contingency fees for attorneys in relation to lawsuits are possible under Japanese law. It depends on the engagement agreement between client and its attorney.

If a franchisee does not opt in to a Collective Action, the franchisee's claim is separated from the Collective Action, so that the franchisee cannot benefit from a successful result of the Collective Action. The franchisee is just regarded as a plaintiff of another lawsuit seeking its own claim, and cannot withdraw its claim without the consent of the counterparty (*i.e.*, the franchisor) after the franchisor has already made statements (*i.e.*, response) or attended a court hearing.

Collective Actions are not common in franchising; however, some cases have been reported where franchisees have jointly filed a lawsuit against the relevant franchisor.

One example is that seven franchisee managers of Seven-Eleven Japan Co. filed a lawsuit seeking payment in compensation for losses they said resulted from unfair business practices by the company.

Another example is that a number of franchisees (most of which are engaged in food restaurants) formed an association (named as "National Network of Venture-link Victims") and jointly filed some lawsuits against several franchisors and their common advisor, Venture-link Co. Among those lawsuits, the Tokyo High Court has recently awarded about 47 million Japanese yen in compensation by the reason of the franchisors' default of obligation in relation to management instruction.

(ii) *Arbitration*

International franchise disputes often involve arbitration. However, not all of the arbitration systems specifically provide for class action claims. Some of the international arbitration procedures frequently used include:

- International Chamber of Commerce arbitration rules (2008) ("ICC");
- UNCITRAL arbitration rules (2006); and
- London Court of International Arbitration ("LCIA") – ad hoc arbitration.

Under the ICC rules³⁷, Article 10 provides for multiple parties choosing their arbitrator jointly as claimant. The rest of the procedure is given in articles 20-23. Class actions are possible if all the parties involved accept that. However, there have been no franchise class actions under ICC rules so far as the authors are aware.

Section III of the UNCITRAL arbitration rules make provisions for arbitral proceedings. For example, Articles 24 and 25 address how the parties shall give evidence and the procedure at a hearing. Again, the authors are not aware of any franchise class actions under UNCITRAL.

³⁷ 1998 as updated in 2008

(iii) **General**

If the individual franchisees or the franchisor are based in different countries and the venue is not stated in the franchise agreement, it will be necessary to determine which courts are most appropriate for resolution of the dispute. Considerations include the country where the cause of action took place, where the defendant franchisor is located, procedure in each legal system and the remedies available (in terms of quantum or damages, etc.). However, this decision is usually made upfront when the original deal is done as the franchise agreement will usually provide for the choice of law and jurisdiction. If different the franchisees have different agreements which provide for different law and/or jurisdiction, then a class action maybe somewhat difficult.

If forum shopping is possible, the choice of venue for class actions will usually be determined by considering factors such as the ability of the courts to award costs against the claimants, the likelihood of success, the cost of litigation and the availability of contingency fees. For these reasons, for example, U.K. franchisees of a U.S. franchisor would usually prefer to litigate as a class in the U.S., as in the U.K. courts the loser may have to pay the winner's costs,³⁸ there is less likelihood of success, the cost of litigation may be more than damages recoverable, and each individual may have different levels of loss.

2. Managing System-Wide Dispute Resolution

2.1 What role will the in-house lawyer play when a claim is brought?

As with most comprehensive and wide-reaching litigation, the franchisor's in-house lawyers are critical, not only with respect to the defense of the litigation itself but, as importantly, with respect to how the company and its personnel manage through the negative publicity and resource drain that usually accompany such litigation. The company's general counsel, as a member of the senior management team, might also be named as a defendant in the proceedings and, as a result, be the subject of what might be volatile and inflammatory allegations against him or her personally. It is critical to avoid letting the emotions aroused by those allegations drive strategy and decisions.

When the franchisor is served with major litigation, the company's in-house lawyers must immediately begin the process of preserving evidence, notifying insurance carriers, and assembling the outside legal team. Following are a few of the key missions and objectives of the franchisor's in-house lawyers when faced with system-wide litigation:

(i) *Selecting and Managing the Outside Legal Team*

The franchisor should recognize that the company's normal outside counsel might not be the appropriate lawyers to represent it in the litigation. That decision can be a tough one to make, particularly where the relationship with outside counsel has developed over years, but the assessment of outside counsel is necessary and must be commenced immediately.

- Franchisors who have defended against similar lawsuits will generally be willing to discuss their experiences with, and the pros and cons of, the outside counsel who represented them. Reach out to those franchisors who successfully defeated the claims as well as those who were unsuccessful, and try to understand why. Realize that franchisors who are in the midst of defending ongoing litigation will be reluctant to see their outside counsel take on another time-consuming case.

³⁸ Group Litigation Order – 19.6 and 19.11

- Interview prospective outside counsel. Assess counsel's existing work load, particularly the demands other clients and cases are placing on the lead lawyer's time. Get commitment from the designated lead lawyer, not just from the law firm. The franchisor is putting together a team, so it should understand and be comfortable with how outside counsel intends to staff the engagement. Set clear guidelines for work assignments to avoid duplication of effort and to ensure that the appropriate talent is dedicated to the various tasks.
- Develop and agree upon a budget with outside counsel. Consider alternative fee structures. It is often difficult to predict the evolution of complex litigation, but in-house counsel should make every attempt to hold their outside lawyers to the budget. Ask for and review detailed billings in order to understand what is being done and who is doing it. Demand off-the-clock periodic updates.
- Actively participate in the proceedings. Either because they get caught up in the regular business of the franchisor or because they feel ill-equipped, in-house lawyers will often become passive players. Drive strategy. Determine what the franchisor's ultimate objective should be, whether it be to defend the case at all costs or to position the case for settlement. Help develop the strategy to get the company to its ultimate objective then work with and hold outside counsel accountable for getting there. If the general counsel is not going to be available, he or she should assign a second-in-command, with authority, to actively participate in the process.
- Be prepared to make decisions, adjusting strategy where necessary. Not everything will go according to plan, and interests and objectives will change, especially in lawsuits that could last several years. Accept that fact and be prepared to adjust, including not only with respect to overall strategy but with respect to ultimate objectives.

(ii) ***Managing Internal Resources***

In addition to managing outside counsel, the in-house lawyer will be responsible for helping to set and manage the expectations of the company's senior management team and board of directors. In-house counsel will also play a critical role in managing internal resources. The close management of these resources is particularly important given that the company's internal personnel will likely be working with and providing support to the plaintiff franchisees, including those who are either class representatives or class members, as they continue to operate their franchised units.

- Regularly update senior management with respect to the status of the litigation as well as any changes in objectives or strategy. They and their teams will be carrying out the franchisor's missions and will often become witnesses in the litigation. Therefore, they must understand their roles and drive toward the common goal at all times. That becomes impossible if they are not continuously updated with respect to the litigation. This is particularly true with respect to statements they and their teams might make to franchisee class members and actions they might take with respect to the franchise system (for example, if the litigation involves vendor rebates, the senior management team needs to know to consult with in-house counsel, who should consult with outside counsel, before re-negotiating vendor contracts). Participation of functional department heads will also be critical when coordinating deposition schedules and discovery responses and, of course, when arranging for preparation for and participation as witnesses in hearings and trial. Coordination between the legal department and

functional department heads will be necessary to avoid the company's rolling out new initiatives when personnel are needed in connection with the litigation.

- Make sure the field teams have the appropriate tools not only to perform their functional roles but also to avoid saying or doing anything that might cause problems for the company in the litigation. This is especially critical where the litigation involves existing franchisees. Depending on how the franchisor is structured, field team members are often charged with and are compensated on getting the franchisees to follow the required operating procedures. That is sometimes best accomplished by the field team member's developing a strong personal and trust-based relationship with the franchisee. The team member's natural inclination will be to be sympathetic to the franchisees' complaints, and that can result in the team member's being used by the franchisee to gain an advantage in the litigation. The in-house lawyer should provide training to field team members so that they clearly understand what statements and actions should be avoided and to sensitize them to what should be cleared through counsel on a go-forward basis. It might be helpful and appropriate to develop a set of likely questions and appropriate answers to serve as guidance to field team members.
- If the franchisor is still actively selling franchises, the sales teams will likely encounter questions and objections from prospective franchisees, particularly if the litigation has received the attention of the media. In-house counsel should assist in developing appropriate responses to these likely questions and objections realizing, of course, that the natural tensions between the sales team (who are often compensated based on achieving sales goals) and the legal department will be enhanced during this period.
- In-house counsel should always be mindful that rank and file employees will glean whatever they can from the actions and demeanor of everyone in the legal department in order to gauge the seriousness and severity of the litigation. Legal department staff should be constantly reminded of the importance of their roles, not only in connection with the litigation (including their confidentiality obligations), but also in sending the appropriate messages and setting the appropriate tone for the rank and file.

