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"RECENT DEVELOPMENTS IN FORUM SELECTION AND ARBITRATION"

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I. INTRODUCTION - FORUM SELECTION AND ARBITRATION

a. "Sports Warfare"

Imagine this: two well-known professional sports teams are about to meet in the deciding game of the season. Before the action begins, however, a few things must be ironed out. League rules make no provision for *where* the contest is to be played and, under the league's flexible "home rule" policy, the particular rules to be applied to this important match are determined by the ultimate location selected, unless, of course, the "prior agreement" exception applies.

The New Jersey Microwaves claim the game should be played at The Microlands because they were the first ones to arrive at the Commissioner's Office on the morning of the meeting and, as the rules specify, "...if the underdog shows first, the match shall be played in the underdog's arena". Entering their challenge, the California Crystals offer that the "prior agreement" exception applies to nullify the Microwaves' position. The Crystals display an agreement entered into at the end of last season documenting a Microwaves/Crystals' trade which contains the following clause at the end of the contract:

> If the Microwaves and Crystals meet in the deciding match at the finish of the next season, the Microwaves hereby agree that the match shall be played in Crystal Coliseum and agree further that the "prior agreement" and "home rule" policies shall apply.

The Microwaves respond by stating the obvious but hope that the Commissioner understands the equity and fairness of their position. At the end of last season the Microwaves were the dreaded underdogs, the Crystals have always had the better players and the most lucrative media market in the league, and as a result, the Microwaves had no reasonable alternative but to accept the Crystals' language when making the trade. It was fraud, duress and a misrepresentation of the oral "handshake" deal struck before the lawyers got involved. The Microwaves admit they did not specifically try to negotiate the provision out of the written agreement because, in the first instance, they were unaware of it, and in the second, had they been aware of it, they knew "our chances of getting the Crystals to relinquish the clause would have been slim to none and slim was out of town!" This was based upon their prior dealings with the Crystals. The Crystals finally contend that the clause was a material part of the trade and without it they would not have offered J. Stein for such a reasonable price.

Realizing he was in a sticky position, the Commissioner requests an hour of deliberation to review the "entire" contract struck by the parties. Before breaking up the Crystals remind the Commissioner that the General Policy Statement on Sports and Other High Matters specifies that all trade agreements containing a choice of match provision "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract". "Our point exactly", offer the Microwaves in their parting shot, "the contract should be revoked because of the Crystals' overreaching — they knew they had us over a barrel". "Plus, our 'home rules' say provisions of this nature are unenforceable".

At the appointed hour the Commissioner assembles the teams and their learned counsel to issue his proclamation. Looking over his pince nez glasses, the Commissioner announces that his decision will rest upon Section 99 of the Agreement: the Arbitration Clause. He points out that the parties agreed to arbitrate "all disputes arising from this trade agreement" and "the decision of the arbitrator shall be final and binding." Sports fans the world over, not to mention the Crystals and Microwaves, are sorely disappointed that the game will be delayed until the end of next season.

A preposterous scenario? Not in the least. The battle over the "battleground" in franchise litigation rages at this moment. You can smell the gunpowder in the air. Courts and commentators alike (including this one) cannot resist the "sports warfare" analogy when discussing this topic:

- "The strongest single factor weighing against enforcement of forum-selection clauses in franchise agreements is the Legislature's avowed purpose...*to level the playing field*...; New Jersey Supreme Court in *Kubis & Perszyk Associates v. Sun Microsystems, Inc.*, 146 N.J. 176, 680 A.2d 618 (1996).

- "....[D]espite the increasing willingness of courts to respect contractual choice of forum provisions, the *'race to the courthouse'* which has been the subject of much legal commentary continues to be significant in franchise litigation"; Abrams and Eleff, *Procedural Litigation Issues in Franchise Disputes*, American Bar Association, Fifteenth Forum on Franchising, Hilton Head, South Carolina (October 28-30, 1992).

- "*Turf Warfare*"; the section heading assigned to Arbitration Clauses, Choice of Forum and Choice of Law by Susan A. Cahoon in her presentation before the 1988 Forum on Franchising. Susan A Cahoon, *Representing The Franchisee in Disputes with the Franchisor: Trying to Hit The Target With Blanks*, American Bar Association, Eleventh Forum on Franchising, Atlanta, Georgia (October 27-28, 1988).

