A TRIAL LAWYER'S REFLECTIONS ON ARBITRATING FRANCHISE DISPUTES

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I begin with a declaration about perspective, because my perspective on franchising and franchise law is, I believe, necessarily different from those of the other participants in this Symposium. Some of my fellow panelists are distinguished academics, like Sandy Meikeljohn and Chris Drahozal, on the faculties of eminent law and business schools. Matt Shay is the skillful leader of an influential trade association. Other panelists are notable corporate lawyers with an elegant, intellectual approach to structuring deals and assessing regulatory and relationship issues. These include my good friend Rupert Barkoff, as well as Phil Zeidman, arguably the country's pre-eminent franchise lawyer, who has played a leading role in exporting franchise law to the world.

And then we have yours truly, the lone—and lonely—trial lawyer in the bunch. What *I* do is *fight* with people. Most of my practice over the last two decades has involved representing franchisors in disputes with franchisees, area developers, development agents, vendors, and competing franchisors. I have tried many lawsuits and arbitrations on behalf of franchisors. I was even forced to develop a particular subspecialty in litigation *about* arbitration, when my client, Doctor's Associates, the Subway franchisor, was hit with a series of system-threatening class actions and consolidated claims in certain county courthouses reputedly inhospitable to large, out-of-state corporations.[2] I am pleased to report that we were able to use the franchise agreement arbitration clause to stop those class actions and consolidated cases in their tracks, and compel the franchisees to bring individual arbitrations in the contractually designated venue. Those outcomes were not, however, self-executing.

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[2] *See, e.g.,* We Care Hair Development v. Engen, 180 F.3d 838 (7th Cir. 1999); Doctor's Associates, Inc. ("DAI") v. Hamilton, 150 F.3d 157 (2d Cir. 1998), *cert. denied,* 525 U.S. 1103 (1999); DAI v. Distajo, 107 F.3d 126 (2d Cir. 1997), *cert. denied,* 522 U.S. 948 (1997); DAI v. Stuart, 85 F.3d 975 (2d Cir. 1996); DAI v. Distajo, 66 F.3d 438 (2d Cir. 1995), *cert. denied,* 517 U.S. 1120 (1996); Kroll v. DAI, 3 F.3d 1167 (7th Cir. 1993); DAI v. Hollingsworth, 949 F. Supp. 77 (D. Conn. 1996), *aff'd,* No. 96-9599 (2d Cir. Feb. 5, 1998); DAI v. Keating, 72 Conn. App. 310 (Conn. App. Ct. 2002); Bishop v. We Care Hair Development Corp., 738 N.E.2d 610 (Ill. App. Ct. 2000).

They took a few sound tactical judgments,[3] more than a little luck, a great deal of our client's money, and rulings by many federal judges, including numerous panels of the United States Court of Appeals for the Second Circuit.[4]

That whole, arduous process of getting claims into arbitration, along with my experiences trying arbitrations, bench trials and jury trials, has allowed me to consider, up close over an extended period of time, arbitration's relative benefits and drawbacks as a dispute resolution mechanism in franchise systems.[5] In this article I want to share some reflections on this subject – not from a theoretical or academic perspective, but from my vantage point as an occasionally bruised and bloodied combatant.

I. REFLECTION #1 – ARBITRATION IS ARBITRARY[6]

To understand arbitration, and appropriately calibrate expectations about what the process holds in store, it is important to remember one illuminating etymological fact: "Arbitrate" and "arbitrary" share the same Latin root, the noun "arbiter," which refers to a person who mediates a

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[3] For a discussion of the process involved in compelling arbitration under the Federal Arbitration Act and related tactical considerations, see Mark R. Kravitz and Edward Wood Dunham, *Compelling Arbitration*, 23 LITIG 34 (1996).

[4] *See, e.g.,* We Care Hair Development v. Engen, 180 F.3d 838 (7th Cir. 1999); Doctor's Associates, Inc. ("DAI") v. Hamilton, 150 F.3d 157 (2d Cir. 1998), *cert. denied,* 525 U.S. 1103 (1999); DAI v. Distajo, 107 F.3d 126 (2d Cir. 1997), *cert. denied,* 522 U.S. 948 (1997); DAI v. Stuart, 85 F.3d 975 (2d Cir. 1996); DAI v. Distajo, 66 F.3d 438 (2d Cir. 1995), *cert. denied,* 517 U.S. 1120 (1996); Kroll v. DAI, 3 F.3d 1167 (7th Cir. 1993); DAI v. Hollingsworth, 949 F. Supp. 77 (D. Conn. 1996), *aff'd,* No. 96-9599 (2d Cir. Feb. 5, 1998); DAI v. Keating, 72 Conn. App. 310 (Conn. App. Ct. 2002); Bishop v. We Care Hair Development Corp., 738 N.E.2d 610 (Ill. App. Ct. 2000).