(iii) *Managing the Media and Social Media*

With the availability of the Internet, any high profile litigation is likely to draw media attention as well as comments from bloggers and other participants in social media. The in-house lawyers should participate in developing the media strategy and in creating and enforcing the company's policies with respect to social media.

- Access to media should be restricted. Members of the media will utilize whatever tools available to them to "get the story." That includes trying to access information from unsuspecting sources. Discussions with the media should be restricted to the franchisor's chief executive officer and the general counsel. Allowing others, particularly other corporate officers, to participate in media interviews opens the door to possibly conflicting statements, improper release of information and inconsistent statements that could be used against the company in the litigation.
- Prohibit franchisor personnel from discussing the litigation on social media. With the ever increasing presence of unregulated franchisee gripe sites and blogs, the franchisor's personnel will be tempted to follow the chatter. When an outrageous or outright false

assertion or personal attack is made, it becomes too enticing to respond to it to “set the record straight.” Not only is this a huge diversion from the company’s proper mission, but it likely provides the plaintiffs with information that could perhaps be used against the company in the litigation. On the other hand, the franchisor can, at times, access information about the plaintiffs that could become important in the litigation. In-house counsel should assign someone to monitor, but not participate in, the internet chatter and blogs.

(iv) ***Managing the Franchise Relationships***

Depending on the nature of the litigation, the plaintiffs might be former franchisees, but as likely, they might be existing franchisees who are continuing to operate as such under their franchise agreements. The franchisor cannot lose sight of the fact that it has continuing obligations under its franchise agreements and, unfortunately, those obligations might run in favor of persons who also happen to be suing the company. Managing the franchise relationships during the litigation is critical and could set a trap for unsuspecting counsel, particularly in the U.S.

- In-house counsel must be mindful of any rules and regulations or codes which govern their roles as lawyers. In the U.S., all attorneys are bound by codes of ethics that prohibit direct contact with opposing parties who are represented by counsel. This is particularly problematic in the context of a class action where the class representatives and members of the class are existing franchisees with whom the franchisor continues to do business on a daily basis. Until the class is certified, in-house counsel should, without the consent of opposing counsel, avoid direct contact with the named class representatives. Once the class is certified, the entire class, particularly in the U.S. where class members are required to opt out, should be viewed as an opposing party represented by counsel. It is helpful to try to make an arrangement with plaintiffs’ counsel that would allow communications with the franchisees on routine matters, perhaps with a copy to opposing counsel. But the better posture would be to avoid direct lawyer-to-franchisee client under those circumstances.
- Make sure that the franchisor is in compliance with its obligations under the franchise agreements and is providing the franchisees with the levels of support required under the franchise agreements. Changes to operating procedures should be reviewed and understood to avoid creating admissions against interest.
- Provide the franchisor’s personnel with regular reminders that all communications and other documents are likely to be discoverable in the litigation. In-house counsel should review and approve any communications to the franchise system during the pendency of the litigation, particularly communications that bear any relationship to the issues in the litigation.
- Document the franchisee’s failure to comply with its franchise agreement. Continue to hold franchisees accountable for those failures but be mindful to avoid taking action which might be viewed as taken in retaliation for the franchisee’s participation in the litigation or for the franchisee’s participation in a franchisee association, particularly in those jurisdictions where the franchisees’ right to associate is statutorily protected.
- Prior to certification of the class, attempt to reduce the size of the class pool by amicably resolving disputes with and securing releases from franchisees. Class counsel will likely

attempt to have the court void the releases, but being able to demonstrate fair consideration for the releases will help diffuse plaintiffs' counsel's argument.

2.2 What is the anatomy of a typical system-wide dispute in the U.S.?

The adage, “I know it when I see it” — the definition of pornography adopted by the late Justice Potter Stewart in his concurring opinion in the U.S. Supreme Court's decision in *Jacobellis v. Ohio*, 378 U.S. 184 (1964) — may *not* apply to the litigation of system-wide disputes in the U.S. A system-wide dispute may manifest itself — at least at first — in the form of a lawsuit against a franchisor brought by a single franchisee. (Or a franchisor may commence a “test case” against a single franchisee.) If the “test case” has been brought by a franchisee association and/or plaintiffs' franchisee lawyers, the claims of the lone plaintiff may be similar to those shared by many franchisees. Rather than litigate all or many claims at once, franchisees may decide they are better off trying to first establish a precedent for the benefit of other franchisees. Alternatively, once one franchisee has filed suit asserting a common complaint, other franchisees may end up “waiting in the wings” to see how the case turns out. Either way, a franchisor may find itself named as a defendant:

- in a “Judicial Hellhole®” — perhaps a state court with elected judges;
- brought by a plaintiff who is attractive, personable, and otherwise a proverbial “pillar of the community;” and
- in which the facts — even without a “home court advantage” — are likely to skew the results in favor of the franchisee.

Conversely, a franchisor facing a system-wide dispute may commence a declaratory judgment or other action against a franchisee (or group of franchisees) in the hope of establishing a favorable precedent. Under these circumstances, the franchisor might:

- select a forum that is its home court, is judicially conservative and pro-business, and is within the jurisdiction of a U.S. Circuit Court of Appeals with favorable precedents;
- name as defendant(s) one or more franchisee(s) whose poor performance, demeanor, or other negative characteristics may affect the outcome on the merits; and
- assert causes of action that frame the issues more favorably from the standpoint of the franchisor than would a simple breach of contract claim and/or a declaratory judgment action seeking a judicial determination that the franchisor has not violated franchise “relationship” laws.

(i) ***Not-So-Typical System-Wide Litigation:
Volvo Market Withdrawal Litigation***

Or sometimes both the franchisor and the franchisee may commence “test cases.” That was certainly true during the nine years of litigation over a system-wide dispute involving Volvo Construction Equipment North America, Inc. (“Volvo Construction”). This dispute (the “Volvo Market Withdrawal Litigation”) was the subject of litigation in state and federal courts in Arkansas, Connecticut, Kansas,

Illinois, New Jersey, North Carolina, and Texas.³⁹ The Volvo Market Withdrawal Litigation followed a series of acquisitions of competing manufacturers by the European parent of Volvo Construction, the Volvo Construction Equipment Group in Brussels, Belgium. The acquired manufacturers included Champion Road Machinery Limited (“Champion”) in Canada and Samsung Heavy Industries (“Samsung”) in Korea. As a result of these acquisitions, Volvo Construction ended up with significant overlaps in its North American distribution. In some cases, Volvo Construction found itself with as many as three dealers in a given geographic area. Pursuant to an ongoing program of “Volvoization,” the products of these acquired construction equipment manufacturers were — following the acquisitions — rebranded under the VOLVO® trademark. Pursuant to an ongoing program of dealer “rationalization,” what had previously been three separate dealer networks were consolidated into one network of Volvo Construction equipment dealers.

Some of the cases in the Volvo Market Withdrawal Litigation went all the way to trial in courts that were not exactly franchisor-friendly. For example, following a two-week trial, Volvo Construction obtained a unanimous defense verdict from a state court jury in Corpus Christi, Texas.⁴⁰ The verdict reflected a defense strategy to address jurors in terms to which they, as consumers, could relate so that they would understand the franchisor’s desire to have greater control over its distribution and offer “one-stop shopping.

One case that was ultimately decided in federal court in Asheville, North Carolina resulted from “dueling test cases” brought by both the franchisor and several franchisees. The franchisees were equipment dealers in various alleging multiple statutory, tort, breach of contract, and quasi-contractual claims. Following procedural wrangling over whose choice of forum would be given precedence,⁴¹

³⁹ Mr. Lockerby represented Volvo Construction in the Volvo Market Withdrawal Litigation.