- "*Kubis* does not level the playing field; *it changes the rules of the game entirely*"

Levin and Morrison, *Kubis and the Changing Landscape of Forum Selection Clauses*, 16 Franchise L.J. 97 (Winter 1997).

Trite as it may be, the sports analogy captures the spirit of the forum selection and arbitration games. Recent decisions suggest, however, that the game has taken on new proportions --- states rights v. federal power. This dimension will be addressed further below.

b .The Current State of Affairs Between Franchisors and Franchisees.

A few recent cases speak well to the present state of affairs existing between franchisors and franchisees in these important areas. *Kubis & Perszyck Associates v. Sun Microsystems, Inc.,* 146 N.J. 176, 680 A.2d. 618 (1996), which involved a choice of forum clause in conflict with a loose interpretation of state statutory law and *Doctors Associates, Inc. v. Casarotto*___U. S.___, 116 S. Ct. 1652, 134 L. Ed.2d 902 (1996), which epitomizes the ongoing tug-of-war between the United States Supreme Court and state Supreme Courts over the scope of the Federal Arbitration Act, 9 U.S.C. §2. So important are these issues to the parties that despite clear pronouncements from the U.S. Supreme Court in both the forum selection and arbitration areas, challenges continue. It seems that nothing less than the Supremacy Clause of the United States Constitution itself is necessary to resolve these bitter disputes. Few franchise issues have reached these lofty decisional heights.

But what is at the heart of this conflict? Why do franchisees and franchisors expend such energies battling over *where* to fight? Does it actually have that much bearing on the outcome? Are other motives at work— does the advantage lie more in the tortured journey then in the destination itself?

To some degree the simple answer to many of these questions rests in the phenomenon known as the "home field advantage". The roar of the crowd, the familiar surroundings, the effect on the umpire, and that unmistakable comfort of knowing you are home. Jealously sought, contentiously achieved, the "home field advantage" may provide the psychological edge needed to overcome a well-matched opponent. In addition, the traveling team always spends more money than the home town favorites. Is it any wonder why litigants crave the same advantage in the courtroom or arbitration room?

More precisely, franchisors and franchisees contend over "the *where"* because they believe it has a dramatic effect on the result as well as the cost of it. And, to some extent, "the *where"* does have a significant impact on *how* a matter will be decided. Indeed, even when a contractual choice of law is found valid, forum courts will draw distinctions between the procedural and substantive aspects of a case when determining which state law to apply. A forum court is more inclined to apply its own

choice of law rules to determine which aspect of a case is procedural and which is substantive. And once that is determined, the forum court will apply its own rules of law to matters of procedure, i.e. service of process, pleadings, whether an issue may be tried by jury, the statute of limitations and the burden of proof. *Restatement (Second) of Conflicts of Laws (1971),* § 122 and 123-139. Further, despite our overriding belief that justice is blind, the reality is that it is not always. And, sometimes the cost of justice is so expensive that it can be denied by winning the forum game. This skepticism surfaced in *Kubis.*

The New Jersey Appellate Division affirmed the trial court's dismissal of the reputed franchisee's complaint on the basis of a California forum selection clause contained in the parties' agreement. In doing so the Appellate Division conditioned their dismissal on a California court's application of New Jersey law to the threshold question of whether a "franchise" existed and, if so, how it effected the parties. The court particularly stated:

> ...we should trust the courts of California to be as protective of the rights of the New Jersey litigant under New Jersey law as it would hope another state would protect a California resident under California law, if the case were referred elsewhere. *Kubis,* 146 N.J. 176, 181, 680 A.2d 618, 620.

Apparently however, the New Jersey Supreme Court did not share the same level of confidence in its sister state's ability to apply New Jersey law efficiently and economically:

> Contrary to the Appellate Division's view, our concern is not focused only on the likelihood that the designated forum would properly interpret and apply the Franchise Act, *but rather on the denial of a franchisee's right to obtain injunctive and other relief from a New Jersey court.* The added expense, inconvenience, and unfamiliarity of litigating claims under the Act in a distant forum could, for some marginally financed franchisees, result in the abandonment of meritorious claims that could have been successfully litigated in a New Jersey court. *Id.* at 196, 680 A.2d 628.

In other words, the New Jersey Supreme Court did not want a New Jersey franchisee to get "homered".

And so, at the heart of this conflict is the belief that the location of the battle may have a decided effect on the success of the battle...or, at a minimum, whether one can even afford to wage it.

c. The New Uniform Franchise Offering Circular Weighs-in.