[5] This is a subject that I have been contemplating, and writing about, for many years. *See, e.g.,* Edward Wood Dunham & Erika P. Amarante, *DAI v. Downey: Associational Standing and Arbitration,* 27 FRANCHISE L.J. 16 (2007); Edward Wood Dunham, et al, *Franchisor Attempts to Control the Dispute Resolution Forum: Why the Federal Arbitration Act Trumps the New Jersey Supreme Court's Decision in Kubis,* 29 RUTGERS L.J. 237 (1998); Edward Wood Dunham, *The Arbitration Clause as Class Action Shield,* 16 FRANCHISE L.J. 141 (1997), reprinted in BEST OF ABA SECTIONS, Spring 1998 at 36.

[6] Portions of the next two sections of this article are adapted from material that Mr. Dunham wrote for a paper that he and Michael J. Lockerby presented at the 2005 annual meeting of the American Bar Association Forum on Franchising, in a workshop entitled "Shall We Arbitrate? The Pros and Cons of Arbitrating Franchise Disputes." *See* Edward Wood Dunham and Michael J. Lockerby, *Shall We Arbitrate? The Pros and Cons of Arbitrating Franchise Disputes*, 28th A.B.A. Forum on Franchising § L3 at 4-5. Mr. Dunham extends his thanks to Mr. Lockerby for his editorial comments on this material and for his insights into the subject of franchise arbitration.

dispute.[7] It also pays to remember that arbitration developed, and still exists, as an alternative to, not an imitation of, the lawsuit. Accordingly, compared to litigation, there may always be a somewhat arbitrary quality to arbitration's procedures and fidelity to governing law. Most arbitrators pay no regard at all to evidentiary rules. Many arbitrators see their mission as imposing equitable solutions, with equity measured by entirely personal, subjective and undisclosed yardsticks, not objective standards explicated in published case law as it has developed over the centuries. And while arbitration awards are nominally subject to judicial review, in the overwhelming majority of cases that review consists of wielding a rubber stamp, no matter how contrary to law, downright goofy, or just plain *arbitrary* the award might be.

Sounds pretty bad, right? True enough, but whatever arbitration's flaws may be—and they are many—litigation is no prize either.

II. REFLECTION # 2 – LITIGATION MAY BE EVEN WORSE

In fact, at least for franchisors, the real case for arbitration may boil down to this: litigation could be even worse. As another practitioner and I have observed elsewhere, "American litigation is untidy, expensive, time-consuming, wildly unpredictable, fraught with risk, and conducted in a broad variety of judicial systems involving disparate rules, judicial quality and juror attitudes. Any franchisor contemplating national expansion—or even units in multiple states—should understand what litigation in these diverse judicial systems can actually involve before concluding that it would rather litigate than arbitrate."[8]

If I could always guarantee a bench trial in federal court, I might never consider arbitration. The federal courts are certainly not perfect, but for businesses confronting litigation, the obvious merits of the federal judicial system include the high quality of the judges, appointed for life and therefore largely immune to untoward influence; an ample supply of smart law clerks to help those judges get it right; sensible procedural and evidentiary rules that are consistently applied; and meaningful review by appellate courts full of many extraordinarily talented jurists.[9]

But franchisors *cannot* always secure federal jurisdiction. Most claims in cases brought by franchisees and other parties that sue franchisors involve no questions of federal law. And in my experience, if a plaintiff really wants to defeat diversity jurisdiction, it often is not that difficult to identify and add a plausible local defendant, such as an employee or agent of the franchisor or another local franchisee.

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[7] The Oxford English Dictionary Online, http://dictionary.oed.com/ (definition for "arbiter") (last visited Mar. 3, 2009).

[8] Dunham & Lockerby, *supra* note 5.

