

International Franchise Association
51st Annual Legal Symposium
May 6-8, 2018
Washington, DC

A Litigator's Perspective on Arbitration— A Practical Session

Hon. Jeffrey Keyes (Ret.)
Keyes ADR
Minneapolis, Minnesota

Melissa Durso
Subway Restaurants
Milford, Connecticut

James M. Susag
Larkin Hoffman Daly & Lindgren Ltd.
Minneapolis, MN

Paul Ferak
Greenberg Traurig, LLP
Chicago, Illinois

A Litigator's Perspective on Arbitration—A Practical Session

Between 2011 and 2015, U.S. district court cases took more than 12 months longer to get to trial than AAA-ICDR administered arbitration. The additional time to get to trial during this period resulted in direct losses of \$10.9 to \$13.6 billion, or more than \$180 million per month.

Appeals over the same period added further delays, with U.S. district and circuit court cases requiring at least 21 more months than arbitration to resolve when they went through appeals. The extra time to resolve these cases led to about \$20 billion to \$22.9 billion in losses, or more than \$330 million per month.¹

MICRONOMICS ECONOMIC RESEARCH AND CONSULTING, EFFICIENCY AND ECONOMIC BENEFITS OF DISPUTE RESOLUTION THROUGH ARBITRATION COMPARED WITH U.S. DISTRICT COURT PROCEEDINGS 2–5 (March, 2017).

I. INTRODUCTION

Arbitration can be an efficient and effective tool to resolve disputes and eliminate certain risks. Too often franchisors ignore these benefits and fail to take full advantage of their right to arbitrate. This paper provides an overview of recent arbitration issues and key trends affecting franchise disputes. It then applies that information to focus on how best to position your company for handling and resolving disputes in arbitration.

Arbitration offers many advantages over the judicial system for resolving disputes in industry-specific areas like franchising. First, arbitration allows franchisors to craft custom dispute resolution procedures designed to control their cost and exposure, particularly for recurring and anticipated claims, which in turn benefits the franchise system as a whole. Second, arbitration allows the parties to select a decision-maker with experience in franchising, making the process more efficient and reducing the likelihood of error that could be committed by a judge or jury lacking such experience. Finally, despite anecdotal experiences to the contrary, studies continue to show that in the aggregate arbitration remains the more efficient method of dispute resolution, with its abbreviated procedures for discovery, motion practice, and appeals, providing the parties with greater finality than district court, usually sooner, and at less cost. But litigators need to have practical skills and an understanding of arbitration in order to realize the advantages that can make it a worthwhile method of dispute resolution for their clients.

The law surrounding arbitration has developed quickly over the past decade, sometimes quicker than the drafters of franchise agreements and their arbitration clauses can keep up. It is essential for litigators to stay current on the latest cases and trends in order to spot issues early on, enforce their clients' arbitration agreements, and efficiently navigate the process, thereby optimizing their likelihood of success. With such knowledge, there are many practical ways that litigators can maximize their clients' right to arbitrate, eliminate risks, and narrow others. This paper first reviews several key

¹ AAA-ACDR, Arbitration Remains a Trusted Venue for Resolving B2B Disputes (February 27, 2018) available at <http://go.adr.org/impactsofdelay.html>.

trends and cases affecting arbitration of franchise disputes over the past couple years. Next, it analyzes several practical areas of arbitration procedure where litigators can maximize their clients' right to arbitration. Finally, it identifies common arbitration terms that litigators should focus upon in order to eliminate risks and narrow others.

II. KEY TRENDS IN ARBITRATION

The most apparent and enduring trend in arbitration remains its continued favor under the law. Most of the time, courts predictably enforce arbitration agreements. Even California seems to be catching up with the trend.² This year in *Lenz v. FSC Sec. Corp.*, the Montana Supreme Court basically apologized for its “problematic” history of invalidating arbitration agreements, admitting that it had “perpetuate[d] confusion” and “failed to recognize the manifest incompatibility” of its precedent as “a generally applicable contract principle” for evaluating arbitration agreements.³

But counsel opposing arbitration, often representing franchisees, are creative and tenacious in testing the limits of the law's presumption in favor of arbitration. Recognizing the difficulty of challenging final arbitration awards, most of the fight over arbitration typically occurs at the outset, where recent trends are most evident. Opponents of arbitration can cite examples of success, often borne to some extent by a persistent undercurrent of judicial hostility towards arbitration. Even when you have an arbitration agreement and the cases are on your side, some judges may still look for ways to retain their jurisdiction or vacate awards.⁴ But these situations are becoming less common as appellate courts continue to close avenues for avoiding arbitration.

Over the past couple years, the most popular and novel avenues for challenging arbitration of franchise disputes have focused on three areas. First, whether the threshold issue of arbitrability will be decided by the court or arbitrator. Second, whether statutes guaranteeing rights to jury trials, such as those governing the franchise relationship, can preclude arbitration agreements. And third, the enforcement of arbitration agreements by and against non-signatories, including the many persons and entities that orbit the direct relationship between the franchisee and the franchisor. Despite challenges with respect to each of the forgoing areas, the overall trend in favor of enforcing arbitration agreements continues mostly undeterred.

A. Arbitrability

“Arbitrability” refers to the threshold question of whether an arbitrator has the authority to rule on a dispute, most often raised when one party disputes the enforceability of the parties' agreement. It is usually the first issue raised in opposition to arbitration in order to prevent the dispute from reaching an arbitrator in the first place. If there is any question over a dispute's arbitrability, a party opposing arbitration will want

² *Baltazar v. Forever 21, Inc.*, 367 P.3d 6, 18 (Cal. Mar. 28, 2016) (rejecting arguments that arbitration agreement was procedurally and substantively unconscionable).

³ 2018 MT 67, ¶ 28 (2018).

⁴ See, e.g., *Glob. Client Sols., LLC v. Ossello*, 367 P.3d 361, 371 (Mont. 2016) (“*Concepcion* and *Mortensen* cautioned against courts invoking state law defenses to upend an otherwise valid arbitration clause. That is not what has occurred here. . . . [O]ne-sided arbitration clauses do not serve the objectives of the FAA.”).

to raise the issue in court since it can be pretty difficult to get a decision from an arbitrator relinquishing his or her jurisdiction, and the decision will very likely be unreviewable.

So in the first instance, who decides the arbitrability of a dispute, the court or the arbitrator? One of the more popular arguments of franchisees opposing arbitration is that the arbitration agreement itself is unenforceable because the franchise agreement as a whole was the product of fraudulent inducement, adhesion, unconscionability, or some other inequity. In these circumstances, the franchisees argue, the court should decide in the first instance whether the franchise agreement and its arbitration clause are enforceable.

But franchisees usually lose this argument when faced with a franchise agreement containing a well-drafted arbitration clause that delegates authority of deciding arbitrability to the arbitrator, i.e., a “delegation clause.”⁵ The landmark decision on this issue is *Rent-A-Center, West, Inc. v. Jackson* where the U.S. Supreme Court, notwithstanding challenges to the validity of the contract as a whole, upheld the enforceability of an arbitration clause that delegated to the arbitrator “any dispute relating to the . . . enforceability or formation of this Agreement, including but not limited to any claim that all or any part of this Agreement is void or voidable.”⁶

The Court applied its “severability rule” to reason that the arbitration agreement, as well as its specific delegation of arbitrability, was severable from the contract as a whole and any surrounding questions about its overall enforceability.⁷ As a result, barring a specific challenge to the enforceability of the arbitration agreement’s delegation clause itself, an arbitration agreement having such a clause will be enforced. It follows then that a party can be forced to arbitrate under an arbitration agreement contained in a contract that is otherwise found unenforceable.⁸

Despite the Court’s decision in *Rent-A-Center*, recent opponents of arbitration have continued to focus on arbitrability as a way to avoid the enforcement of arbitration agreements. And while they have had some recent successes, the decisions are at odds with the continued federal trend favoring arbitration. In a recent example, a party

⁵ Well-drafted arbitration agreements usually provide arbitrators with the authority to decide issues concerning the enforceability of the arbitration agreement. This is because if you are going to arbitrate some issues you probably will want to arbitrate all of them to reduce the risk that the court retains its jurisdiction. In the absence of a delegation clause, “courts presume that the parties intend courts, not arbitrators, to decide what we have called disputes about “arbitrability.” *BG Grp., PLC v. Republic of Argentina*, 134 S. Ct. 1198, 1207, 188 L. Ed. 2d 220 (2014). But “courts presume that the parties intend arbitrators, not courts, to decide disputes about the meaning and application of particular procedural preconditions for the use of arbitration,” such as “waiver, delay, or a like defense to arbitrability,” and “the satisfaction of ‘prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate.’” *Id.*

⁶ 130 S. Ct. 2772 (2010).

