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Arbitration Pacts In Franchising: One Size Doesn't Fit All

By **Doug Knox** (May 22, 2019, 11:10 AM EDT)

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While arbitration provisions were previously the norm, many franchise companies have started to shift away from making this the default and preferred method for dispute resolution. The decision whether to require binding arbitration of franchise disputes can be a million-dollar question for any franchise company.

On the one hand, and at one extreme, the prospect of defending a franchise system-wide class action over multiple years in a court of law will not sit well with most franchisors. On the other hand, and at the other extreme, the risk of an adverse ruling by a runaway arbitrator with no right of judicial review persuades many franchisors to prefer litigation.

Between these extremes lie many factors that franchise companies should carefully consider when deciding whether to include an arbitration provision in their franchise agreements.

Arbitration allows parties to avoid the expense and publicity of litigating in court by submitting their disputes to a neutral third-party arbitrator. Most franchise agreements requiring arbitration require the parties to submit all disputes “arising out of or relating to” the franchise agreement (or, more broadly, the franchise relationship) to binding arbitration. The arbitration agreement should designate an arbitration organization, such as the American Arbitration Association or JAMS, to administer the arbitration proceedings. It should also provide a locale for the arbitration and specify whether a single arbitrator or a panel of multiple arbitrators will decide the dispute.

Arbitration proceedings are confidential, and the arbitration award will be final and binding. Grounds for judicial review of an arbitration award are usually limited to instances where the award was procured by fraud, there is evidence of bias or corruption in the arbitrators, or the arbitrators exceed their authority or fail to exercise their powers.

Many franchisors prefer arbitration as the more efficient and streamlined means of dispute resolution.

However, many of the presumed upsides of arbitration are subject to scrutiny. Given the high filing and administrative fees involved with arbitration, as well as fees required for the arbitrators’ compensation, arbitration often is not cheaper than litigation. Given the finality and lack of available review of an award, it may prove a better idea to have a panel of three arbitrators decide the dispute, but that protection will require an exponential cost.

Although arbitrations can conclude quicker than lawsuits, a quicker resolution is by no means guaranteed. Whereas courts of law will usually require a showing of good cause to continue a trial or summary judgment deadline, arbitrators are more likely to extend proceedings to give both parties every opportunity to present their claims and defenses. Courts are more likely to dismiss claims on motions to dismiss or for summary judgment.

Arbitrators, on the other hand, often have a reputation for splitting the proverbial baby.

Putting these pros and cons aside, the prospect of enforcing class action waivers remains the one factor that persuades many franchisors to include arbitration provisions in their franchise agreements. Since the United States Supreme Court decisions in AT&T Mobility LLC v. Concepcion[1] and American Express Co. v. Italian Colors Restaurant,[2] many companies have viewed arbitration agreements as the most reliable way to enforce class action waivers. The Supreme Court has consistently held that the Federal Arbitration Act preempts state courts' decisions invalidating arbitration class actions waivers as unconscionable.

More recently, the Supreme Court held that the collective bargaining rights granted by the National Labor Relations Act does not override the FAA's policy favoring arbitration.[3] Accordingly, only fraud or duress will invalidate an agreement to arbitrate; any state or federal right to bring a class action will not override federal policy favoring enforcement of arbitration agreements.

While arbitration agreements remain the surest way for franchisors to enforce class action waivers, the question remains whether such agreements are necessary for that purpose.

Many companies now view arbitration agreements and class action waivers as synonymous, but new franchise companies should consider employing stand-alone class action waivers — that is, waivers in franchise agreements that do not contain arbitration provisions. Although such stand-alone waivers will not have the presumptive validity under the FAA as those set forth in arbitration agreements, courts have upheld the validity of stand-alone class action waivers in various contexts.

Examples include:

- Bonanno v. Quizno's Franchise Co.[4]
- America Online Inc. v. Booker[5]

Still, other courts have refused to enforce non-arbitral waivers. Examples of this include:

- In re Yahoo! Litigation[6]
- Doe 1 v. AOL LLC[7]

Determining the necessity of an arbitration agreement to enforce a class action waiver will require a careful consideration of the states where a franchisor intends to offer franchise units for sale.

Franchise companies should consider that not all potential franchisee claims are susceptible to class adjudication. For instance, only claims involving a predominance of common questions of fact may be certified for class adjudication. Claims premised on specific breaches of the franchise agreement, or specific promises made to certain franchisees, will not be appropriate for class adjudication.

Likewise, state laws vary greatly as to whether a nonarbitral class action waiver is enforceable or may be found as unconscionable.

Any franchise company considering whether to include an arbitration provision in a standard franchise agreement should carefully consider many factors. Even if avoiding class actions is the company's primary concern, an arbitration agreement may not be necessary to affect that end.

In many states, stand-alone class action waivers may suffice for avoiding classwide claims. Even in states where such waivers may be held unenforceable, the downside to arbitration may outweigh the benefit of avoiding classwide claims. Franchise companies should cautiously approach this issue and carefully consider the states where they may sell franchise units and the applicable law governing class action waivers.

Most importantly, franchise companies should avoid a one-size-fits-all approach to this pivotal issue.

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[1] AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011)

[2] American Express Co. v. Italian Colors Restaurant, 133 S. Ct. 2304 (2013)

[3] Epic Systems Corp. v. Lewis, 138 S. Ct. 1612 (2018)

[4] Bonanno v. Quizno's Franchise Co., No. 06-cv-02358-CMA-KLM, 2009 U.S. Dist. LEXIS 37702, at *69 (D. Colo. Apr. 20, 2009) (enforcing nonarbitral class action waiver)

[5] Am. Online, Inc. v. Booker, 781 So. 2d 423, 425 (Fla. Dist. Ct. App. 2001) (enforcing forum-selection clause despite unavailability of class actions in chosen forum).

[6] In re Yahoo! Litig., 251 F.R.D. 459, 469-70 (C.D. Cal. 2008) (refusing to enforce a nonarbitral class waiver and denying motion for summary judgment pending a "more developed evidentiary record")

[7] Doe 1 v. AOL LLC, 552 F.3d 1077, 1085 (9th Cir. 2009) (per curiam) (refusing to enforce forum-selection clause when forum selected does not permit class actions).