[9] *Id.*

As for state courts, I offer some statistics that always startle me: there are over 4,400 state trial courts in the United States, and about 72% of state court trial judges are elected.[10] An additional nine per cent are subject, at some point during their tenures, to a popular retention vote. Fifty-three per cent of state court appellate judges are elected, and another 26% are subject to popular retention votes.[11] Obviously, many of these state court judges are terrific—every bit as good as their federal counterparts. Some of my fondest professional memories involve smart, gutsy trial and appellate judges in Chris Drahozal's home state of Kansas.[12] But it is sometimes hard to shake the fear that in certain jurisdictions, judges elected with the help of campaign contributions from the local plaintiffs' bar will not be very fond of out-of-state corporations, and that fair treatment will prove illusive.[13]

This may seem like the paranoia of an anti-populist and provincial Easterner, from a state whose judges are all appointed by the Governor after being cleared by a merit selection panel. But this is not just my fevered imagination. In the immortal words of former Justice Richard Neely of the West Virginia Supreme Court, "As long as I am allowed to redistribute wealth from out-of-state companies to injured in-state plaintiffs, I shall continue to do so. Not only is my sleep enhanced when I give someone else's money away, so is my job security."[14]

Now, that may simply have been an example of judicial humor, but we have also seen news accounts in recent years about questionable behavior by another West Virginia Supreme Court Justice, socializing—in Monte Carlo, no less—with the CEO of a large mining company that was a party to a case before the court.[15] And I certainly do not mean to be a rude guest, but *The New York Times* published a story in October 2006 about Justices of the Ohio Supreme Court accepting campaign contributions from the political action committees of companies that were parties to appeals before the court, and then joining majority decisions in favor of those companies.[16]

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[10] Data compiled by Wiggin and Dana's Information Center, from THE AMERICAN BENCH: JUDGES OF THE NATION (16th ed. 2006) and THE SOURCEBOOK TO PUBLIC RECORD INFORMATION (9th ed. 2008).

[11] *Id.*

[12] Subway Restaurants, Inc. v. Kessler, 970 P.2d 526 (Kan. 1998), *cert. denied,* 119 S. Ct. 1756 (1999).

[13] *See, e.g.,* American Tort Reform Association, JUDICIAL HELLHOLES (2007), *available at* http://www.atra.org/reports/hellholes, (last visited Mar. 3, 2009).

[14] RICHARD NEELY, THE PRODUCT LIABILITY MESS: HOW BUSINESS CAN BE RESCUED FROM THE POLITICS OF STATE COURTS 4 (1988).

[15] Len Boselovic, *W. Va. Chief Justice Accused of Bias*, PITTSBURGH POST-GAZETTE, Jan. 15, 2008 at A1.

[16] Adam Liptak & Janet Roberts, *Campaign Cash Mirrors a High Court's Ruling*, N.Y. TIMES, Oct. 1, 2006, at 1.

Most people do not like to admit it, especially in public, but if you represent an out-of-state franchisor in a dispute with a local franchisee, these news items, and the whole practice of judges receiving campaign contributions in contested elections, does not instill confidence that your client will be treated fairly by the state judiciary in certain jurisdictions. At least with arbitrators, both sides share the cost and the economics of the relationship are transparent.

Of course, arbitration clauses are not the only contract provisions that franchisors employ in their efforts to specify forums and manage risk. Judicial forum selection clauses, jury trial waivers, damage caps and punitive damage waivers can all be extremely effective tools if a court will enforce them.[17] But in all probability, no franchisor doing business nationwide will ever achieve uniform enforcement of such contract terms. Certain states have passed legislation expressly prohibiting enforcement of these franchise agreement provisions,[18] and in most jurisdictions, state and federal, their enforcement will depend upon application of complicated, multi-part tests that involve several subjective factors, susceptible to highly variable judicial construction.[19]

In sharp contrast, there is a federal statute whose sole purpose is to ensure enforcement of agreements to arbitrate in accordance with their terms. Space does not permit either a detailed exegesis of the Federal Arbitration Act, [20] or discussion of the recent, misguided proposals before Congress that would ban pre-dispute, franchise agreement arbitration

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[17] Dunham & Lockerby, *supra* note 5, at 6-7.

[18] *See, e.g.,* NEV. REV. STAT. ANN. § 482.3638 (West 2003); N.J. STAT. ANN. § 56:10-7.2 (West 2001); ARIZ. REV. STAT. ANN. § 44-1560 (2004); W. VA. CODE R. § 47-11C-3 (2004); S.D. CODIFIED LAWS § 32-6B-49.1 (2004); OR. REV. STAT. ANN. § 650.165 (West 2003); VA. CODE ANN. §59.1-21.11 (West 2004); N.Y. VEH. & TRAF.LAW § 463(x) (McKinney 2005). Certain state statutes also bar franchise agreement clauses choosing another state's laws to govern the parties' relationship. *See, e.g.,* WIS. STAT. ANN. § 553.76 (West 2005); DEL. CODE ANN. tit. 6 § 4917(2004); GA. CODE ANN. § 10-1-624 (West 2004); HAW. REV. STAT. § 482E-6 (2003); IDAHO CODE ANN. § 49-1632 (West 2004); 815 ILL. COMP. STAT. ANN. 705/41 (West 204); IOWA CODE ANN. § 323.13 (West 2004); MICH. COMP. LAWS ANN. § 445.1527 (West 2002); MINN. STAT. ANN. § 80C.21 (West 2005); MO. ANN. STAT. § 392.300 (West 1994); N.C. GEN. STAT. ANN. § 20-308.2 (West 2004); VA. CODE ANN. § 59.1-21.11 (West 2004); WYO. STAT. ANN. § 31-16-124 (West 2003). It appears that even more states have statutes invalidating forum selection clauses. Benjamin A. Levin and Richard S. Morrison, *Kubis and the Changing Landscape of Forum Selection Clauses,* 16 FRANCHISE L.J. 97, 116 (1997) ("California, Connecticut, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, North Carolina, North Dakota, Rhode Island, and South Dakota all have statutes, rules, or policies which regulate where franchise related litigation and/or arbitration may occur.").