⁷ *Id.*

⁸ *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 448–49 (2006) (“It is true, as respondents assert, that the *Prima Paint* rule permits a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void. . . . [R]egardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator.”).

opposing arbitration in *Smith v. D.R. Horton, Inc.* convinced the South Carolina Supreme Court to invalidate an arbitration agreement because it was poorly drafted in a paragraph containing other terms and conditions that the court found were unconscionable.⁹ In *Morgan v. Sanford Brown Inst.*, the New Jersey Supreme Court recently found the delegation of “any objection to arbitrability” invalid because it failed to clearly “explain that an arbitrator will decide whether the parties agreed to arbitrate legal claims.”¹⁰

But successful challenges to well-drafted delegation clauses are the exception, not the norm. This is particularly true in federal courts. For example, in *Mohamed v. Uber Techs., Inc.*, the Ninth Circuit recently upheld a delegation clause notwithstanding challenges to its clarity and conscionability, holding that “[t]he delegation provisions clearly and unmistakably delegated the question of arbitrability to the arbitrator.”¹¹

Most state courts have followed the federal trend. For example, in *Regions Bank v. Rice*, the Alabama Supreme Court recently upheld a delegation clause explaining that although the party opposing arbitration “challenged the validity of the arbitration provision as a whole, she has not specifically challenged the delegation provision,” which “clearly and unmistakably delegates questions of substantive arbitrability to the arbitrator.”¹² Likewise, this year in *Family Dollar Stores of W. Virginia, Inc. v. Tolliver*, the West Virginia Supreme Court enforced an arbitration agreement because the party opposing it had failed to “specifically address the delegation provision.”¹³

Continued challenges to arbitrability confirm the importance of having a well-drafted delegation clause that clearly and unmistakably provides the arbitrator with the authority to decide in the first instance whether the dispute is arbitrable. The authority should be defined as broadly as possible to include all issues relating to the enforceability, revocability, validity, conscionability, scope, reach, or existence of the arbitration agreement itself. Furthermore, to ensure clarity the language delegating this authority to the arbitrator should be separate from the language providing generally for the parties’ agreement to arbitrate. Finally, delegation clauses should clearly explain that the parties are waiving their right to have issues of arbitrability decided by a judge or jury.

In the unfortunate situation that you find yourself without a well-drafted delegation clause, check to see whether the arbitration agreement adopts any particular arbitral rules. If so, check those rules to see whether they provide the arbitrator with any authority to decide arbitrability issues regarding their jurisdiction. The rules promulgated

⁹ 790 S.E.2d 1, 5 (S.C. 2016) (“[I]n accordance with the *Prima Paint* doctrine, we find that in determining whether the arbitration agreement is unconscionable, we may properly consider the entirety of paragraph 14.”).

¹⁰ 225 N.J. 289, 306, 137 A.3d 1168, 1179 (2016) (“[N]or does it explain that arbitration is a substitute for bringing a claim before a court or jury. . . . Significantly, defendants did not raise the issue of a delegation clause or even once cite *Rent-A-Center* before the motion court.”).

¹¹ 848 F.3d 1201, 1209 (9th Cir. 2016) (“The delegation provisions were not procedurally unconscionable . . .”).

¹² 209 So. 3d 1108, 1111 (Ala. 2016) (“Pursuant to the delegation provision, the arbitrator must resolve the disputed issue whether Rice’s claim is arbitrable under the arbitration provision.”).

¹³ 2018 WL 1074947, at *1 (W. Va. Feb. 27, 2018).

by both AAA and JAMS provide arbitrators with such authority.¹⁴ More and more courts are holding that the incorporation of such rules constitutes “clear and unmistakable evidence” of the parties’ intent to delegate questions of arbitrability to the arbitrator.¹⁵

A final trend regarding arbitrability in the past year has been the continued development of an exception involving disputes for which their arbitrability is deemed “wholly groundless.” According to the Federal Circuit, “the ‘wholly groundless’ standard applies when an arbitration agreement clearly and unmistakably refers the issue of arbitrability to the arbitrator.”¹⁶ The Federal Circuit applied the standard in *Evans v. Bldg. Materials Corp. of Am.* to uphold a district court’s denial of a motion to compel arbitration, despite a valid delegation clause, when the claims were “so plainly outside the arbitration provision that a contrary argument is wholly groundless.”¹⁷

The Fifth and Sixth Circuits have also issued decisions applying the “wholly groundless” standard,¹⁸ while the Tenth and Eleventh Circuits held last year that no such standard is permitted under the U.S. Supreme Court’s existing precedent.¹⁹ Given this circuit split, litigators should keep abreast of future developments and make appropriate strategic decisions in light of the applicable jurisdiction’s law on this issue.

B. Statutory Preclusion

Another popular argument raised by opponents of arbitration is that it is precluded by some statute or rule, usually one that guarantees their right to a jury trial. This situation can arise under state franchise statutes, some of which protect such rights, for example, by prohibiting franchise agreements from requiring franchisees to waive their right to a jury trial.²⁰ This argument, however, faces an uphill battle and the trend disfavoring it has continued in recent years.

¹⁴ AAA Commercial Rules R-7; JAMS Comprehensives Rules R-11.

¹⁵ See, e.g., *Simply Wireless, Inc v. T-Mobile US, Inc.*, 877 F.3d 522, 527 (4th Cir. 2017); *Belnap v. Iasis Healthcare*, 844 F.3d 1272, 1284 (10th Cir. 2017); *Cooper v. WestEnd Capital Mgmt., L.L.C.*, 832 F.3d 534, 546 (5th Cir. 2016); *Brennan v. Opus Bank*, 796 F.3d 1125, 1130 (9th Cir. 2015); *Chevron Corp. v. Republic of Ecuador*, 795 F.3d 200, 207–08 (D.C. Cir. 2015); *Fadal Machining Centers, L.L.C. v. Compumachine, Inc.*, 2011 W.L. 6254979, at *2 (9th Cir. 2011); *Fallo v. High-Tech Inst.*, 559 F.3d 874, 878 (8th Cir. 2009); *Qualcomm Inc. v. Nokia Corp.*, 466 F.3d 1366, 1373 (Fed. Cir. 2006); *Terminix Int’l Co. v. Palmer Ranch Ltd. P’ship*, 432 F.3d 1327, 1332–33 (11th Cir. 2005); *Contec Corp. v. Remote Sol., Co.*, 398 F.3d 205, 208 (2d Cir. 2005); *Apollo Comput., Inc. v. Berg*, 886 F.2d 469, 473–74 (1st Cir. 1989).

¹⁶ *Evans v. Bldg. Materials Corp. of Am.*, 858 F.3d 1377, 1381 (Fed. Cir. 2017).

¹⁷ *Id.* n.1.

¹⁸ *Douglas v. Regions Bank*, 757 F.3d 460 (5th Cir. 2014) (“The *Qualcomm* test is an attractive one and most accurately reflects the law—that what must be arbitrated is a matter of the parties’ intent.”); *Turi v. Main Street Adoption Services, LLP*, 633 F.3d 496 (6th Cir. 2011) (“A dispute that plainly has nothing to do with the subject matter of an arbitration agreement, for example, would not give the arbitrator the authority to decide the arbitrability of this wholly unrelated claim.”).

¹⁹ *Jones v. Waffle House, Inc.*, 2017 WL 3381100 (11th Cir. Aug. 7, 2017) (“We agree that the wholly groundless exception has no place in this analysis.”); *Belnap v. Iasis Healthcare*, 844 F.3d 1272, 1286 (10th Cir. 2017) (“[W]e decline to adopt the “wholly groundless” approach.”).

²⁰ See, e.g., Minn. R. 2860.4400(J) (“It shall be unfair and inequitable for any person to . . . require a franchisee to waive his or her rights to a jury trial or to waive rights to any procedure, forum, or remedies provided for by the laws of the jurisdiction.”).