⁴⁰ The plaintiff in *Nueces Farm Center, Inc. v. Volvo Construction Equipment North America, Inc.*, Trial Court Cause No. 00-4732-E (Dist. Ct. Nueces County, Texas 2000) challenged the termination of its dealer agreement. The termination resulted from Volvo Construction’s decision to discontinue the manufacture of CHAMPION motor graders and to rebrand the product with the VOLVO® trademark. The plaintiff in Corpus Christi sought recovery based on more than a dozen legal theories. The relief sought included approximately \$6 million in compensatory damages for breach of contract and wrongful termination in violation of the Texas Farm, Industrial and Outdoor Equipment Act; punitive damages for fraud and tortious interference with contract; treble damages for violation of the Texas Deceptive Trade Practices Act, and costs and attorneys’ fees. By the time of trial, the plaintiff — which was represented by the law firm of Dady & Garner, P.A. — had spent in excess of half a million dollars on attorneys’ fees, expert witness fees, and other costs. Following more than two years of litigation, the case was submitted to the jury in September 2002. Although the presentation of the evidence had taken nearly a week and a half, it took the jurors less than half an hour to reach a unanimous verdict in favor of Volvo Construction.

⁴¹ Rather than defend a multiplicity of actions by terminated CHAMPION dealers in a multiplicity of forums, Volvo Construction and two affiliated companies sought a declaratory judgment that the termination of various CHAMPION motor grader dealers in various states was proper. The plaintiffs also sought a ruling that the federal trademark statute, the Lanham Act, preempted and therefore “trumped” the various state franchise and dealership “relationship” laws under which the dealers contested their termination. In particular, the plaintiffs sought a declaratory judgment that it would violate the Lanham Act if Volvo Construction were required to supply VOLVO®-branded product to dealers that — like the plaintiff in Corpus Christi — had not previously been licensed to use the federally registered VOLVO® trademark. The plaintiffs also sought a declaratory judgment that, under the Lanham Act, they could not be forced to license the VOLVO® trademark to dealers whose contracts had been assigned to Volvo Construction following the Champion acquisition (such as the dealer that had previously filed suit in Corpus Christi).

In fact, one of the defendants named in the declaratory judgment action in Asheville was the plaintiff in Corpus Christi. The dealer in Corpus Christi was unsuccessful in having Volvo Construction’s Lanham Act claims dismissed notwithstanding the pendency of the first-filed action in Nueces County, Texas. *Volvo Trademark*

Volvo Construction obtained judgment on the pleadings dismissing all claims and counterclaims of all dealers.⁴² On appeal, the Fourth Circuit affirmed the dismissals with the exception of one statutory claim asserted by one dealer — a claim for violation of the Arkansas Franchise Practices Act (the “AFPA”).⁴³ On remand, notwithstanding a subsequent judicial determination that Volvo Construction had violated the AFPA⁴⁴, the jury found that the plaintiff had suffered no damages. The district court thereafter refused to order a new trial⁴⁵ or award attorneys’ fees⁴⁶ as the Arkansas dealer sought. The Fourth Circuit affirmed this judgment on appeal.⁴⁷

Ironically, the very first case to be filed in the Volvo Market Withdrawal Litigation (back in the year 2000) was the very last to reach final resolution. Initially all of the plaintiffs’ claims — which had been asserted by multiple dealers from the U.S. and Canada — were dismissed on summary judgment by the Chicago trial court, the U.S. District Court for the Northern District of Illinois.⁴⁸ On appeal, the Seventh Circuit affirmed the dismissals with the exception of one statutory claim of one dealer.⁴⁹ That

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Holding Aktiebolaget v. Nueces Farm Center, Inc., No. 1:01cv122-T, 2001 U.S. Dist. LEXIS 17635 (W.D.N.C. Oct. 26, 2001).

All of the dealers were also unsuccessful in obtaining dismissal of Volvo Construction’s complaint. The dealers contended that the Lanham Act claims were not actionable and that federal question jurisdiction was therefore lacking. The court denied the motion, rejecting the dealers’ argument “that this case presents nothing more than a contract dispute over the termination of the dealership agreements.” *Volvo Trademark Holding Aktiebolaget v. AIS Construction Equipment Corp.*, 162 F. Supp. 2d 465, 470 (W.D.N.C. 2001).

While their motion to dismiss the declaratory judgment action was still pending in North Carolina, the dealers commenced a separate action against Volvo Construction in federal court in Little Rock, Arkansas on March 20, 2001. On June 21, 2001, the Arkansas federal court transferred the case to North Carolina. *AIS Construction Equipment Corp. v. Volvo Construction Equipment North America, Inc.*, Court File No. 4-01 CV 00166 (SWW) (E.D. Ark. 2001). Following transfer, the case was consolidated for trial with the Lanham Act claims of Volvo Construction and its affiliates. The dealers named as defendants in the declaratory judgment action in Asheville later filed counterclaims that were virtually a mirror image of the claims asserted in the complaint that they had originally filed in Arkansas.

⁴² *Volvo Trademark Holding Aktiebolaget v. CLM Equipment Co.*, 236 F. Supp. 2d 536, 2002 U.S. Dist. LEXIS 25837 (W.D.N.C. Dec. 13, 2002).

⁴³ *Volvo Construction Equipment North America, Inc. v. CLM Equipment Co.*, 386 F.3d 581 (4th Cir. 2004).

⁴⁴ *Volvo Trademark Holding Aktiebolaget v. AIS Construction Equipment Corp.*, 416 F. Supp. 2d 404, 2006 U.S. Dist. LEXIS 10020, Business Franchise Guide (CCH) ¶ 13,279 (W.D.N.C. Feb. 16, 2006).

⁴⁵ *Volvo Trademark Holding Aktiebolaget v. CLM Equipment Co.*, 2006 U.S. Dist. LEXIS 64626 (W.D.N.C. Sept. 8, 2006) (denying dealer’s motion for new trial following jury verdict that it suffered no damages as a result of termination in violation of Arkansas Franchise Practices Act).

⁴⁶ *Volvo Trademark Holding Aktiebolaget v. CLM Equipment Co.*, 2006 U.S. Dist. LEXIS 75515 (W.D.N.C. Oct. 2, 2006) (denying dealer’s motion for costs and attorneys’ fees on the grounds that the dealer had not been harmed by the violation of the Arkansas Franchise Practices Act and on the grounds that a reasonable attorneys’ fee for the recovery of zero damages was zero).

⁴⁷ *Volvo Trademark Holding Aktiebolaget v. Clark Mach. Co.*, 510 F.3d 474 (4th Cir. 2007).

⁴⁸ *Cromeens, Hollomon, Sibert, Inc. v. AB Volvo*, 2001 U.S. Dist. LEXIS 15482 (N.D. Ill. Sept. 25, 2001).

⁴⁹ *Cromeens, Hollomon, Sibert, Inc. v. AB Volvo*, 349 F.376, 2003 U.S. App. LEXIS 22859 (7th Cir. Nov. 7, 2003), *reh’g denied*, 2003 U.S. App. LEXIS (7th Cir. Dec. 17, 2003). The statute at issue, the Maine Franchise Law, explicitly states that a manufacturer has “good cause” for termination if it discontinues the production or distribution of the franchise goods. The statute defines “franchise” in terms of a license to use a trademark. On remand, however, the district court held that discontinuation of the manufacture of excavators under the SAMSUNG trademark was insufficient to establish discontinuation of the franchise goods. *FMS, Inc. v. Volvo Construction Equipment North America, Inc.*, 2005 U.S. Dist. LEXIS 1808 (N.D. Ill. Jan. 20, 2005). Rather, the district court held, the franchise goods would be discontinued only if the rebranded VOLVO[®] excavators were “substantially changed” and “substantially different” from the discontinued SAMSUNG excavators. Based on this interpretation

one remaining claim was not decided until last year. In a subsequent appeal following trial in Chicago, the Seventh Circuit held that the scope of a “franchise” protected from termination without “good cause” is limited to the trademark that the dealer, distributor, or franchisee has been authorized to use. *FMS, Inc. v. Volvo Construction Equipment North America, Inc.*, 2009 U.S. App. LEXIS 4938 (7th Cir. March 4, 2009), rev’g 2007 U.S. Dist. LEXIS 19577 (N.D. Ill. March 20, 2007).⁵⁰ In so holding, the Seventh Circuit rejected the notion that “franchise” protections extend to similar goods and services that manufacturers and franchisors offer under other trademarks. The significance of the decision is reflected in the fact that three trade associations submitted a “friend of the court” brief to the Seventh Circuit in support of Volvo Construction’s position: (1) the National Association of Manufacturers (www.nam.org), comprised of 14,000 companies in every industrial sector in every state; (2) the Association of Equipment Manufacturers (www.aem.org), comprised of more than 800 companies that manufacture agriculture, construction, forestry, mining, and utility equipment; and (3) the National Marine Manufacturers Association (www.nmma.org), comprised of more than 1,400 companies that manufacture products used by recreational boaters — including boats and engines.