[19] Edward Wood Dunham, *Enforcing Contract Terms Designed to Manage Franchisor Risk,* 19 FRANCHISE L.J. 91, 97 (2000).

[20] 9. U.S.C. §§ 1.

clauses.[21] Suffice, for now, to say that under the current state of the law, if a franchisor wants to achieve the predictability that comes from uniform enforcement of its risk management contract provisions, the arbitration clause is easily the best option.

I have managed to get this far with barely a mention of one of the most significant factors in assessing the relative merits of arbitrating franchise disputes: the jury. For any trial lawyer worth his or her salt, "jury trials are the ultimate expression of the lawyer's art and craft. An intimate stage, a live audience, no second takes available—the trial lawyer is the producer, director, occasional bit player and sometimes star of a play with no fixed script and an ending entirely unknown until the jury knocks on the door and returns to the box to deliver its news."[22]

It is so much fun! But for clients—especially corporate defendants—jury trials are more often than not quite anxiety-provoking, and sometimes simply terrifying. It is now widely recognized that jury trials are an increasingly rare phenomenon in American civil litigation, and franchise cases are no exception. (The vanishing trial is a subject, already much discussed and written about, for a different symposium.).[23] Some cases are won by motion. The vast majority settle. There is always the chance, however, that your client's case will be the statistical exception and the prospect of trial before a jury of your client's "peers" can induce settlement at numbers far larger than would be paid if the jury were not looming as the audience and decisionmaker. The possibility of trial by jury in one of the aforementioned county courthouses is an especially bracing reminder that arbitration, for all its warts, may not be so bad after all.

III. REFLECTION # 3 – PUNITIVE DAMAGES AND CLASS ACTIONS

Every sensible franchisor wants to avoid punitive damage claims and class actions. On the latter subject, I defer to Professor Drahozal, except to say this: I used to believe that an arbitration clause was an impregnable class action shield, and that this was the trump argument in favor of arbitration.[24] But given recent developments in the law, including the Supreme Court's decision in *Green Tree Financial v. Bazzle*[25] and the passage of the Class Action Fairness Act,[26] the relative merits of litigation

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[21] Arbitration Fairness Act, S. 1782, 110th Cong. (2007); H.R. 3010, 110th Cong. (2007).

[22] Edward Wood Dunham, *A Rare But Scary Thing: More on Franchise Jury Trials,* 21 FRANCHISE L.J. 179 (2002).

[23] Symposium, *The Vanishing Trial*, JOURNAL OF EMPIRICAL LEGAL STUDIES, Nov. 2004, at v.

[24] Edward Wood Dunham, *The Arbitration Clause as Class Action Shield,* 16 FRANCHISE L.J. 141 (1997).

[25] 539 U.S. 444 (2003).

[26] Class Action Fairness Act of 2005, Pub. L. No. 109-2, § 119 Stat. 4-14 (2005).

and arbitration in fending off class claims may well have shifted, although a carefully drafted arbitration clause that expressly prohibits consolidated or class claims still ought to work.

As for punitive damages, arbitration is a decidedly mixed bag. On the one hand, if the arbitration clause expressly provides that the arbitrator has no power to award punitive damages, that provision should be binding. (If the arbitrator were to ignore that limit on his power, this would probably be one of those rare occasions when a court would actually scrutinize and overturn an award). On the other hand, if there is no such contractual limit on the arbitrator's authority, the prevailing judicial view is that there are also no legal limits on the arbitrator's power to award any amount of punitive damages he sees fit, no matter how disproportionate they may be to the compensatory damage award. So far, most courts that have considered the question have held that *BMW v. Gore*[27] and the other Supreme Court decisions establishing constitutional limits on punitive damages in litigation[28] have no application at all to arbitration,[29] notwithstanding the obvious state action when a court enters an order enforcing an arbitration award, thereby turning it into a judgment subject to the same enforcement powers as judgments following bench and jury trials.[30]