The presumption in favor of arbitration arises from the Federal Arbitration Act (“FAA”), and to a large extent, its preemptive effect on state law. In *AT&T Mobility LLC v. Concepcion*, the U.S. Supreme Court held that a California statute and related case law were preempted since they “stand[] as an obstacle” to the “liberal federal policy favoring arbitration” under the FAA.²¹ This holding has exponential weight given the Court’s previous decision in *Citizens Bank v. Alafabco, Inc.*, which basically held that the FAA applies to everyone, everywhere, engaged in any sort of commercial activity.²²

Consequently, arguments that state franchise statutes preclude arbitration have been rejected by most courts.²³ But franchisees opposing arbitration do not appear entirely ready to put the issue to rest and continue to come up with creative interpretations of state franchise statutes in order to argue that they preclude arbitration agreements. To counteract these continued efforts, franchisors should draft their arbitration agreements to provide a clear statement that the FAA governs the agreement, which should in turn emphasize that the FAA preempts any state statutes that stand as an obstacle to its liberal policy favoring arbitration.

But what happens when a state requires a franchisor to include language guaranteeing a jury trial in the franchise agreement itself? For example, in *Chorley Enterprises Inc. v. Dickey’s Barbecue Restaurants, Inc.*, franchisees enjoined the arbitration of the claims arising under Maryland’s franchise law because the franchise agreements expressly provided that they “shall not require” the franchisees to waive their “right to file a lawsuit alleging a cause of action arising under Maryland Franchise Law in any court of competent jurisdiction in the State of Maryland.”²⁴ The Maryland Commissioner of Securities had required the franchisor to include this statutory language in its franchise agreements as a condition to doing business in Maryland.

The court rejected the franchisor’s argument that the exception was preempted by the FAA. The court reasoned that the franchisor “was not forced to do anything” because “[i]t could have simply declined to do business in Maryland” or “filed a declaratory action challenging the [state’s] position before including the Maryland Clause in its agreements.”²⁵ The U.S. Supreme Court recently declined to review

²¹ 563 U.S. 333 (2011).

²² 539 U.S. 52 (2003) (“[W]e have interpreted the term ‘involving commerce’ in the FAA as the functional equivalent of the more familiar term ‘affecting commerce’—words of art that ordinarily signal the broadest permissible exercise of Congress’ Commerce Clause power.”).

²³ See, e.g., *Bradley v. Harris Research*, 275 F.3d 884 (9th Cir. 2001) (holding that FAA preempted out-of-state venue restriction in California franchise statute); *KKW Enters. v. Gloria Jean’s Gourmet Coffees Franchising Corp.*, 184 F.3d 42 (1st Cir. 1999) (holding that FAA preempted out-of-state venue restriction in Rhode Island franchise statute); *Doctor’s Assocs v. Hamilton*, 150 F.3d 157 (2nd Cir. 1998) (holding that FAA preempted out-of-state venue restriction in New Jersey franchise statute); *Mgmt. Recruiters Int’l, Inc. v. Bloor*, 129 F.3d 851, 856 (6th Cir. 1997) (holding that validity of Washington franchise statute “would be in serious doubt as a result of the preemptive effect of the FAA” if it “imposed an absolute requirement of in-state arbitration notwithstanding the parties’ agreement to arbitrate” elsewhere); *Alphagraphics Franchising v. Whaler Graphics*, 840 F. Supp. 708 (D. Ariz. 1993) (holding that FAA preempted out-of-state venue restriction in Michigan franchise statute).

²⁴ 807 F.3d 553, 570 (4th Cir. 2015).

²⁵ *Id.*

Chorley, but whether the FAA should preempt Maryland from requiring franchisors to include language waiving arbitration in their franchise agreements remains an open question.²⁶

There is reason to think that such a requirement would be struck down if challenged. In *Kindred Nursing Ctrs v. Clark*, the U.S. Supreme Court held last year that Kentucky's "clear-statement rule," requiring an explicit statement in a power of attorney that the attorney-in-fact has authority to waive the principal's right to a jury trial, disfavors arbitration agreements, and thus, the rule was preempted by the FAA.²⁷ As evidenced by the Nevada Supreme Court's decision this year in *U.S. Home Corp. v. The Michael Ballesteros Trust*, an increasing number of states are recognizing that "[t]he Supreme Court has made unmistakably clear that, when the FAA applies, it preempts state laws that single out and disfavor arbitration."²⁸ Barring some specific regulation by Congress, those seeking to enforce arbitration agreements will likely continue to prevail over arguments that they are precluded by state law.

C. Non-Signatories

As signatories to the franchise agreement and any arbitration clause contained therein, the franchisor and franchisee should expect that they can enforce the agreement against each other. There are however many persons and entities surrounding the franchise relationship who may not have signed the agreement but are nevertheless involved in the franchise's operation. This may include family members, business associates, independent contractors, or employees. The issue can get even more complex when there are multiple persons or entities who have signed some, but not all of the many agreements involved in the franchise relationship, such as guarantees, licenses, or leases, or when there are master and sub franchisees.

Can arbitration be enforced by or against any of these non-signatories? In a growing number of situations, the answer is yes. Courts generally recognize five circumstances where signatories can compel non-signatories to arbitration: 1) incorporation by reference; 2) assumption; 3) agency; 4) veil-piercing/alter ego; and 5) estoppel.²⁹ Last year in *Half Dental Franchise, LLC v. Houchin*, the Nevada Supreme Court found that the arbitrators were not exceeding authority because they "provided 'colorable justification' for finding [the non-signatory] bound to arbitration by the theory of estoppel."³⁰ In *Torres v. Simpatico, Inc.*, the Eighth Circuit held that "the language of the Agreement is sufficiently broad and inclusive to express an intent to benefit not only

²⁶ *Dickey's Barbecue Restaurants, Inc. v. Chorley Enterprises, Inc.*, 194 L. Ed. 2d 800 (2016).

²⁷ 137 S. Ct. 1421 (2017).

²⁸ 2018 WL 1755536 (April 12, 2018).

²⁹ See *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 631 (2009); *Crawford Prof'l Drugs, Inc. v. CVS Caremark Corp.*, 748 F.3d 249, 257 (5th Cir. 2014); *CD Partners, LLC v. Grizzle*, 424 F.3d 795, 799 (8th Cir. 2005); *Zurich Am. Ins. Co. v. Watts Indus., Inc.*, 417 F.3d 682, 687 (7th Cir. 2005); *Denney v. BDO Seidman, L.L.P.*, 412 F.3d 58, 71 (2d Cir. 2005); *Trippe Mfg. Co. v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005); *Javitch v. First Union Securities, Inc.*, 315 F.3d 619, 6280-29 (6th Cir. 2003); *Employers Ins. Of Wausau v. Bright Metal Specialties*, 251 F.3d 1316, 1322 (11th Cir. 2001); *Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, 416-17 (4th Cir. 2000); *Thomson-CSF, S.A. v. Am. Arbitration Ass'n*, 64 F.3d 773, 776 (2d Cir. 1995).

³⁰ 2017 WL 3326425 (Nev. Aug. 3, 2017).

the actual signatories and named beneficiaries, but also the other Non-Signatory Parties, all of whom are owners, operators, agents, officers, or employees of the master franchisers.”³¹

Non-signatories are also able to compel signatories to arbitration, often under a third-party beneficiary theory, which requires the agreement to evidence a clear intent to benefit the third-party.³² For example, this year in *Melendez v. Horning*, the North Dakota Supreme Court allowed a non-signatory to compel a signatory to arbitration merely because the allegations involved “intertwined conduct by the non-signatories and related signatories.”³³ Also this year in *Bridgestone Americas Tire Operations, LLC v. Adams*, the Alabama Supreme Court allowed a non-signatory company affiliated with a signatory to compel another signatory to arbitration.³⁴

But there are limits to the availability of arbitration for disputes with non-signatories. For example, in *Oudani v. TF Final Mile, LLC*, the First Circuit held that independent contractors are not “agents” that can be compelled to arbitration.³⁵ And in *White v. Sunoco, Inc.*, the Third Circuit denied a non-signatory’s motion to compel arbitration finding an absence of “concerted conduct” between the non-signatory and signatory or reliance necessary to establish estoppel.³⁶

It is an increasing possibility for arbitration to be enforced by or against non-signatories, but the circumstances are factually dependant. To the extent that a franchisor wants to maximize the scope of an arbitration clause to include potential non-signatories, it should consider identifying categories of third-party beneficiaries it wants to include in the agreement, such as the franchisee’s subsidiaries, family members, business associates, independent contractors, employees, and master and sub franchisees. To further this end, a franchisor might incorporate by reference other agreements signed by third-parties. Finally, a franchisor must evaluate the laws of each particular state, and consider designating a favorable one to apply, because the law in this area continues to develop in varying ways from state-to-state.