Like much commercial litigation in the U.S., other cases that resulted from the Volvo Construction Market Withdrawal were resolved at the preliminary injunction stage or “on the courthouse steps” once trial was underway. These include cases brought against Volvo Construction or affiliated companies in federal courts in Hartford, Connecticut⁵¹ Kansas City, Kansas,⁵² Memphis, Tennessee,⁵³ and Trenton, New Jersey. In Trenton, the case settled following pre-trial rulings limiting the damages

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of the Maine Franchise Law that was reflected in the district court’s jury instructions, the jury found liability and awarded the damages sought by the plaintiff. The district court entered judgment on the verdict. *FMS, Inc. v. Volvo Construction Equipment North America, Inc.*, 2007 U.S. Dist. LEXIS 19517 (N.D. Ill. Mar. 20, 2007). The Seventh Circuit heard oral argument on January 25, 2008 (www.ca7.uscourts.gov/fdocs/docs.fwx?caseno=07-1896&submit=showdkt&yr=&num=) and issued its [ruling](#) in favor of Volvo on March 4, 2009.

⁵⁰ The Seventh Circuit’s March 4, 2009 [opinion](#) is publicly available on the Seventh Circuit web site, as is a recording of the January 25, 2008 [oral argument](#).

⁵¹ The plaintiff’s claims in *F&W Equipment Corp. v. Volvo Construction Equipment North America, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,028 (D. Conn. March 7, 2001) arose out of Volvo Construction’s discontinuation of the SAMSUNG excavator line and failure to supply the plaintiff — a dealer of the SAMSUNG excavators — with VOLVO[®] trademarked excavators. The plaintiff alleged violations of the Connecticut Franchise Act, breach of contract, promissory estoppel, breach of the implied covenant of good faith and fair dealing, fraud, violation of the Connecticut Unfair Trade Practice Act, and negligent misrepresentation. The federal court in Hartford, Connecticut denied the plaintiff’s motion for preliminary injunction even though the product line at issue accounted for more than 75 percent of dealer’s business.

⁵² In *Victor L. Phillips Co. v. Volvo Construction Equipment North America, Inc.*, Case No. 02-2144-JAR, 2002 U.S. Dist. LEXIS 11297, 2002 U.S. Dist. LEXIS 11354 (D. Kan. June 3, 2002), the court denied the plaintiff’s motion for preliminary injunction and dissolved a consent restraining order that had previously been entered in Kansas state court. In response to Volvo Construction’s motion to enforce the contractual arbitration provision, the federal court in Kansas City, Kansas stayed all proceedings and transferred the case to the U.S. District Court for the Northern District of Georgia for a ruling on Volvo Construction’s motion to compel arbitration in Atlanta.

The plaintiff in that case had brought suit in state court seeking a declaratory judgment under the Kansas Outdoor Power Equipment Dealer Act against both Volvo Construction and one of its Kansas dealers. Volvo Construction had removed the case to federal court. The federal court denied the plaintiff’s motion to remand, holding that the plaintiff had improperly joined the dealer for the purpose of defeating diversity jurisdiction. *Victor L. Phillips Co. v. Volvo Construction Equipment North America, Inc.*, Case No. 02-2144-JAR, 2002 U.S. Dist. LEXIS 11355, Bus. Franchise Guide (CCH) ¶ 12,236 (D. Kan. May 17, 2002).

⁵³ *JEH, Inc. v. Volvo Construction Equipment Rents, Inc.*, Civ. Action No. 2:05cv2509 (W.D. Tenn. 2005).

recoverable for violation of the New Jersey Franchise Practices Act and dismissing ancillary non-statutory claims⁵⁴

(ii) ***Franchisee Class Actions***

Last but not least, system-wide disputes can of course be the subject of a lawsuit brought by a franchisee association and/or a class action purportedly brought on behalf of many if not all franchisees. The fact that a claim was brought as a class action, however, does not necessarily mean that it reflects a system-wide dispute. Examples of some recent franchisee association lawsuits and/or franchisee class actions include the following:

- *Awuah v. Coverall North America, Inc.*, 554 F.3d 7 (1st Cir. 2009) (franchisee class action filed in 2007 for fraud, misrepresentation and breach of contract, among other claims);
- *Bonanno v. Quizno's Franchise Co., LLC*, 255 F.R.D. 550 (D. Colo. 2009) (putative class action by franchisees alleging violation of the Colorado Consumer Protection Act); and
- *Jones v. Petland Inc.*, No. 2:08cv1128 (S.D. Ohio Nov. 26, 2008) (class action alleging franchisor duped franchisees into investing in doomed franchise system).

(iii) ***Common Franchisor Defense Strategies***

Regardless of whether a system-wide dispute is brought by (or against) a single franchisee, multiple franchisees, or a class representative who purports to represent all similarly-situated franchisees, the most common franchisor strategies for successfully litigating such cases can best be characterized as follows:

- “Nip it in the bud”;
- “Divide and conquer”; and
- “Take no prisoners.”

Of course, franchisor success in executing one or more of the foregoing strategies can often result in fewer cases being filed in the first place and/or settlement of remaining disputes. An expanded description of each of these strategies follows.

“*Nip it in the bud.*” Examples of cases in which an early victory by the franchisor had the result of dissuading other franchisees from filing suit include:

- Federal court litigation in Tennessee on behalf of the Arby's Restaurant Group to enforce the Arby's “Pinnacle” restaurant design requirement in the case of *Johnson v. Arby's*,

⁵⁴ In *Harter Equipment, Inc. v. Volvo Construction Equipment North America, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,651 (D.N.J. Sept. 2, 2003), a case that resulted from Volvo Construction's market withdrawal of SAMSUNG excavators, the federal court in Trenton, New Jersey dismissed the plaintiff's breach of contract and New Jersey common law franchise claims. A subsequent pre-trial ruling interpreting the damages recoverable under the New Jersey Franchise Practices Act reduced Volvo Construction's maximum exposure from \$6.9 million to approximately \$900,000. Thereafter the case settled.

Inc., Bus. Franchise Guide (CCH) ¶ 12,018 (E.D. Tenn. 2000) (summary judgment in favor of Arby's);⁵⁵

- Federal court litigation in North Carolina behalf of Hilton Hotels Corporation to enforce the HAMPTON INNS “Make It Hampton” Program. In prior state court proceedings in Memphis, Hilton Hotels’ Promus Hotels subsidiary — the franchisor of HAMPTON INNS — had not prevailed on its contention that it could impose additional requirements on franchisees by amending the operating standards manual unilaterally. Follow-up litigation in federal court in North Carolina resulted as the company sought to require franchisees to make major capital expenditures pursuant to the “Make It Hampton” program for the HAMPTON INNS brand. By asserting new counterclaims under the federal trademark statute, the Lanham Act, the company was able to bring about a speedy resolution of that litigation before it progressed very far in the case of *Inn on Robinwood, Inc. v. Promus Hotels, Inc.*, Civ. Action No. 1:03cv885 (M.D.N.C. 2003); and
- Federal court litigation in Virginia on behalf of Hilton Hotels Corporation to vindicate the company’s right to open additional hotels in the vicinity of existing franchisees. In the first “test case” by a plaintiffs’ franchisee firm of an “encroachment” claim against Hilton Hotels, the plaintiff capitulated on the first day of trial following opening statements in the case of *William H. Price & Associates v. Promus Hotels, Inc.*, Civ. Action No. 7:06cv147 (W.D. Va. 2006).⁵⁶

“Divide and conquer.” In the experience of many litigators, coalitions of franchisees in litigation are fragile to say the least. Early victories on procedural matters such as choice of forum or enforcement of an arbitration clause have on occasion caused the coalition to fracture. In litigation, half the secret of winning is picking someone that you can beat. In this regard, it may make sense to settle early with plaintiffs whose claims are particularly strong or whose presence in the case makes it difficult for the franchisor to end up in its desired forum. For example, in the Volvo Market Withdrawal Litigation, the litigation that resulted in a March 4, 2009 Seventh Circuit decision in favor of Volvo Construction was originally filed in state court in Arkansas. The Arkansas state court judge simply refused to enforce the Illinois choice of forum provision. By settling its claims against the Arkansas plaintiff — which like Volvo Construction, was incorporated in Delaware — Volvo Construction was able to remove the case to federal court once there was diversity of citizenship and then have the case transferred to the Northern District of Illinois. The rest is history.