Today, the practical starting point in the franchise relationship for choice of forum and arbitration matters is the cover page of the Uniform Franchise Offering Circular ("UFOC"). The Cover Page Instructions require the disclosure of certain "Risk Factors". *See* Uniform Franchise Offering Circular Guidelines ("Guidelines"), Cover Page Instruction iv (1), CCH Business Franchise Guide ¶ 5902. Among the designated "risks" are forum selection and arbitration. These are both captured in the first risk factor required in the UFOC:

> 1. THE FRANCHISE AGREEMENT PERMITS THE FRANCHISEE (TO SUE) (TO ARBITRATE WITH) [THE FRANCHISOR] ONLY IN [INSERT STATE]. OUT OF STATE (ARBITRATION) (LITIGATION) MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST MORE (TO SUE) (TO ARBITRATE WITH) [THE FRANCHISOR] IN [INSERT STATE] THAN IN YOUR HOME STATE.
> (Language in brackets supplied).

As experienced franchise counsel know the "Risk Factors" section was added recently to the new Guidelines. *See* UFOC Guidelines adopted by the North American Securities Administrators Association ("NASAA") on April 25, 1993 and approved by the Federal Trade Commission on December 30, 1993, Business Franchise Guide (CCH) ¶ 5900. The prominent inclusion of forum selection and arbitration in the new "Risk Factors" section is further testament to the importance assigned to these issues by the franchise community.

By requiring this type of neon disclosure for forum selection and arbitration, NASAA sought to eliminate the pitfalls inherent in these provisions for franchisees. But, as we will discuss below, NASAA may have unwittingly handed franchisors an additional plum in the battle over the battlefield.

NASAA's good intentions notwithstanding, does the "Risk Factors" warning actually aid potential franchisees? Although some potential purchasers may heed, and indeed act on the warning, the only real effect for the majority of franchisees is that they are merely notified in advance of the perilous consequences that may some day await them. And, this may be the best effect of NASAA's warning. The worst effect of the warning is that it may strengthen a franchisor's litigation position on these matters. Because of the new prominence of the selected forum and mandatory arbitration provisions on the UFOC cover page, franchisors may now advance persuasive arguments to enforce these provisions focusing on a franchisee's heightened awareness. Inquiry will be made into whether the purchaser considered the effect of

these provisions or sought legal counsel to do so. If they did not, they can only be charged with blatant ignorance and, if they did, they must be charged with complete knowledge and acceptance. Worse yet, if they attempted to negotiate either provision out of the agreement and failed, since most courts will find that there was a knowing and bargained for acceptance.

How the UFOC's "Risk Factors" warning and other complimentary provisions of state law help or hurt franchisees and impact franchisors will be part of our continuing discussion.

II. OVERVIEW OF SIGNIFICANT CASE LAW AND STATE STATUTES/REGULATIONS

a. The Supreme Court Cases

i. Forum Selection

1972 marks the beginning of the Supreme Court's modern consideration of the enforceability of forum selection clauses. Before that forum selection clauses were not historically favored. Since then courts are more likely to honor the expressed intentions of contractual parties. In *The Bremen v. Zapata Off-Shore Company*, 407 U.S. 1, 92 S.Ct. 1907, 32 L. Ed.2d 513 (1972), the Supreme Court blazed a new trail for the enforcement of forum selection clauses, eschewing the long-held traditional view that enforcement of such clauses ousted a court's inherent jurisdictional power and were generally against public policy. The Court drew upon changing times as its rationale for the course correction: "in 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". *Id.* at 407 U.S. at 15, 92 S.Ct. at 1916.

The new standard became that forum selection clauses were considered "*prima facie* valid and should be enforced unless enforcement is shown by the resisting party to be unreasonable under the circumstances" *Id.* at 407 U.S. at 10, 92 S.Ct. at 1913. In essence, the Supreme Court placed its stamp of approval upon all such clauses provided they were freely negotiated and not the result of "fraud, undue influence, or overweening bargaining power." *Id.* at 407 U.S. at 12-13, 92 S.Ct. 1914-15. Of course the qualifying language left the door open for "resisting parties" to mount a challenge. These challenges spawned future decisions announced by the Court. And it did not take long for the Court to address these issues in the franchise and distribution law context– with a twist.