II. MAXIMIZING YOUR RIGHT TO ARBITRATION

In order to have a right to arbitrate your dispute with your opponent, you first need an agreement to do so. The good news is that so long as you have an agreement, the law’s strong presumption in favor of arbitration very likely means that your agreement is enforceable. At the arbitration’s conclusion, the presumption also protects

³¹ 781 F.3d 963, 971 (8th Cir. 2015).

³² *Ex parte Stamey*, 776 So.2d 85, 92 (Ala. 2000) (holding under a third-party-beneficiary theory a nonsignatory could enforce an arbitration agreement against a signatory because the agreement specifically stated that the signatory had agreed to arbitrate disputes against the nonsignatory).

³³ 908 N.W.2d 115, 120 (2018).

³⁴ 2018 WL 1355966, at *2 (Ala. Mar. 16, 2018) (“[E]ven if Bridgestone is, as Adams suggests, not a party to the agreement, which provided that disputes would be resolved pursuant to the EDR Plan, Bridgestone is entitled to enforce the agreement.”).

³⁵ 2017 WL 5587648 (1st Cir. Nov. 21, 2017) (refusing to compel arbitration of class wage and hour claims brought by independent contractors).

³⁶ 2017 WL 3864616 (3d Cir. Sept. 5, 2017).

the result from collateral attack, providing the parties with even greater finality than if they litigated in district court.

But what happens in between? Many are intimidated by the uncertainty of allowing their dispute to unfold in a private office as opposed to a courtroom. It is true that the efficiency of arbitration comes at the cost of certain procedures, such as abbreviated discovery, motion practice, and appeals. This can be addressed, however, through careful drafting of the arbitration agreement and an experienced understanding of how arbitration disputes can be litigated.

The following analyzes several areas of the arbitration procedure where parties can maximize their arbitration rights. These include: compelling the arbitration, selecting a neutral, controlling the arbitration's venue, controlling the proceeding, dispositive motions, and injunctive relief.

A. Compelling the Arbitration

If a party to an arbitration agreement is unwilling to arbitrate a dispute, then the other party first needs to secure a court order compelling them to do so. But just how this is accomplished is not particularly clear under most procedural rules and arbitration statutes. What is the appropriate pleading, a complaint, petition, or motion, and when will the court hear the application? In the first instance, it depends on which party is taking the initiative.

If the party opposing arbitration has already filed a complaint in court then the appropriate response is a motion to compel arbitration. While there is no specific procedure for moving to compel arbitration, courts have held that a motion to compel arbitration may be filed in lieu of answering the complaint under Rule 12.³⁷ While in theory one can answer a complaint prior to moving to compel arbitration, doing so risks providing the opponent of arbitration with a waiver argument in the event the defense is not timely raised.³⁸ In addition, if the party opposing arbitration filed the complaint in state court and there is a basis for federal jurisdiction, then the party seeking arbitration should strongly consider first removing the case to federal court where federal law favoring arbitration is applied more consistently.

Whether the motion is categorized as raising a Rule 12(b) defense for (1) lack of subject-matter jurisdiction, (3) improper venue, or (6) failure to state a claim depends on your jurisdiction. In most circuits, including the Second, Sixth, Eighth, Ninth, Eleventh, and Federal Circuits, the motion should raise Rule 12(b)(1).³⁹ In the Fourth and Seventh

³⁷ See *Lamkin v. Morinda Properties Weight Parcel, LLC*, 440 F. App'x 604, 607 (10th Cir. 2011) (“[A] defendant in a pending lawsuit may file a petition or motion to compel arbitration in lieu of an answer to the complaint.”); *Tuttle v. Sallie Mae, Inc.*, 2014 WL 545379 at *2 (N.D. Ind. Feb. 11, 2014); *MQDC, Inc. v. Steadfast Ins. Co.*, 2013 WL 6388624 at *6 (E.D.N.Y. Dec. 6, 2013); *Whaley v. T-Mobile, Inc.*, 2013 WL 5155342, at *2 (E.D. Ky. Sept. 12, 2013).

³⁸ See *Principal Investments v. Harrison*, 366 P.3d 688, 697 (Nev. 2016) (holding that the party seeking arbitration “waived its right to arbitrate to the extent of inviting its borrower to appear and defend on the merits of that claim.”).

³⁹ See *Geographic Expeditions, Inc. v. Estate of Lhotka*, 599 F.3d 1102, 1106–07 (9th Cir. 2010); *U.S. ex rel. Lighting & Power Servs., Inc. v. Interface Constr. Corp.*, 553 F.3d 1150, 1152 (8th Cir. 2009); *Harris v.*

Circuits, the motion should raise Rule 12(b)(3).⁴⁰ And in the Third Circuit, the motion should raise Rule 12(b)(6).⁴¹ Courts in the First, Fifth, and Tenth Circuits have not addressed the issue, and so your best bet is probably to go with the majority by raising Rule 12(b)(1).

If the party opposing arbitration has not yet filed a complaint in court, then the party seeking arbitration will first need to initiate their own court action, preferably in federal court if there is a jurisdictional basis. The FAA provides that a party seeking arbitration may proceed by “petition.”⁴² So in federal court, the appropriate procedure is to file a “Petition to Compel Arbitration,” which may be heard on as little as five days’ notice.⁴³ Under state arbitration acts, the procedure varies. For example, in Minnesota, the application is “made by motion to the court and heard in the manner and upon the notice provided by law or rule of court for making and hearing motions.”⁴⁴

If the court compels arbitration, it should stay the action instead of dismissing it. The FAA provides that the court “shall on application of one of the parties stay the trial.”⁴⁵ The Second Circuit has held that it is an abuse of discretion to dismiss the action after compelling arbitration.⁴⁶ Most states also require courts to stay any action pending arbitration.⁴⁷

B. Selecting the Neutral

Once the parties appear for the arbitration, by choice or compulsion, they have to select a neutral to serve as the arbitrator. Like many aspects of arbitration, the process is easier if the parties planned for it in advance. If the arbitration agreement specifies an arbitral provider like the AAA or JAMs, those organizations have promulgated rules

United States, 841 F.2d 1097, 1099 (Fed. Cir. 1988); *Multiband Corp. v. Block*, 2012 WL 1843261, at *5 (E.D. Mich. May 21, 2012); *Orange Cnty. Choppers, Inc. v. Goen Techs. Corp.*, 374 F. Supp. 2d 372, 373 (S.D.N.Y. 2005).

⁴⁰ See *Gratsy v. Colo. Technical Univ.*, 599 Fed. App’x 596, 597 (8th Cir. 2015); *Hayes v. Delbert Servs. Corp.*, 2015 WL 269483, at *4 n.1 (E.D. Va. Jan. 21, 2015).

⁴¹ See *MRI Scan Ctr., L.L.C. v. Nat’l Imaging Assocs., Inc.*, 2013 WL 1899689, at *2 (S.D. Fla. May 7, 2013).

⁴² 9 U.S.C. § 4 (“A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.”).

⁴³ 9 U.S.C. § 4 (“Five days’ notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.”).

⁴⁴ Minn. Stat. § 572B.05.

⁴⁵ 9 U.S.C. § 3.

⁴⁶ *Virk v. Maple-Gate Anesthesiologists, PC*, 2016 WL 3583248 (2d Cir. July 1, 2016) (“We agree that the district court lacked discretion to dismiss the case under *Katz* as well as the plain language of 9 U.S.C. § 3.”).

⁴⁷ See, e.g., *City of Rochester v. Kottschade*, 2017 WL 2464520 (Minn. June 7, 2017) (“[T]he court of appeals should have considered the legislative directive to district courts to impose a stay when entering an order compelling arbitration.”).

establishing procedures for selecting arbitrators and assembled rosters with background information to aid in the selection process.⁴⁸ Case managers are often available to assist the parties, if requested, by providing access to arbitrator information and extending deadlines to assist the parties in selecting an arbitrator before imposing a more formal process as set forth in the arbitration agreement or arbitral rules. For example, the AAA's rules provide that "[i]f the parties fail to agree . . . , the AAA shall have the power to make the appointment."⁴⁹

One of the benefits of arbitration in industry-specific areas like franchising is that the parties can have their dispute heard by an arbitrator with franchise experience. This can be accomplished by requiring specific qualifications in the arbitration agreement. There are, however, two downsides to requesting an experienced arbitrator. First, there are a limited number of them, and as a result, the request can narrow the pool of potential candidates, particularly outside of major cities. Second, the more experience an arbitrator has in franchising, the more likely he or she is to have either conflicts precluding his or her service as an arbitrator or a background suggesting preference for one-side of the franchise relationship over the other. The result of either downside is a prolonged selection process.