“Take no prisoners.” In view of the number of dealers terminated as part of the Volvo Construction Market Withdrawal, the number of lawsuits filed was actually quite small. By vigorously defending these claims — and going on the offensive — Volvo Construction was able to prevent many more lawsuits from being filed. The same is true with respect to the cases discussed under the “nip it in the bud” strategy.

(iv) **Settlement**

Although litigation is often necessary to bring about meaningful settlement discussions, litigation is obviously not the best way to resolve system-wide disputes in franchising. It is expensive and can preoccupy management for years. Many lawsuits can be avoided if the first place if the franchisor undertakes “random acts of kindness,” *i.e.*, doing things that it may not be contractually obligated to do.

⁵⁵ Mr. Lockerby represented Arby’s in the Tennessee litigation.

⁵⁶ Mr. Lockerby represented Hilton Hotels in the litigation in North Carolina and Virginia.

Such actions may prevent or may prompt franchisees to avoid seeking out plaintiffs' franchisee lawyers. At the very least, the franchisor may look better in any subsequent litigation.

Although mediation can be a very effective method of dispute resolution, in the experience of most litigants, it does not succeed unless and until both sides have a realistic view of the strengths and weaknesses of their respective cases. Like it or not, this unfortunately may require substantial litigation costs — and the risk of even more — before the parties will come to terms.

2.3 What special issues arise in the U.S. when the system-wide litigation is the subject of a class action?

Before even addressing the merits of a class action, franchisors typically seek to defeat class certification — a variant of the previously discussed “divide and conquer strategy.” To obtain class certification, a putative class must satisfy the distinct but related requirements of “numerosity,” “typicality,” and “commonality” under Federal Rule of Civil Procedure 23(a).

(i) “Numerosity,” “Typicality,” and “Commonality” Requirements

Under the Federal Rules of Civil Procedure:

One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

Fed. R. Civ. P. 23(a)(1) (emphasis added).

“Numerosity” Under Fed. R. Civ. P. 23(a)(2): Whether the numerosity requirement is met in a particular case is examined on a case-by-case basis. *General Telephone Co. v. E.E.O.C.*, 446 U.S. 318, 330 (1980). The answer is often more obvious in consumer class actions than in the typical franchise case.⁵⁷ According to one leading commentator, the “numerosity” requirement — consistent with the plain language of Rule 23(a) — measures the impracticality of joining all potential class members in a single lawsuit and is presumptively satisfied with 40 class members. Newberg on Class Actions, “Prerequisites for Maintaining a Class Action,” §3:5, p. 246-47 (4th ed. 2002).

Examples of franchisee class actions in which the numerosity requirement has been held satisfied include the following:

- *Bird Hotel Corp. v. Super 8 Motels, Inc.*, 246 F.R.D. 603 (D. S.D. 2007) (class with 226 members satisfied numerosity requirement); and

⁵⁷ See, e.g., *Georgine v. Amchem Products, Inc.*, 83 F.3d 610, 626 n.11 (3d Cir. 1996), *aff'd*, *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 117 S.Ct. 2231 (1997) (“This class, which may stretch into the millions, easily satisfies the numerosity requirement.”); *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 800 (3d Cir. 1995), *cert. denied*, *General Motors Corp. v. French*, 516 U.S. 824, 116 S.Ct. 88 (1995) (“The numerosity requirement of Rule 23(a) is plainly satisfied in this action encompassing nearly six million truck owners.”); *Ballard v. Equifax Check Services, Inc.*, 186 F.R.D. 589, 594 (E.D. Cal.1999) (class of “approximately 1.4 million California residents” satisfied numerosity).

- *Quadrel v. GNC Franchising, LLC*, 2007 U.S. Dist. LEXIS 87942, at *14-15 (W.D. Pa. Nov. 29, 2007) (class with approximately 1,800 potential members satisfied numerosity requirement).⁵⁸

Examples of franchisee class actions in which the numerosity requirement has been held not satisfied include the following:

- *McCleery Tire Service, Inc. v. Texaco, Inc.*, 22 Fed. R. Serv. 2d (Callaghan) 675 (E.D. Pa. 1976) (numerosity requirement *not* satisfied where only one wholesaler appears to meet class requirements and twenty-four others possibly qualify); and
- *Anderson v. Home Style Stores, Inc.*, 58 F.R.D. 125 (E.D. Pa. 1972) (numerosity requirement *not* satisfied where potential class included eighteen franchisees in same geographical area because joinder was still practical).

“Commonality” Under Fed. R. Civ. P. 23(a)(3): Satisfying the commonality requirement of Fed. R. Civ. P. 23(a)(3) “does not require that the representative plaintiff have endured precisely the same injuries that have been sustained by the class members, only that the harm complained of be common to the class, and that the named plaintiff demonstrate a personal interest or ‘threat of injury . . . [that] is “real and immediate,” not “conjectural” or “hypothetical.”’ *Hassine v. Jeffes*, 846 F.2d 169, 177 (3d Cir. 1988) (emphasis added) (quoting *O’Shea v. Littleton*, 414 U.S. 488, 494, 94 S.Ct. 669 (1974)). In one case in which class certification was denied, the Third Circuit held that “commonality” did not exist because “this class is a hodgepodge of factually as well as legally different plaintiffs.” *Georgine v. Amchem Products*, 83 F.3d at 632. As the Supreme Court explained,

The commonality and typicality requirements of Rule 23(a) tend to merge. Both serve as guideposts for determining whether under the particular circumstances maintenance of a class action is economical and whether the named plaintiff’s claim and the class claims are so interrelated that the interests of the class members will be fairly and adequately protected in their absence.

General Telephone v. Falcon, 457 U.S. 147 at 157 n.13.

“Typicality” Under Fed. R. Civ. P. 23(a)(1): To satisfy the “typicality” requirement of Federal Rule of Civil Procedure 23(a)(3), the plaintiffs must show that “the claims or defenses of the representative parties are typical of the claims or defenses of the class.” “The typicality requirement is said to limit the class claims to those fairly encompassed by the named plaintiffs’ claims.” *General Telephone*, 446 U.S. at 330 (1980).

In practice, courts appear to “collapse” the commonality and typicality requirements, considering them together. Examples of franchisee class actions in which the commonality and typicality requirement have been held satisfied include the following:

- *Bird Hotel Corp. v. Super 8 Motels, Inc.*, *supra* (commonality and typicality requirements satisfied even though class included both current and former franchisees and were not destroyed by the fact that 20% of the franchisees had signed releases); and

⁵⁸ On other grounds, the claims were later dismissed. *Quadrel v. GNC Franchising, L.L.C.*, 2008 U.S. Dist. LEXIS 12445 (W.D. Pa. Feb. 19, 2008).

- *Quadrel v. GNC Franchising, LLC, supra* (commonality and typicality requirements satisfied where common issues prevailed).

Examples of franchisee class actions in which the typicality requirement has been held not satisfied include the following:

- *Broussard v. Meineke Disc. Muffler Shops*, 155 F.3d 331 (4th Cir. 1998) (reversing district court's class certification because class could not satisfy commonality and typicality requirement due to disparate nature of claims); and
- *Auto Ventures, Inc. v. Moran*, 1997 U.S. Dist. LEXIS 7037, at *13-15 (S.D. Fla. April 3, 1997) (plaintiffs could not meet requirements of commonality and typicality because each dealer advanced distinct and highly individualized claims that were not common or typical of the purported class).

(ii) ***Additional Required Showings Under Federal Rule 23(b)***

If the requirements of Federal Rule 23(a) are satisfied, class certification also requires the following showings:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

Fed. R. Civ. P. 23(b) (emphasis added).

For an example of a franchisee class action in which the additional requirements of Rule 23(b) have been held satisfied, see *Seligson v. Plum Tree, Inc.*, 55 F.R.D. 259 (E.D. Pa. 1972) (concluding that

complaint satisfies prerequisites of class action as set forth in Rule 23(b)(3) and that common questions of law and fact predominate over questions affecting only individual members). For an example of a franchisee class action in which the additional requirements of Rule 23(b) have been held not satisfied, *see Free World Foreign Cars, Inc. v. Alfa Romeo, S.p.A.*, 55 F.R.D. 26 (S.D.N.Y. 1972) (class certification denied in part because class action vehicle not considered superior to other available methods for adjudication).