In *Stewart Organization, Inc. v. Ricoh*, 487 U.S. 22, 108 S.Ct. 2239, 101 L.Ed.2d 22 (1988), the Court considered the effect of a forum selection clause in a copier dealership's agreement. The clause read as follows:

> Dealer and Ricoh agree that any appropriate state or federal court located in the Borough of Manhattan, New York City, New York, shall have exclusive jurisdiction over any case or controversy arising in connection with this Agreement and shall be a proper forum in which to adjudicate such case and controversy.

The procedural context of the *Stewart* case was all important to the Court's ultimate finding and would shape future litigation strategy when contractual choice of forum clauses were at issue. The dealer filed suit in the United States District Court for the Northern District of Alabama premised upon diversity of citizenship. Ricoh, relying upon the forum selection clause, filed a motion to transfer the case to the Southern District of New York under 28 U.S.C. §1404(a), which provides as follows:

> For the convenience of the parties and witnesses, in the interests of justice, a district court may transfer any civil action to any other district or division where it might have been brought.

The district court denied the motion to transfer because of a strong Alabama state policy disfavoring contractual forum selection clauses. The Court of Appeals for the Eleventh Circuit reversed the district court on the basis of *The Bremen,* finding that venue in a federal court is a matter of federal procedural law and that the forum selection clause was enforceable as a matter of federal law. More precisely, the Court of Appeals undertook an arduous analysis of different statutes and judicial opinions that, in their opinion, evidenced a significant federal interest in matters of venue in general, and in forum selection clauses specifically, and then applied the instructive reasoning of *The Bremen* to reach their conclusion.

The Supreme Court agreed with the Eleventh Circuit's result but took exception to their reasoning. The Court narrowly framed the issue as follows: "This case presents the issue whether a federal court sitting in diversity should apply state or federal law in adjudicating a motion to transfer a case to a venue provided in a contractual forum-selection clause." *Stewart Organization* at 487 U.S. 24, 108 S.Ct. at 2240-41, 101 L.Ed. 2d 24. From there the Court indicated they believed that the issue lent itself to much easier resolution than the Court of Appeals had found and began by "underscor[ing]" a different methodological approach to the question. This different approach marked the beginning of a slow erosion of a state's influence in forum selection matters when the case was before a federal court.

The Court reasoned that the entire matter simply boiled down to whether the federal venue transfer statute, 28 U.S.C. §1404(a), applied to the issue before the court and if so, whether it was constitutional, citing *Hanna v. Plummer,* 380 U.S. 460, 471 (1965)

and *Prima Paint Corp. v Flood & Conklin. Mfg. Co.,* 388 U.S. 395, 406 (1967). As such, the Supreme Court found that a district court sitting in diversity must apply a federal statute that controls an issue before it, that §1404(a) was the first level of inquiry, and that it applied in this instance. Next, the Court instructed that a forum selection clause "should receive neither dispositive consideration...nor no consideration..., but rather the consideration for which Congress provided in § 1404(a)". *Stewart Organization* at 487 U.S 31, 108 S. Ct. 2245, 101 L.Ed. 2d 31.

The next significant pronouncement from the Supreme Court came a few years later. Though it did not involve a franchise or distribution agreement, *Carnival Cruise Lines v. Shute,* 499 U.S. 585, 111 S.Ct. 1522, 113 L.Ed.2d. 622 (1991), endorsed the enforcement of forum selection clauses in the previously sacrosanct field of consumer form contracts. This was glorious news for franchisors, and devastating news for franchisees. Although only occasionally adopted by courts, franchisee-counsel often analogized the bargaining position of franchisees to that of ordinary consumers in the hope that a sympathetic court would imbue applicable legal theories with a touch of "consumerism". *Carnival Cruise Lines* neutralized this argument, holding that even "consumers" were subject to enforcement of pre-printed, non-negotiable forum selection clauses.

The Shutes were a Washington State couple who had the misfortune of purchasing tickets for passage on the Florida-based Carnival Cruise Lines. The tickets contained a Florida forum selection clause. The ship departed from Los Angeles and, while at sea, Mrs. Shute was injured following a fall. Upon their return, the Shutes commenced suit in a Washington Federal District Court which promptly dismissed their action because of the forum selection clause. The Court of Appeals reversed on the basis of *The Bremen*, finding that the clause was not "freely bargained for" and that enforcement would deprive the Shutes of a fair opportunity to litigate their dispute. *Id. at Syllabus,* 499 U.S. 585, 111 S.Ct. 1522, 113 L.Ed.2d. 622.