Since impartiality is one of the few grounds to vacate an arbitration award, it is in both parties' interest to fully vet the arbitrator's potential conflicts of interest and agree-upon one without any in order to ensure finality to their dispute.⁵⁰ But as recent cases have shown, not every failure to disclose a potential conflict of interest is grounds to vacate an award.⁵¹ Regardless, the AAA and JAMs rules both impose a continuing obligation upon arbitrators to disclose any potential conflicts of interest.⁵² If anything comes up in an arbitrators' disclosures that seems concerning, counsel should follow-up with the arbitrator to obtain additional information about the disclosure.

C. Controlling the Venue

The goal of many franchise systems is growth, which is often accompanied by geographic expansion. In order to control the franchise systems' exposure in distant jurisdictions or for other reasons, most franchise arbitration agreements include a mandatory forum selection clause. Since franchisors draft the franchise agreement, which typically includes a forum selection clause, the company has the opportunity to choose the most convenient and favorable venue for resolving disputes in the system.

⁴⁸ See AAA Commercial Rules R-12; JAMS Comprehensives Rules R-7.

⁴⁹ See AAA Commercial Rules R-12.

⁵⁰ 9 U.S.C. § 10.

⁵¹ *Narayan v. Assoc. of Apt Owners of Kapalua Bay Condominium*, 2017 WL 2591321 (Haw. June 15, 2017) ("[I]t was not clearly erroneous for the circuit court to conclude that the Arbitrator's undisclosed 'relationship' with Stellmacher did not constitute evident partiality."); *Eagle Jet Aviation v. Milton Woods*, 2017 WL 2813985 (Nev. June 27, 2017) ("EJA fails to point to any evidence which would prove that the alleged relationships are 'so intimate—personally, socially, professionally, or financially—as to cast serious doubt on the arbitrator's impartiality.'").

⁵² See AAA Commercial Rules R-17; JAMS Comprehensives Rules R-15.

Forum selection clauses in franchise arbitration agreements are usually enforced. Both AAA and JAMS rules defer to the parties' agreed-upon forum.⁵³ While courts historically disfavored forum selection clauses, that preference has flipped and courts now defer to the parties' agreed-upon forum.⁵⁴ Some states have attempted to enact statutes precluding franchise agreements from selecting out-of-state arbitration forums, but courts usually hold that they are pre-empted by the FAA.⁵⁵ Being compelled to arbitrate in the wrong forum, however, is generally not a basis for vacating an award.⁵⁶

Given the importance of venue, there is almost no circumstance where a franchise arbitration agreement should not contain a mandatory forum selection clause. One exception might be where a franchisor decides to carve out claims likely to warrant injunctive relief, such as trademark infringement and enforcement of non-competes. Bringing these claims in a franchisee's home state can avoid delays in litigating forum selection issues, as well as recording and enforcing a foreign judgment.

The forum selection clause should specify that the parties agree to the chosen venue as the exclusive one for arbitrating their disputes. Since some courts link their jurisdiction to the venue where they compel arbitration, the forum selection clause should also specify that the parties consent to the court's jurisdiction there as well. That way, the party seeking arbitration can move to compel where the arbitration will ultimately be venued, and the party opposing arbitration will be subject to the court's jurisdiction for the purpose of that motion.

D. Controlling the Proceeding

⁵³ See AAA Commercial Rules R-11; JAMS Comprehensives Rules R-19.

⁵⁴ *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9 (1972) ("Forum-selection clauses have historically not been favored by American courts. . . . [But] in the light of present-day commercial realities and expanding international trade we conclude that the forum clause should control absent a strong showing that it should be set aside.").

⁵⁵ See, e.g., *KKW Enters., Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 51-52 (1st Cir. 1999) (holding that the FAA preempts statute invalidating venue clauses in franchise agreements); *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998) ("[T]o the extent that [case law] can be read to invalidate arbitral forum selection clauses in franchise agreements, it is preempted by the FAA."); *Management Recruiters Int'l v. Bloor*, 129 F.3d 851, 856 (6th Cir. 1997) (holding that a statute that "imposed an absolute requirement of in-state arbitration notwithstanding the parties' agreement to arbitrate [elsewhere], its validity would be in serious doubt as a result of the preemptive effect of the FAA"); *Prude v. McBride Research Labs, Inc.*, No. 07-13472, 2008 WL 360636, at *5 (E.D. Mich., Feb. 8, 2008) (holding that the FAA preempts state statute voiding franchise agreement's venue clauses requiring out of state arbitration); *Flint Warm Air Supply Co., Inc. v. York International Corp.*, 115 F.2d 820 (E.D. Mich. 2000) (same); *Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc.*, 840 F. Supp. 708 (D. Ariz. 1993) (same); *Newman ex rel. Wallace v. First Atlantic Resources Corp.*, 170 F. Supp. 2d 585, 592-93 (M.D.N.C. 2001) (same).

⁵⁶ *Saleemi v. Doctor's Assocs., Inc.*, 292 P.3d 108 (Wash. 2013) (refusing to vacate award based on franchisor's argument that court refused to enforce forum selection clause).

Arbitration unfolds in many ways like a typical lawsuit does before the court, but since neither the rules of civil procedure nor the rules of evidence necessarily apply, there is understandable uncertainty about the specifics. Some enjoy this cavalier approach while others dread the thought of proceeding without the detailed rules they are accustomed to relying upon. The good news is that if the parties have selected an administrator like the AAA or JAMS, then their arbitral rules fill in some of the gaps and provide a basic framework for the procedure. Parties can also add certainty to the process up front by including specific provisions in their franchise agreement detailing how long the proceeding should take, what type of discovery is permitted, or even the type of award that is entered.

Unlike a typical lawsuit, arbitration is not initiated by a complaint. Instead, the party seeking arbitration only provides the other party with an arbitration demand.⁵⁷ Personal service is not required unless provided in the arbitration agreement. If the arbitration provider is AAA or JAMS, both have published demand forms that generally require identification of the parties, amount in controversy, a brief description of the dispute, and a copy of the arbitration agreement. Since there are no minimal pleading requirements, an arbitration demand does not need to have a particular number of paragraphs or lengthy allegations. Likewise, a response and any counterclaims are optional and should not need to follow any particular format unless specified in the arbitration agreement.

Once the parties have selected an arbitrator, he or she will convene a preliminary conference before issuing a scheduling order that memorializes the roadmap for the arbitration.⁵⁸ This is the parties' opportunity to tailor the procedures to fit the needs of each, individual case. Experienced arbitrators are involved case managers and will likely come to the preliminary conference with their own "housekeeping" protocols. But the parties are free to make their own requests, which are often granted so long as they are warranted by the interests of efficiency and justice. During the preliminary conference, examples of topics for procedural decisions include: statements of claims, forms of discovery, schedules for document exchanges, necessity of depositions, expert discovery, third-party subpoenas, pre-hearing exhibit and witness disclosures, stipulated facts, pre- and post-hearing briefs, hearing date and length, and the form of the award.

In order to further the objective of making arbitration a less-costly alternative to traditional litigation, discovery in arbitration is usually limited. Since arbitration is a creature of contract, arbitrators will usually go along with the parties' stipulations. 91% of arbitrators report that they "usually" or "always" work with counsel to limit discovery and 94% of arbitrators report that they "usually" or "always" encourage the parties to limit the scope of discovery.⁵⁹ Document exchanges are the norm and courts have upheld the power of arbitrators to compel parties to perform such exchanges.⁶⁰ Depositions are sometimes permitted, but usually limited in number or length. Written

⁵⁷ See AAA Commercial Rules R-4; JAMS Comprehensives Rules R-5, R-9.

⁵⁸ See AAA Commercial Rules R-21; JAMS Comprehensives Rules R-16.

⁵⁹ Thomas J. Stipanowich & Zachary P. Ulrich, *Arbitration in Evolution: Current Practices and Perspectives of Experienced Commercial Arbitrators*, 25 AM. REV. INT'L ARB. 395, 402-03 (2014).

⁶⁰ *In Re Sec. Life Ins. Co.*, 228 F.3d 865, 870-71 (8th Cir. 2000).

discovery is infrequent unless a party can meet the difficult challenge of justifying it. Provisions can be included in the arbitration agreement if additional certainty on these issues is desired.