2.4 What makes the international franchise dispute different from a domestic one?

There are a number of differentiating factors, in addition to the obvious cultural and linguistic differences, that makes the international franchise dispute different from a domestic one.

(i) *Arbitration is more likely*

Although arbitration is used in some domestic franchise disputes, it is far more prevalent in international franchise disputes. This is due to the ability to keep arbitrations confidential and easier enforceability of awards. The enforceability of court judgments depends on bilateral treaties between the relevant jurisdictions. If there is no treaty allowing enforcement of each other's court judgments between the countries concerned, enforcement can be somewhat problematic. The merits of a foreign judgment may have to be considered by local courts before enforcement for compliance with local mandatory laws and public policy. This can be particularly difficult with class awards as in some jurisdictions they may raise concerns which can make enforcement particularly difficult. However, most countries are parties to the New York Convention 1958 which allows foreign arbitral awards to be enforced (theoretically) without a court hearing in a member country.⁵⁹ There are very limited grounds under which foreign arbitral awards can be challenged, the main one being public policy. So if the countries of both the franchisor and franchisees are parties to the New York Convention arbitration is often the best option in practical terms and involves less publicity. However, it tends to be more expensive.

In some jurisdictions, such as India, the courts are extremely slow and cumbersome making arbitration and conciliation under the Indian Arbitration Act 1996 even more attractive in franchise disputes, particularly international ones.

In China, arbitrations are by far and away the preferred method of resolution of disputes in relation to franchising generally be they domestic or international disputes.⁶⁰

(ii) *Venue for hearing*

The venue for both litigation and arbitration are usually provided for in the Franchise Agreement. Franchisors generally opt for the home advantage in both litigation and arbitration unless issues of enforceability make this unsatisfactory. For the reasons explained above that is rarely the case in arbitration. Sometimes independent third party jurisdictions are chosen as a compromise between the franchisor and franchisee wanting the home advantage, but agreeing to compromise. Some jurisdictions, such as Sweden, France and Singapore actively promote themselves as independent third country venues.

⁵⁹ United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) (commonly known as the "New York Convention").

⁶⁰ Franchise "Getting the Deal Through" 2009 – International Franchise Association

(iii) ***The number and nature of counsel involved and the need for co-ordination***

Outside of the U.S. there are few, if any, class litigation specialist firms or class action practitioners that are active in the franchising sector. In group representative actions, joint claims tend to be handled by a single law firm allocating an appropriately sized team of lawyers depending upon the complexity of the case and the number of franchisees.

In the U.K., the legal profession is divided into Solicitors and Barristers (advocate trial lawyers). If a group or representative action goes to court then the claimant would have to instruct not only a Solicitor's firm but also a Barrister to give opinion on merits of the claim, draft pleadings in some instances, and argue the matter in court. The costs of litigation could be significant. The tendency is to settle the claim. This is done by the Solicitors on both sides.

In some EU member states class/group franchise actions are seen as matters impacting upon public policy and they tend to be dealt with either as administrative matters by government organisations or the representative or consumer organisation will bring the action and appoint counsel. A number of EU member states have granted the right to act for classes of claimants provided for in the EC Directive on Injunctions for Protection of Consumer Interests to consumer associations or administrative agencies. In such cases no private legal practitioners are involved acting for the franchisees. In the UK, if a number of franchisees complain to the Department of Trade and Industry, it is likely to investigate the matter and take further steps to prevent the above. In such cases Group Litigation Orders and lawyers representing franchisees are irrelevant.

(iv) ***Applicable law***

In international franchise disputes, franchisors usually insist on the agreement being subject to their own national law and the jurisdiction of the courts of their own country (except in relation to intellectual property issue disputes). However, issues of enforceability and commercial reality can result in the agreement being subject to the law of the franchisees' jurisdiction and local courts or, as a compromise, a third party jurisdiction. English law and the jurisdiction of the London courts are often chosen as a compromise by franchisors doing deals in Europe, the Middle East and parts of Asia due to language issues and the integrity of the English Legal System and Courts. This has an immediate impact on the viability of class/group franchise actions.

Sometimes a franchisor may grant court jurisdiction in respect of certain claims only this can make classification very difficult. The same issues regarding choice of law apply regardless of whether litigation or arbitration is opted for.

(v) ***Witnesses, discovery, testimony in writing***

Witness testimony in writing and discovery are impacted vary greatly from jurisdiction to jurisdiction. In court proceedings there is a rigorous discovery procedure. However, although witness statements are taken in order to prepare for litigation and arbitration there is no formal deposition procedure such as that found in the U.S. There is a rigorous cross examination of witnesses, etc.

In civil law countries the disclosure of documents and cross-examination of witnesses is not usual. Legal submissions are usually in writing followed by oral argument by the counsel for the parties. However, in many civil law countries such as France, there are no impediments to the arbitral tribunal giving procedural directions that incorporate common law features, such as oral evidence with cross-examination, partial disclosure and party-appointed experts.

2.5 What is the typical franchise system-wide dispute resolution experience in the U.K. and other European countries?

The U.S. class action approach to system-wide franchise disputes is not common in other jurisdictions. In a number of European jurisdictions the government will act on behalf of franchisees. For example the Director General of Fair Trading in the U.K. the Director of Consumer Affairs in Ireland or Consumer Ombudsman in Denmark.⁶¹

The dispute resolution experience varies greatly from jurisdiction to jurisdiction.

The U.K. The EU Directive on Injunctions for Protection of Consumers Interests, 1998 permits group litigation but that has been implemented by the 27 EU member states in different ways.⁶² In many European countries the right of action has been assigned to consumer associations or administrative agencies who could file ‘group litigation’ on behalf a specifically defined group of people adversely affected by a defendant’s conduct. (See discussion in Section 1.1 of this paper.)

Most of the 27 EU member states allow some degree of group or representative action that can be taken in the collective interest of group members, but only to seek an injunctive or declaratory order to stop unlawful or abusive behaviour or to strike out unlawful clauses in consumer contracts for example and not for the purposes of awarding compensation to those group members.⁶³

In practice class or representative action are rarely used in franchisor-franchisee disputes in Europe. There is a lower appetite for litigation than in the States and other forms of dispute resolutions are often preferred. Efforts have been made to have ADR—arbitration of consumer disputes in Spain, Portugal, Netherlands or pre-litigation procedure like mediation and conciliation.⁶⁴ Encouragement has been given towards settlement. No punitive damages are allowed. Some EU member states, notably Germany and Austria, tend to view franchisees as consumers and so this class brand administrative remedy can be used on behalf of franchisees in those jurisdictions.

Despite the ability of franchisees to obtain Group Litigation Orders, there are very few examples of group or collective franchise litigation in England. Group actions are more common in pharmaceutical product liability and personal injury claims. They tend to be funded by government through the legal aid system, legal expense insurance or are done by lawyers on a contingency fee basis (although this is unusual where the issue is quantum rather than liability). Other such action has been in relation to leasehold and shareholders.

Funding for representative actions is often a problem. In commercial cases the claimant has to have sufficient funds and the loser usually has to pay the winner’s cost. This is a substantial deterrent even though insurance cover is possible. Further, the success rate of group actions is low. Conditional fee arrangements (“CRAs”) agreed with the lawyers and the group, can then take out after the event legal insurance (although premium can be quite high) to cover the other side’s cost should they be ordered to pay is they lose. It is difficult to find insurance to underwrite such risk unless the case is very strong and likely to win. There is little appetite among members of the “franchise bar” for conditional fee arrangements.

⁶¹ 11 Duke J Com & Int’l L 321 2001—Christopher Hodges “Multi party actions: A European Approach”.

⁶² 52 DePaul L Rev. 401 2002-2003.

⁶³ 15 Columbia Journal of European Law 416 2008-2009—Rachael Mulheron The Case for an Opt-Out Class Action for European Member States: A Legal and Empirical Analysis.

⁶⁴ 11 Duke J Com & Int’l L 321 2001—Christopher Hodges “Multi party actions: A European Approach”.