After considering the reasoning of the Court of Appeals, the Supreme Court reversed the intermediate court's holding and broadened the enforcement of forum selection clauses to all manner of contracts. Indicative of the strong nod the Supreme Court gave to the enforcement of forum selection clauses was its statement that the Shutes' argument could not prevail because they had not met the "heavy burden of proof required to set aside the clause on grounds of inconvenience". *Id.* at 595, 111 S.Ct. at 1528 (quoting *The Bremen,* 407 U.S. at 17, 92 S.Ct. at 1917). The only concession allowed by the Court was an indication that forum selection clauses in contracts of this nature would continue to be scrutinized for "fundamental fairness". *Id.* at 595, 111 S.Ct. at 1528.

As later explained by some recent commentators, since the *Carnival Cruise Lines* decision "[f]ederal courts have subsequently distilled the decisions in *The Bremen* line

of cases to a straightforward rule that presumes the validity of forum selection clauses, while imposing a heavy burden on the resisting party to demonstrate that one of the generally-recognized exceptions identified in *The Bremen* or *Carnival Cruise Lines* applies to the facts of the case. The rule is often expressed as follows: generally, a forum selection clause should control absent a strong showing that it should be set aside." Levin and Morrision, *"Kubis* and The Changing Landscape of Forum Selection Clauses" 16 Franchise L.J. 97, 113 (Winter 1997).

Thus, in federal court at least, by 1991, enforcement of contractual choice of forum selection provisions was generally assured.

ii. Arbitration Provisions

Two Supreme Court cases currently mark the beginning and the end of any argument concerning the enforceability arbitration clauses in franchise agreements. In *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d. 1 (1984), when discussing the scope and application of the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*("FAA"), the Supreme Court proclaimed: "In enacting § 2 of the Federal Act, Congress declared a national policy favoring arbitration and *withdrew the power of states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration".* (Emphasis supplied). And, most recently, in *Doctor's Associates, Inc. v. Casarotto*, ___U.S.___, 116 S.Ct. 1652, 134 L.Ed.2d. 902 (1996), the Court reiterated its firm position on federal preemption of any state law which interferes with the objectives of the FAA. Displaying some frustration with the Montana Supreme Court, the Court stated: "By enacting § 2 [of the FAA], we have *several times said,* Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts'". (Emphasis supplied). Stronger and clearer statements from the Supreme Court, especially in the area of franchise law, are difficult to find.

Aside from congressional acts protecting the relationships between car manufacturers and their dealers and oil companies and service station dealers, no other area of franchise and distribution law has been touched more significantly by Congress than arbitration of disputes. While the Congressional declaration of a "national policy favoring arbitration" has a far broader reach than franchise agreements, the relationship between franchisors and franchisees seems to be the most fertile battleground for disputes over the enforceability of arbitration provisions themselves. It has become classic David v. Goliath: state rights v. federal power and big (franchisors) v. small (franchisees). But, the outcome has been quite different than biblical David's.

At the heart of the struggle is the clash between the FAA and various state franchise measures designed to protect franchisees from the perceived disadvantages of "take-

it-or-leave-it" arbitration provisions. As noted in *Southland Corp.*, the FAA provides:

> A written provision in any maritime transaction or a contract evidencing *a transaction involving commerce* to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, *shall be valid, irrevocable, and enforceable*, save upon such grounds as exist at law or in equity for the revocation of any contract. 9 U.S.C. § 2. (Emphasis supplied).

According to the *Southland Corp.* Court, this FAA provision demonstrated Congress' intention to occupy the arbitration field by mandating the enforcement of arbitration provisions. Later, however, in *Info. Sciences v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 477, 109 S.Ct. 1248, 103 L. Ed. 2d 488 (1989), the Court trimmed this pronouncement back somewhat (although not its practical effect) by indicating that Congress did not intend to occupy the entire field and totally preempt state law—but just "to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" (quoting from *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S.Ct. 399, 85 L.Ed. 581(1941)). While few can disagree with the force of Congress' mandate, many have tried to define the scope of the exception which appears at the end of § 2 of the FAA. And this is where state law may come into the picture. The Supreme Court did not leave much room for argument, however.

At issue in *Southland* was whether claims presented by a group of franchisees under the California Franchise Investment Law, Cal. Corp. Code § 31000 *et. seq.* were subject to resolution by arbitration as specified in the franchise agreement or should be separately tried in a judicial proceeding. The franchisees argued, and the California Supreme Court agreed, that the California Franchise Investment Law required judicial consideration because § 31512 of the Law rendered void any provision that seeks to bind a franchisee to waive the protections of the act. The U.S. Supreme Court disagreed.