The hearing will likely take place at the arbitrator's office or some other neutral agreed-upon location. Arbitrators have different styles for conducting hearings. Most will expect the parties to stipulate to certain procedures, such as a joint set of exhibits and the order of witness testimony, with the primary considerations being efficiency and witness convenience. 75% of arbitrations accept practically all non-privileged evidence and discourage traditional evidentiary objections such as hearsay and foundation.⁶¹ Some arbitrators are proactive and may interject with questions or let attorneys know they can "move on." After the hearing, the parties will usually have an opportunity to submit briefs summarizing the relevant facts, applicable law, and arguments in support of their claims and defenses.

Arbitration awards come in three flavors: simple, reasoned, and findings of fact and conclusions of law. The Second Circuit recently explained the differences in *Leeward Construction Co. v. American Univ. of Antigua-College of Medicine*.⁶² A simple award consists solely of a dollar amount or perhaps "a line or two of unexplained conclusions."⁶³ A reasoned award "sets forth the basic reasoning of the arbitral panel on the central issue or issues raised before it," but it "need not delve into every argument made by the parties."⁶⁴ Findings of fact and conclusions of law provides detailed analysis "on each issue raised before the panel."⁶⁵ The distinction is material, according to the Second Circuit, because an arbitrator's failure to issue the type of award required under the arbitration agreement can serve as a basis to vacate it.⁶⁶

Finally, many cite confidentiality as a benefit of arbitration. Arbitrations tend to be more private than courtroom litigation because there is no immediate public record, but arbitration is only confidential if the parties have agreed to that. The prevailing party will also need to file an application to confirm the award, which will be a public record. Moreover, franchisors are required to include arbitration proceedings and awards in their FDDs just like any litigation.⁶⁷ Consequently, the benefits of confidentiality are minimized in resolving franchise disputes. If court action is needed to enforce the award, or one of the parties seeks to try and vacate the award through post-arbitration judicial proceedings, it may not be possible to maintain the confidentiality of the award.

E. Injunctive Relief

The availability of injunctive relief is a significant consideration for franchisors choosing arbitration. Injunctive relief is an important tool for stopping trademark infringement and preventing former franchisees from taking the knowledge and

⁶¹ See Stipanowich & Ulrich, *supra* note 59.

⁶² 2016 WL 3457266 (2d Cir. June 24, 2016).

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ 16 C.F.R. § 436.5(c)(ii).

experience gained from the system and using it to operate their own competing businesses. These are a franchisor's most valuable assets. So if a franchisor is selecting arbitration as a method of dispute resolution, it needs to ensure that injunctive relief will remain available.

There is uncertainty about the availability, enforceability, and possibility for delay in obtaining injunctive relief from an arbitrator. In the first instance, the arbitration agreement must provide the arbitrator with the authority to issue injunctions, including on an emergency, temporary, and ex parte basis. If the arbitration agreement incorporates arbitrable rules issued by the AAA or JAMS, those rules grant arbitrators such authority. To ensure the availability of injunctive relief, for example under the AAA's rules, an arbitration agreement should specifically incorporate the "Optional Rules For Emergency Measures of Protection."

But even with an arbitrator's injunction in hand, issues surrounding enforcement can present a risk of delay, which often runs contrary to the primary motivation for seeking an injunction in the first place—the prevention of immediate and irreparable harm. An arbitrator can issue sanctions against a party violating his or her injunction, but that may have little impact if the party was willing to violate the injunction in the first place. In order to access the more persuasive threat of contempt, a party will first need to have a court confirm the injunction, which under the FAA means it will need to be a "final award."⁶⁸ Of course, confirmation of an award can be challenged, including based on the existence or enforceability of the arbitration agreement, which risks delaying the injunction's enforcement.

Getting an injunction from an arbitrator is an additional procedure that can invite delay based on challenge to the arbitrator's authority. As a result, many franchisors rightfully carve out claims likely to implicate injunctive relief from their arbitration agreements. To have it both ways, the franchise agreement could alternatively provide the option to file such claims either in court or arbitration. In most cases, however, it will be more efficient to seek immediate injunctive relief from the courts.

F. Dispositive Motions

Dispositive motions are another important tool for franchisors, who often raise legal defenses to franchisees' claims based on the language of their franchise agreements or because the asserted claims may be time-barred. There is widespread belief that dispositive motions are unavailable in arbitration, perhaps because the fee structure of arbitration does not seem to incentivize disposition short of a hearing, or because summary legal rulings are more likely to provide grounds for vacating an award.

Even though the arbitral rules of organizations like the AAA and JAMS do not expressly provide for dispositive motions, most arbitrators will at least entertain them if the parties ask. Less than 1% of arbitrators report that they refuse to rule on motions for summary judgment.⁶⁹ Instead, about 70% of arbitrators report that they "readily" rule on

⁶⁸ 9 U.S.C. 10(a)(4).

⁶⁹ See Stipanowich & Ulrich, *supra* note 59.

dispositive motions.⁷⁰ If an arbitrator agrees to hear a dispositive motion, he or she will likely set a briefing schedule, and probably a telephonic hearing. Parties can consider supplementing their franchise agreements by adding provisions to make it clear that certain types of dispositive motions must be entertained, perhaps even within some set period of time or before certain events like discovery occur.

Dispositive motions are in fact available in arbitration, but litigators need to understand their limited utility. Dispositive motions are more likely to be granted by arbitrators when they are characterized as a way to limit the scope of claims and issues as opposed to disposing of the entire action. To that end, they can be an effective way to begin framing the issues for the arbitrator. Even if an arbitrator hears a dispositive motion, he or she may delay ruling on it until after the hearing. Dispositive motions in arbitration can help limit the scope of claims, and perhaps dispose of truly meritless ones short of a hearing, but are less likely to dispose of the entire action than in court.

III. ELIMINATING RISKS AND NARROWING OTHERS

Harmonious and prosperous franchise relationships are the hopes and dreams of all legitimate franchisors. The reality, however, is that disputes are inevitable in almost every franchise system, even highly successful ones. The earlier a franchisor comes to grips with this and makes appropriate risk management plans, the more likely it is to successfully weather the disruption caused by a disgruntled franchisee or even a system-wide concern.

One of the principal benefits of arbitration for franchisors is that it allows them to design custom dispute resolution procedures that control their cost and exposure to liability. When problems arise, having an arbitration agreement can immediately answer many procedural and substantive questions about how a dispute will likely unfold. When the arbitration agreement is well-drafted, many of the answers will provide some degree of certainty and limitation for the franchisor's cost and exposure to liability, which in turn provides stability and protection for the franchise system as a whole.

The following analyzes several common terms found in well-drafted arbitration agreements where litigators should focus to eliminate risks and narrow others. These include contractual limitations on: categories of damages, claim types, class and group actions, statutes of limitations, and appeal rights.

A. Limiting Damages

Damages claims in franchise disputes come in any number of varieties: expectation or "benefit of the bargain" damages, lost profits, fair market value, royalties, liquidated damages, consequential damages, recession damages, restitution, statutory damages, punitive damages, and attorneys' fees. Since arbitration is a creature of contract, the general rule is that the parties are free to stipulate to limitations on the remedies that they may obtain from each other in the event of a dispute.⁷¹

⁷⁰ See *id.*

⁷¹ W. Michael Garner, *FRANCHISE LAW AND PRACTICE*, § 356 (1990) ("A franchise agreement may limit, condition or shape the damages recoverable by either party in the event of litigation between them.").

There are, however, some restrictions on the limits that the parties can place on damages in arbitration. Many state franchise laws invalidate damage limitations in franchise agreements.⁷² Otherwise, most courts evaluate damages limitations using an “unconscionability” standard.⁷³ The results vary widely from case to case and state to state. For example, last year in *United Inv. Grp., LLC v. Beggars Pizza Franchise Corp.*, the Illinois Court of Appeals upheld a limitation on a franchisee’s damages to the amount paid to the franchisor under the franchise agreement.⁷⁴ On the other hand, that damages limitation may not work before the Hawaii Supreme Court, which last year in *Narayan v. The Ritz-Carlton Dev. Co., Inc.* struck down a limitation on special damages citing solely to the parties’ disparate bargaining power.⁷⁵

There are many types of damages limitations that are routinely upheld. Most states uphold limitations on punitive and consequential damages.⁷⁶ Most states also allow one-way attorney fee shifting provisions.⁷⁷ Limitations on expectation damages or express dollar amounts are typically disfavored.⁷⁸ Given that the enforceability of damages limitations varies, arbitration agreements should provide for their severability and enforcement to the extent permitted under the applicable law. Damages limitations are sometimes used as a basis to challenge the enforceability of the arbitration agreement as a whole.⁷⁹ But a well-drafted delegation clause solves that problem.