In addition, damages claims of English Courts are decided by judges (unlike in the U.S. where it may be decided by the jury). As a result, the U.K. damage awards are far lower than in the U.S. Also in English Courts an “opt in” system exists whereby a person must agree to become a Claimant, rather than the “opt out” system in the U.S. where people automatically become members of a class action (entering without knowing it) if they are a member of the class on whose behalf the claim is brought.

In addition, to all the factors, there is a cultural reluctance to become involved in class actions and a lack of entrepreneurial lawyers promoting them as a way of dealing with franchisees’ problems.

The U.K. Ministry of Justice (“MoJ”), in their July 2009 response to the Civil Justice Council’s report “Improving Access to Justice through Collective Actions”, accepted that there are circumstances where cases could be brought more efficiently on a collective basis. However, they rejected the idea of introducing a generic procedure applicable in all cases.

Instead the MoJ reasoned that a sector based approach to the introduction of collective actions is likely to be “more achievable”. Critics of this proposal view this as an attempt to slow down to almost a halt any possibility of bringing in an effective procedure. It certainly seems highly unlikely that the U.K. will see a class action procedure similar to that used in the U.S. – largely due to the vast differences in approach towards funding, costs and damages.

France. In France recognised associations can pursue claims for damages in the name of consumers provided the association is mandated by at least two injured parties. Franchisees can be deemed for the consumer in some circumstances.

The Netherlands. The Dutch Act on Collective Action (2005) enables a legally binding group settlement to be reached between the Defendant and a foundation / association representing the interests of the Claimants. Any agreement must meet certain minimum requirements, *e.g.*, define the group affected, specify the requirements for entitlement and the manner of damages etc. Agreement will be reached with the adverse party out of court, and upon application by one of the parties, the agreement may be declared binding on all Claimants, who have a right to opt out should they not wish to be bound by the judgment.

Portugal. The Portuguese Law 83/95 of August 31, 1995 provides that there is currently an opt-out class action procedure where an injured party can commence proceedings and after admission of the ‘popular action’ (the court will initially examine the legitimacy of the Claimant) those that are potentially affected are publicly informed about the action. They are presumed to consent to participation and the judgment is binding on those who have not expressly opted out.

Civil Procedure Act 1/2000 of January 10, 2000 introduced a class action mechanism for entities to defend the interest of their members. Consumer associations have the right to claim collective damages in court and a group of injured parties can file a group action. All of the potentially affected parties are notified and requested to take part, although the legal force also extends to parties affected who do not participate in the proceedings.

Spain. Spain has an important exception in that it is not possible to claim for losses arising from securities.

Sweden. In May 2002, Swedish Parliament passed the Act on Group Actions which provides for three forms of group action. The first is organisational action brought by affiliations of consumers and wage earners against businesses or NGOs. The second form of group action is by authority stipulated by government and the third is by group action brought by a person who is a member of a group. Those who

fit in with the group cause are given the option to opt in. The representative is authorised to settle the case and approved by court but if there is no settlement and the matter proceeds, the loser has to pay the winner's costs. The group representative and attorney can make risk agreement by which attorney's fees are contingent on finding liability but the fees are on hourly basis.

Germany. There is not currently a system which is akin to class action in Germany. Where claims for damages or rescission are filed, each and every party must enforce his claim in court barring a few exceptions:

- Where incorrect capital markets information is given, the court can take a leading decision on the prerequisites creating or barring a claim or on the clarification of legal issues upon application by at least ten claimants. This has little in common with class action as each entitled party must bring a legal action which is suspended until the court decision becomes legally effective.
- A shareholder minority (representing less than 1% of the share capital or the proportionate amount of €100,000) may apply for permission to file claims for compensation to be paid to the company in their own names. However, this only aims at payment to be made to the company, and therefore is not a collective action filed by the shareholders themselves.

Mostly consumer organisations are principal recipients of the right of action. There is limited injunctive relief and damages are unavailable under this route and is principally designed to enforce competition and business standards, industrial property rules, environment law, etc.⁶⁵

Further, Germany regulates and restricts the reimbursement of winner's lawyers' fees for contentious work. (The losing party has to reimburse the winning party's lawyer's fees calculated in accordance with BRAGO which is a Schedule of Fees which calculates fees on the basis of the amount in dispute.)

The differences in compensation mechanism for injury is based on social security system and product liability directive and not on tort law like that in Common Law jurisdictions.

2.6 The judgment and enforcing the award

There have not been many class or group action cases in relation to franchising outside the U.S. Enforcement of court judgments in other jurisdictions can be difficult and depend upon bilateral treaties. The New York Convention makes enforcement of arbitral awards somewhat easier, (more than 140 countries are parties to it), but that is no guarantee of successful enforcement.

3. Avoiding System-Wide Litigation

It is generally a bad idea to make generalizations as they generally prove to be wrong. But it is generally inevitable that every successful franchisor will, at some point, encounter disputes with its franchisees. Franchisors should plan for that inevitability and take steps to reduce the risk that those disputes escalate to the level of system-wide litigation. Establishing meaningful franchise advisory councils and actively fostering partnerships with franchisees and independent franchisee associations can go a long way toward avoiding the escalation of disputes. Providing for informal and formal mediation

⁶⁵ DePaul L Rev. 401 2002-2003.

processes can help to diffuse contentious situations. And, when all else fails, being able to rely on carefully drafted dispute resolution provisions in franchise agreements will prove to be critical.

3.1 Carefully drafting clauses relating to dispute resolution

Each franchise agreement should contain certain standard provisions which should prove useful in the context of attempted system-wide litigation. Since these provisions involve issues that are often viewed as being subject to local law (regardless of a choice of law provision in the agreement), franchisors should consult with counsel in the country in which the franchise is being granted to determine enforceability of these provisions in that particular jurisdiction.

(i) *Provisions regarding jurisdiction and venue*

With respect to jurisdiction and venue, franchisors typically fall into one of two camps: either all of their franchise agreements, regardless of the location at which the franchised unit will operate, mandate that disputes be resolved in and be governed by the law of the franchisor's home country, or each agreement adopts the law of and requires that proceedings be initiated in the territory in which the franchise rights will be exercised. To some extent, the enforceability of the parties' choice will be determined by the law of the country in which the franchise rights will be exercised, but most developed nations will respect the parties' choice. The franchisor's decision, therefore, is influenced by factors such as convenience and the desire for uniformity and certainty with respect to enforceability of the key terms of the agreements. But franchisors should realize that those factors may not yield the best result with respect to reducing the risk of a system-wide attack mounted by franchisees. For example, a U.S. franchisor's adoption of a particular state's law and provision for mandatory jurisdiction in that state will address the franchisor's interests of convenience and uniformity, but it will also foster a level of commonality that is required in consolidated and class actions (see discussion in Section 1.1 above) and, more importantly, make possible the notion of a class action which involves all of its franchisees, globally, where such an action might not be sustainable, except perhaps on a limited basis, had each agreement adopted the law of and provided for mandatory jurisdiction in the franchisee's home country.

(ii) *Litigation or arbitration*

Franchisors' decisions on choosing litigation or arbitration as a dispute resolution mechanism, in many cases, are themselves arbitrary. If the franchisor has had good experience with arbitration (and often the franchisor has had only limited experience regarding a small dispute), it will likely have its franchise agreement adopt arbitration as the mechanism for resolving disputes; if, on the other hand, the franchisor's experience was less than good, it will likely choose to allow the courts to resolve disputes. If the franchisor is fortunate enough to have had no experience with formal dispute resolution processes, it will often leave the choice to its lawyer. In the international context, particularly when the mission is to draft the agreement to provide the franchisor with the best opportunity to avoid system-wide litigation and to attain a fair result should major disputes arise, this decision-making process will fall short. Careful thought should be given to the decision, and included among the factors that should be considered are: (1) the franchisor's position with respect to mandatory jurisdiction and venue provisions and the local enforceability of that position, (2) the degree of development of the law in the jurisdiction that is adopted in the franchise agreement as the governing law, (3) the sophistication, fairness and stability of the courts in the jurisdiction in which disputes are to be resolved, and (4) the ease with which the proceedings can be initiated and prosecuted. Arbitration will provide the parties with certain advantages over litigation in the

courts,⁶⁶ but arbitration may also make it easier for plaintiff franchisees to initiate and prosecute actions either as class actions or on a consolidated basis than would otherwise be possible if the dispute were in a jurisdiction in which such actions were either unavailable or available on only a limited basis (see discussion in Section 1.1 above).