IV. REFLECTION #4 – IN ARBITRATION, YOU HAVE A ROLE IN PICKING THE DECISIONMAKER AND OTHERWISE SHAPING THE PROCEEDINGS

When all is said and done, whether arbitration is preferable to litigation as the dispute resolution mechanism for franchise systems may depend more than anything else upon just one thing: the quality of the arbitrators. Taking full advantage of the relative informality and flexibility that arbitration provides, a talented arbitrator can limit discovery, conduct efficient hearings and promptly produce a sensible award, all at costs far

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[27] BMW of North. America, Inc. v. Gore, 517 U.S. 559 (1996).

[28] State Farm Mutual Automobile Insurance Company v. Campbell, 538 U.S. 408, 416 (2003).

[29] Davis v. Prudential Securities, Inc., 59 F.3d 1186, 1189 (11th Cir. 1995); Morgan Keegan & Co., v. Lalonde, No. Civ. A.00-2520, 2001 WL 43600 (E.D. La. Jan. 16, 2001); Mantle v. Upper Deck Co., 956 F. Supp. 719, 723-35 (N.D. Tex. 1997); MedvalUSA Health Programs, Inc. v. Memberworks, Inc., 872 A.2d 423, 427 (Conn. 2005); Hadelman v. DeLuca, 274 Conn. 442, 447-9 (Conn. 2005). Mr. Dunham's firm represented the *Memberworks* and *Hadelman* appellants before the Connecticut Supreme Court, and Mr. Dunham represented the *Hadelman* appellants, including the Subway franchisor Doctor's Associates, in the underlying arbitration and the initial challenge to the arbitration award.

[30] Edward Wood Dunham, *Applying Constitutional Limits on Punitive Damages to Franchise Disputes*, 22 FRANCHISE L.J. 203 (2003).

lower than litigation of the same dispute would inevitably generate. Those are the supposed benefits of arbitration, and they can in fact be realized.

They also can in fact bear no relationship whatsoever to the reality of arbitration, if a panel of three arbitrators without much else to do decides to let every stitch of paper into evidence, compete with each other in demonstrating their withering cross-examination techniques and inspiring speechmaking abilities, and allow the lawyers to wander into whatever areas they choose, relevant or not. I once tried a franchise arbitration that could and should have taken at most 10 days of evidence, which instead metastasized into more than 40 days of hearings, spread out over five years. An advertisement for the arbitral process this was not.

The lesson is that franchisors need to be sensible and informed when they draft arbitration clauses. The ADR provider should be chosen not by habit or reflex, but with actual information about the quality of potential arbitrator pools. Likewise, there should be conscious, informed decisions, based upon assessments of relative risks and costs, about whether to have one arbitrator or three, and if the answer is three, whether the extra two arbitrators should be party-appointed advocates or additional neutrals.

One of arbitration's principal virtues is that it never has to be an off-the-rack experience. (By this I do not mean to suggest that franchisors should get creative by drafting complicated, one-sided arbitration clauses that offend courts and make them search for reasons not to enforce. We have seen some judicial pushback against arbitration in recent years, at least some of which is a product of overreaching by the drafters of the arbitration clauses at issue). My point is a practical one: even after the arbitration clause has been written and the franchise agreement containing it has been signed, the arbitration can be custom-tailored as a result of further negotiation between the parties to a particular dispute—to cite a few examples, by changing the contractually designated venue, shrinking from three arbitrators down to one, requiring application of the rules of evidence, or imposing limits on the length of the hearing. If parties to an arbitration agreement genuinely want to attain arbitration's benefits and avoid its pitfalls, they can keep working at that, and improve their odds of success throughout the process, to an extent that litigation can never permit.

Thus ends my brief dispatch from the battlefield. I make no claims that my opinions are anywhere close to universally held. Quite the contrary: a poll of experienced franchise lawyers and franchisor executives concerning arbitration would yield a wide scatter of opinion. Some swear by it, others loath it, and others are somewhere between those polls, having concluded that—on balance—a sensibly drafted, prudently enforced arbitration clause is probably still preferable to the vicissitudes of litigation.

Whether arbitration makes sense for a particular franchise system is, in significant measure, a function of many factors specific to that system. But for every franchise system, the first response to this question should always be another question—compared to what? The comparison must be

to litigation, not as we learn about it in casebooks at fine institutions like the Moritz College of Law at The Ohio State University, but as it exists out there in the messy, unpredictable real world.