B. Limiting Claims

⁷² See, e.g., Cal. Bus. & Prof. Code §§ 20010, 20040; Conn. Gen. Stat. §§ 42-133f to 133g; 815 Ill. Comp. Stat. §§ 705/41, 705/26; Ind. Code §§ 23-2-2.5-28, 23-2-2.7-1; Iowa Code §§ 523h.4, 523h.14; Md. Code, Bus. Occ. & Prof. §§ 14-226 to -227; Mich. Comp. L. §§ 445.1527(b), 445.1531; Minn. Stat. §§ 80c.17, .2; R.I. Gen. L. § 19-28.1-21; S.D. Cod. L. §§ 37-5a-83, -85, -86; Wis. Stat. §§ 135.025, 135.06.

⁷³ See, e.g., *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 694 (Cal. 2000) (“The unconscionable one-sidedness of the arbitration agreement is compounded in this case by the fact that it does not permit the full recovery of damages . . .”).

⁷⁴ 2017 IL App (1st) 162275-U, ¶ 25.

⁷⁵ 400 P.3d 544, 554 (“It would create an untenable situation if parties of superior bargaining strength could use adhesionary contracts to insulate ‘aggravated or outrageous misconduct’ from the monetary remedies that are designed to deter such conduct.”).

⁷⁶ See, e.g., *Dollar Rent A Car Sys., Inc. v. P.R.P. Enters., Inc.*, 242 F. App’x 584, 588 (10th Cir.2007) (affirming the district court’s decision that a franchisees’ contractual waiver of the right to recover lost profits or consequential damages precluded such damages); *Stark v. Sandberg*, 381 F.3d 793 (8th Cir. 2004) (“The arbitration clause states any claims will be resolved in accordance with the FAA, which permits a waiver of punitive damages.”); *Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, 298 F.3d 314, 318 n.1 (5th Cir. 2002) (“Provisions in arbitration agreements that prohibit punitive damages are generally enforceable.”).

⁷⁷ Only seven states have statutes requiring reciprocal fee shifting. See Cal. Civ. Code § 1717; Fla. Stat. § 57.105(7); Haw. Rev. Stat. § 607-14; Mont. Code § 28-3-704 (2011); Or. Rev. Stat. § 20.096; Utah Code § 78B-5-826; Wash. Rev. Code § 4.84.330.

⁷⁸ *City of Dillingham v. CH2M Hill Northwest, Inc.*, 873 P.2d 1271 (Alaska 1994) (court concluded that limitation of liability clauses were merely attempts to bargain away liability and as such were barred by the statute).

⁷⁹ *Booker v. Robert Half Int’l, Inc.*, 413 F.3d 77 (D.C. Cir. 2005) (punitive damages waiver in arbitration clause was unenforceable, but could be severed as employer had not engaged in bad faith drafting).

Arbitration agreements can carve out which claims are subject to arbitration, but they generally cannot limit the parties' substantive rights.⁸⁰ The FTC Rule and almost all state franchise laws contain anti-waiver provisions that prohibit franchise agreements from waiving prospective liability under them.⁸¹ Courts also generally prohibit parties to an arbitration agreement from waiving their statutory rights.⁸² But the parties may certainly agree which types of claims are subject to arbitration.

As discussed above, there are good reasons for franchisors to carve out claims seeking injunctive relief from arbitration. Last year in *Archer & White Sales v. Henry Schein, Inc.*, the Fifth Circuit affirmed the denial of a motion to compel arbitration of claims seeking injunctive relief because they were excluded from the arbitration agreement.⁸³ The Fifth Circuit applied the "wholly groundless" exception to hold that the claims were not subject to arbitration despite the existence of a valid delegation clause because the arbitration agreement so clearly carved out claims seeking injunctive relief that it would be pointless to submit them to the arbitrator for a determination of their arbitrability.⁸⁴

The U.S. Supreme Court has "interpreted [the FAA] to require that if a dispute presents multiple claims, some arbitrable and some not, the former must be sent to arbitration even if this will lead to piecemeal litigation."⁸⁵ Recent decisions have continued to apply that holding. Last year in *Family Security Credit Union v. Etheridge*, the Alabama Supreme Court upheld an arbitration agreement even though it provided one party with the option to bring some claims in court.⁸⁶ Likewise, in *Meadows v. Dickey's Barbecue Restaurants Inc.*, the Northern District of California upheld the arbitration agreement despite the franchisor's reservation of the right to litigate certain claims.⁸⁷ Based on these decisions and others like them, franchisors are free to provide themselves with the option to bring certain claims in court or arbitration so that litigators can strategically select between them.

C. Limiting Class and Group Actions

One of the most powerful limitations available to franchisors under arbitration agreements is the ability to limit exposure to actions brought by a class or group of franchisees. When a system-wide issue arises, franchisees will often attempt to leverage their strength in numbers by bringing class or group actions despite the fact that their claims are of an individualized nature.

⁸⁰ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) ("By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.").

⁸¹ See, e.g., 16 C.F.R. § 436.

⁸² *Graham Oil Co. v. Arco Products Co.*, 43 F.3d 1244 (9th Cir. 1995).

⁸³ 878 F.3d 488 (5th Cir. 2017).

⁸⁴ *Id.*

⁸⁵ *KPMG LLP v. Cocchi*, 565 U.S. 18, 19 (2011).

⁸⁶ 2017 WL 2200364 (Ala. May 19, 2017) (rejecting argument that one party's reservation of right to bring claims in court was invalid for lack of mutual consideration).

⁸⁷ 144 F. Supp. 3d 1069, 1087 (N.D. Cal. 2015) ("Although Dickey's reservation of the right to litigate certain claims lacks mutuality, under Texas law this "allocation of risk because of superior bargaining power" is enforceable.").

Class and group actions present a particularly dangerous threat to the franchise system not only because their numerosity can evidence larger problems, but also because they are exceedingly expensive and difficult to resolve. Class and group actions can also be used as a tool for leverage, even when the underlying claims do not have any merit. When attempting to reach a global settlement with a concerted group of franchisees represented by a single attorney, there is a risk that the franchisor is essentially forced to negotiate with the most unreasonable hold out of the group. One-on-one negotiations allow the franchisor to address the specific demands of each franchisee, which can bring about a more efficient settlement. In other circumstances, one-on-one litigation can also more directly address the particular issues being raised.

Arbitration agreements with class action waivers are enforceable. Under the U.S. Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, class action waivers in arbitration cannot be invalidated based on state law, including contract-based defenses like unconscionability, as well as state statutes.⁸⁸ Lower courts have applied the holding in *Concepcion* to approve class action waivers in franchise agreements. For example in *Muriithi v. Shuttle Exp., Inc.*, the First Circuit held that "the district court erred in holding that the class action waiver was unconscionable."⁸⁹

While the U.S. Supreme Court has also held in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* that class actions cannot proceed in arbitration unless expressly authorized, lower courts have not always applied that ruling consistently.⁹⁰ For example, in *Fantastic Sams Franchise Corp. v. FSRO Ass'n Ltd.*, the First Circuit barred one group of franchisees from class arbitration under arbitration agreements that expressly excluded it, but allowed another group of franchisees to proceed with class arbitration where the arbitration agreements were silent, leaving it for the arbitrator to determine whether the class claims were arbitrable.⁹¹

Consequently, a well-drafted arbitration clause in a franchise agreement should always contain a provision waiving the right to assert class actions and requiring franchisees to bring their claims individually in arbitration. Provisions can also be added to further limit the ability to file consolidated or other group pleadings in arbitration. But who decides in the first instance whether class claims are arbitrable? That can be unclear if the arbitration agreement fails to include a delegation clause.⁹² So long as the arbitration agreement contains a class action waiver, it should also contain a clause delegating the authority to decide the arbitrability of disputes to the arbitrator.

⁸⁸ 563 U.S. 333, 352 (2011) ("Because it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' . . . California's *Discover Bank* rule is preempted by the FAA.").

⁸⁹ 712 F.3d 173, 180–81 (4th Cir. 2013).

⁹⁰ 559 U.S. 662, 687 (2010) ("[T]he differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings.").

⁹¹ 683 F.3d 18, 26 (1st Cir. 2012).