In most developed jurisdictions, the parties' choice will be respected,⁶⁷ but from the perspective of system-wide litigation, the choice in itself will not generally be determinative of the availability or viability of system-wide litigation. The tribunal's approach to resolving issues around mandatory arbitration clauses, availability of consolidated or class actions, and class arbitration waivers (see below) will be impacted by both the tribunal's rules⁶⁸ and the law applicable to the contract.⁶⁹ Outside the U.S., the availability of class actions in the arbitration context is not widely tested and, therefore, is not universally resolved.⁷⁰

(iii) ***Waivers with respect to class actions***

Whether choosing litigation or arbitration, parties to franchise agreements routinely agree to resolve disputes on an individual basis and waive their right to have their claims joined with others or to proceed as a class. In the arbitration context, where the issue has more often arisen, the dominant position in the U.S. is that these provisions are enforceable, although certain courts have ruled otherwise where enforcing the provision would effectively preclude any action seeking to vindicate statutory rights asserted by the plaintiff or where enforcement would be unconscionable under state law.⁷¹ In the litigation context, two recent cases interpreting the same provision have yielded opposite results. In *Bonanno v. The Quiznos Franchising Co.*,⁷² the U.S. federal court in Colorado upheld the parties' waiver of the right to proceed via class action, holding that the provision was not unconscionable under state law. In *Martrano v. The Quiznos Franchising Co.*,⁷³ the U.S. federal court in Pennsylvania invalidated the parties' waiver of the right to proceed via class action, holding that the parties may not, by private agreement, displace the court's ability to take action in connection with efficient judicial administration. What is clear from both decisions is that the waiver should be conspicuous (that is, not hidden among the contract's boilerplate) so that it is clear that the waiver is given freely and knowingly.

⁶⁶ For example, the opportunity to have disputes resolved by subject-matter experts, impartiality of decision makers in a neutral forum, confidentiality of proceedings, potential for limited discovery, and, in some cases, brevity of proceedings.

⁶⁷ This is a matter of local law which should be confirmed in each relevant jurisdiction.

⁶⁸ The arbitration rules for the major international arbitration bodies (for example, the International Chamber of Commerce's International Court of Arbitration, the United Nations Commission on International Trade Law, the Commercial Arbitration and Mediation Center for the Americas, and the London Court of International Arbitration) are all silent with respect to consolidated or class actions, specifically, but each provides generally that the rules shall govern the arbitration except that where in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate and, further, give the arbitral tribunal the power to conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and *that at any stage of the proceedings each party is given a full opportunity of presenting his case*. Query whether the impact of these requirements is to make representative actions unavailable

⁶⁹ See discussion in Section 1.1 above with respect to availability of class action and similar proceedings.

These Rules shall govern the arbitration except that where any of these Rules is in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail.

⁷⁰ S.I Strong, *Enforcing Class Arbitration in the International Sphere: Due Process and Public Policy Concerns*, University of Pennsylvania Journal of International Law 30:1 (2008)

⁷¹ See *The Anatomy of a Franchise Class Action*, presented October 14-16, 2009, by Fredric A. Cohen and Peter C. Lagarias at the American Bar Association's 32nd Annual Forum on Franchising in Toronto, Canada.

⁷² 200 U.S Dist. Lexis 37701, at #56-73 (Colo. 2009)

⁷³ Bus. Fran.Guide (CCH) Para. 14,161 (W.D. Pa 2009)

(iv) *Use of releases*

Throughout the franchise relationship, there might be occasions for the franchisor to elect to waive certain requirements in the franchise agreement in response to a franchisee's particular situation or there may be cause to amend certain provisions of the franchise agreement. These opportunities are typically at the franchisee's request or for the franchisee's benefit. As a general rule, franchisors should use these opportunities to secure general releases from franchisees. The validity of the release will be determined, in large part, by applicable law, but franchisors wishing to take advantage of them should be prepared to demonstrate that they were freely and knowingly granted and that there was adequate consideration for them. If valid under applicable law, these releases, procured at various times during the franchise relationship, could prove to be beneficial to the franchisor should litigation be subsequently initiated.

(v) *Drafting Techniques*

Drafting a robust dispute resolution clause is essential. Non-binding mediation is strongly recommended by many lawyers as a way of defusing and often solving international system-wide disputes. This has been used to successfully deal with such disputes in a range of jurisdictions, including China, Russia, Australia, India and the Middle East.

Arbitration is generally recommended in preference to litigation due to enforceability issues, although this does depend upon the jurisdiction concerned.

In ICC Commercial Arbitration, the 2008 rules recommend that the following language is used:

“All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.”

An alternative clause is:

“The arbitration will be under the rules applied by the London Court of International Arbitration and the governing law/substantive law will be English law and the venue will be London. The number of arbitrators will be three one chosen by either party and the chairman chosen by the other two. Both you and we agree to be bound by the award given by the arbitral panel and to bear the cost of such arbitration in equal shares unless otherwise directed by the arbitral panel.”

Even if arbitration is opted for it is important to reserve for the franchisor the right to obtain injunctive relief in the courts. For example:

“Without prejudice to the arbitration clause [____] we shall nevertheless have the right to apply at any time for injunctive, other interlocutory or emergency relief to any competent court.”

3.2 Dealing with franchise advisory councils and independent franchisee associations

Most experienced and successful franchisors recognize that the best weapon in the battle against system-wide litigation is to avoid disputes altogether. While avoiding all conflict is impossible in most

franchise systems, particularly the larger and more diverse the franchise system becomes, it is much easier to reduce the risk of major disputes when the franchisees are a respected, meaningful part of the system and are able to participate in or provide input on issues that they view as critical to their individual success and to the success generally of the brand and system under which they operate. Establishing one or more franchise advisory councils can be an effective tool, but franchisors will be doing themselves a disservice and will probably create, rather than resolve, issues if the franchise advisory councils are viewed as “talking heads” without any meaningful role. Franchise advisory councils will be much more effective as a tool against system-wide litigation if (a) they have a clear charter, (b) all of the franchisor’s executives accept and value the councils’ roles, (c) the councils’ members are elected by the franchisees rather than appointed by the franchisor, (d) the councils have regular meetings with meaningful agendas or other regular interaction with the franchisor’s executives, and (e) the councils’ activities are transparent and communicated to the franchisees. The more autonomous the council and the more influence the council is given by the franchisor (without relinquishing its rights ultimately to make decisions and without paralyzing the system), the more credibility its members will have among franchisees throughout the system and the better able will it be to be a true partner and advocate for the franchisor and to influence thought and acceptance among the broader franchisee constituents.

While no legal system requires a franchisor to establish advisory councils, some jurisdictions do protect the franchisees’ rights to associate and to form an independent franchisee association⁷⁴ while stopping short of requiring the franchisor to recognize or interact with the association. If, as is usually the case, it is true that independent franchisee associations are not viewed by franchisees as necessary until they feel frustrated with their interactions with the franchisor or feel that the franchisor is unduly taking advantage of them, it should be equally true that the franchisees’ desire to form an independent association will be mitigated by the presence of one or more advisory councils that are formed and operated as discussed above where the franchisees have a meaningful voice. But if franchisees do take steps to form an association, franchisors must be ever mindful of the restrictions that are, in turn, placed on their dealings with its franchisees. While a franchisee will not be able to hide behind the franchisee association to avoid being issued a default or termination notice for the franchisee’s breach of the franchise agreement, the franchisor must ensure that its actions cannot be viewed as retaliatory against the franchisee for organizing or participating in the franchisee association, particularly in those jurisdictions which statutorily protect the rights of franchisees to associate.

4. Conclusion

Class actions and system-wide litigation still is most likely to occur in the U.S. and, while several other countries have procedures that might allow similar types of joint actions, system-wide litigation is less likely to occur in other countries although a few jurisdictions have seen similar types of actions. Furthermore, class action and system-wide litigation is less likely to occur when a cross-border franchise system is involved because of a lack of commonality among the franchisees of the system. While such types of actions may exist, lawyers are often reluctant to talk about their experiences due to confidentiality obligations and/or client discomfort at having its “dirty linen” discussed in public.

⁷⁴ See, for example, Chapter 3 of Ontario, Canada’s Arthur Wishart Act, S.O. 2000, which expressly grants a franchisee a right of action against the franchisor if the franchisor interferes with, prohibits or restricts (by contract or otherwise) a franchisee from or penalizes or threatens to penalize a franchisee for forming or joining an organization of franchisees or from associating with other franchisees.