⁹² *Compare Sandquist v. Lebo Automotive, Inc.*, 376 P.3d 506 (Cal. July 28, 2016) (holding that the arbitrator decides the arbitrability of class claims), with *Dell Web Communities, Inc. v. Carlson*, 2016 WL 1178829 (4th Cir. Mar. 28, 2016) (holding that the court decides the arbitrability of class claims).

D. Limiting Time

Parties to arbitration agreements are also free to shorten the deadline for bringing claims. Courts generally uphold contractual claim limitation periods so long as they are “reasonable.”⁹³ This analysis could depend on factors such as the type of claim at issue, the amount of time provided to bring it, and whether the limitations period was triggered by discovery or the mere existence of the claim.⁹⁴

Some states have passed laws providing that their statutes of limitation apply to arbitrations.⁹⁵ Other states have decided that their statutes of limitations do not apply to arbitrations at all.⁹⁶ In those states, it is essential that the arbitration agreement provide a limitations period or else there might not be one. Given that the law can vary considerably from case-to-case and state-to-state, well-drafted arbitration clauses should always provide a limitations period and it should be reasonable.

To improve the enforceability of the limitations period, the arbitration agreement could also include a severability clause providing that the limitation period will apply to the extent permitted by law, but in no case longer than the statute of limitations that would normally apply to the claim. Parties opposing arbitration sometimes argue that the arbitration agreement is unconscionable because of an unreasonable limitations period.⁹⁷ Consequently, a delegation clause is also an important component of an arbitration agreement containing a shortened limitations period.

E. Limiting Appeals

Arbitrators get the distinction of having more of a “final say” than district court judges. If you are disappointed with your arbitration award, too bad because the grounds to appeal it are incredibly narrow. The FAA provides several grounds to vacate awards but frankly it can be even worse than it looks.⁹⁸ In *Oxford Health Plans LLC v. Sutter*, the U.S. Supreme Court explained that “convincing a court of an arbitrator’s error—even his grave error—is not enough.”⁹⁹ The Court upheld the award because the arbitrator was “arguably construing” the contract “however good, bad, or ugly.”¹⁰⁰ According to the Court, once you “chose arbitration,” you “must now live with that choice.”¹⁰¹

⁹³ *Order of United Commercial Travelers of America v. Wolfe*, 331 U.S. 586 (1947).

⁹⁴ See, e.g., *Letourneau v. FedEx Ground Package Sys., Inc.*, No. Civ. 03-530-B, 2004 WL 758231, at *1 (D.N.H. Apr. 7, 2004) (upholding ninety-day limitations period); *McKee v. AT&T Corp.*, 191 P.3d 845, 859-60 (Wash. 2008) (invalidating two-year limitations period).

⁹⁵ See N.Y. C.P.L.R. § 7502; Ga. Code Ann. § 9-9-5; Wash Rev. Code § 7.04A.090(3); see also *Raymond James Financial Services, Inc. v. Phillips*, 126 So. 3d 186 (Fla. 2013) (holding that statute of limitations applied to arbitration).

⁹⁶ See, e.g., *NCR Corp. v. CVS Liquor Control, Inc.*, 874 F. Supp. 168, 172 (S.D. Ohio 1993).

⁹⁷ See, e.g., *Vlahos v. Int’l Baking Co.*, 2005 WL 1632089 at *1 (Cal. Ct. App. July 12, 2005) (holding that shortening of statutes of limitations in distributorship agreement was unconscionable).

⁹⁸ 9 U.S.C. § 10.

⁹⁹ 569 U.S. 564, 572 (2013).

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

State courts are following the same general rules. Last year in *Washoe County School District v. White*, the Nevada Supreme Court affirmed an award because there was “colorable justification” for it.¹⁰² Similarly, last year in *Forest Oil Corp. v. El Rucio Land & Cattle Co.* the Texas Supreme Court explained that “the proper inquiry is not whether the arbitrator decided an issue correctly, but rather, whether he had the authority to decide the issue at all.”¹⁰³

The U.S. Supreme Court held in *Stolt-Nielsen*, “It is only when [an] arbitrator strays from interpretation and application of the agreement and effectively ‘dispense[s] his own brand of industrial justice’ that his decision may be unenforceable.”¹⁰⁴ As opined by the Sixth Circuit in *Schafer v. Multiband Corp.*, it is a legitimate question whether arbitrators are bound to follow the law at all: “The very idea that an arbitral decision is not appealable for legal error leads to the conclusion that the arbitrator is not necessarily bound by legal holdings of this court.”¹⁰⁵

Some drafters of arbitration agreements have attempted to circumvent the finality of arbitration awards. The U.S. Supreme Court, however, held in *Hall St. Assocs., L.L.C. v. Mattel, Inc.* that the FAA provides the exclusive grounds for vacating or modifying an award and the parties may not contract around them.¹⁰⁶ This year in *Citizen Potawatomi Nation v. Oklahoma*, the Tenth Circuit actually found an arbitration agreement unenforceable because it provided for judicial de novo review of awards.¹⁰⁷ Arbitral providers like the AAA and JAMs, however, do provide optional appellate rules that the drafters of arbitration agreements may incorporate if they want to have some form of appellate review within the arbitration.¹⁰⁸

In the event that a party who lost in arbitration decides to try and vacate the award, it will need to have preserved the issues and raised a timely challenge. First, only a final award can be challenged, not an interim one.¹⁰⁹ Second, the contested arguments must be part of the record. As the Seventh Circuit held earlier this year in *Laborers’ Pension Fund v. W.R. Weis Co.*, arguments for vacating an award are waived when they are not raised in arbitration.¹¹⁰ Moreover, the arguments should be transcribed or decided by an award with detailed findings of fact and conclusions of law.¹¹¹ Finally, under the FAA a party seeking to vacate an award has three months to

¹⁰² 396 P.3d 834, 838 (Nev. 2017).

¹⁰³ 518 S.W.3d 422, 431 (Tex. 2017).

¹⁰⁴ 559 U.S. 662, 687 (2010).

¹⁰⁵ 2014 WL 30713 (6th Cir. 2014).

¹⁰⁶ 552 U.S. 576, 584 (2008).

¹⁰⁷ 881 F.3d 1226, 1228 (10th Cir. 2018).

¹⁰⁸ See AAA Optional Appellate Arbitration Rules, available at <https://www.adr.org/Rules>.

¹⁰⁹ *Savers Property & Cas. Ins. Co. v. Nat’l Union Fire Ins. Co. of Pittsburg*, 2014 WL 1378134 (6th Cir. April 9, 2014) (“[T]he awards fail to satisfy the complete arbitration rule, and judicial review was improper at this stage of the proceedings.”).

¹¹⁰ 2018 WL 316555 (7th Cir. Jan. 8, 2018).

¹¹¹ *Physicians Ins. Capital v. Praesidium Alliance Group*, 2014 WL 1388835 (6th Cir. April 10, 2014) (holding that the moving party could not “meet its high burden of showing that the arbitration award must be vacated” because it lacked a “complete record of the arbitration proceedings”).

notify the other party.¹¹² Courts have recently held that besides fraud there are no exceptions to this deadline.¹¹³

IV. CONCLUSION

Court decisions over the past couple years confirm the continuation of a strong federal presumption in favor of arbitration. Franchisors can be more confident than ever that courts will enforce their arbitration agreements and the procedures they have drafted to accompany them.

There are certainly cases when arbitration is no less time consuming and expensive than traditional litigation. But franchisors should not let these anecdotal experiences lead them to completely ignore the benefits of arbitration. Since franchisors get to draft the arbitration agreement, they can create a custom dispute resolution system that provides themselves with additional procedural protections and certainty, such as limitations on claims, class and group actions, and forum-selection clauses, to name a few. They can also tailor the procedures to ensure a more efficient proceeding for all parties, or include more specific qualifications for an arbitrator. With the right practical skills and understanding of arbitration, litigators can navigate the arbitration procedure in a way that minimizes their clients' exposure to liability and obtains results that are less costly, quicker, and even more predictable than what can occur in the courts.

4825-1897-4818, v. 3

¹¹² 9 U.S.C. § 12.

¹¹³ See *Move, Inc. v. Citigroup Global Markets, Inc.*, 2016 WL 6543522 (9th Cir. Nov. 4, 2016) ("Accordingly, we hold that the FAA is subject to the established doctrine of equitable tolling."); *Karo v. Nau Country Ins. Co.*, 297 Neb. 798, 816, 901 N.W.2d 689, 701 (2017) ("Congress intended that a party's failure to serve notice of the application in the manner directed, and within mandatory time limits, would have jurisdictional consequences.").