After discussing the FAA's limitations, the Court stated: "We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under State law." *Southland Corp., supra* at 465 U.S. 11, 104 S.Ct. 858, 79 L.Ed.2d 11. The source of Congress' authority in this area is the Commerce Clause. Drawing upon this broad power, the Court noted that the FAA "creates a body of federal substantive law" which is equally applicable in state and federal court. *Id.* at 465 U. S.12, 104

S.Ct.859, 79 L.Ed.2d 12, quoting from *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.,* 460 U.S. at 1, 25 and n.32, 103 S.Ct. at 942 and n.32. Further, the court reasoned that it did not believe Congress intended enforcement of the FAA to be forum-dependent, considering that the majority of civil actions are filed in state court. Thus, with the *Southland* decision, franchisors now had an enforceable super-forum selection provision: the arbitration clause. This was later explained in another Supreme Court decision, *Scherk v. Alberto-Culver Co.,* 417 U.S. 506, 519, 94 S.Ct. 2449, 2457, 41 L.Ed.2d. 270 (1974). An agreement to arbitrate in a specific forum was "in effect, a specialized kind of forum-selection clause that posits not only the situs of the suit but also the procedure to be used in resolving the dispute." *See also Volt Info. Sciences v. Board of Trustees of Leland Stanford Junior Univ., supra.*

A dozen years later, however, the Montana Supreme Court was unwilling to accept the Supreme Court's interpretation of the FAA's preemptive effects on state law. In what ended up being a true "turf warfare" battle, the Montana Supreme Court was reversed by the U.S. Supreme Court in *Doctor's Associates v. Casarotto, supra,* when it sought to uphold a Montana statute which required that the first page of any contract containing an arbitration provision set forth a notice announcing this in underlined, capital letters.

The *Doctor's Associates'* Subway franchise agreement did not contain the notice. Because of this, the Montana Supreme Court found that the dispute was not subject to arbitration. After considering the argument that the Montana statute fell within the qualifying language of the FAA ("...save upon such grounds as exist at law or in equity for the revocation of any contract"), the U.S. Supreme Court declared "State law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the text of § 2].", quoting from *Perry v. Thomas,* 482 U.S. 483 (1987). In essence, arbitration provisions are sacrosanct under federal law and subject to few challenges. (A recent California case, *Stirlen v. Supercuts, Inc.,* 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138, 1997 Cal. App. LEXIS 13 (January 9, 1997), declaring an arbitration clause found in an employment contract to be unconscionable, is instructive on the type of challenges that may survive).

Before leaving the Supreme Court's handling of arbitration matters, two additional cases warrant mention: *Prima Paint Corp. v. Flood & Conklin Manufacturing Corp.,* 388 U.S. 395, 115 S.Ct. 838, 130 L.Ed.2d 762 (1967) and *Allied-Bruce Terminex Cos. v. Dobson,* 513 U.S. 265, 115 S.Ct. 834, 130 L.Ed.2d 753 (1995). Both cases touch on matters of interest to franchise litigators.

Prima Paint resolved the question of "whether the federal court or an arbitrator is to resolve a claim of 'fraud in the inducement', under a contract governed by the [FAA],

when there is no evidence that the contracting parties intended to withhold that issue from arbitration." *Prima Paint, supra* at 396-397. The question was resolved by drawing a distinction between general fraud in the inducement and that which may pertain to the arbitration clause itself. The Court: "...if the claim is fraud in the inducement of the arbitration clause itself— an issue which goes to the 'making' of the agreement to arbitrate—the federal court may proceed to adjudicate it [footnote omitted]. But the statutory language [of the FAA] does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Id.* at 403-404.

Allied-Bruce Terminex, supra, had a *Carnival Cruise Line*-like impact in the world of arbitration clause enforcement. That is, the case involved the enforcement of an arbitration clause contained in a pre-printed form contract presented to a consumer/homeowner. Despite the existence of an Alabama statute invalidating arbitration agreements which are entered into before a dispute arises and, what amounted to a very local dispute, the Supreme Court mandated that the matter be arbitrated because the reach of the FAA extended to all matters "affecting interstate commerce". As will be discussed later, *Prima Paint* and *Allied-Bruce Terminex* create large obstacles for any franchisee seeking a judicial, rather than an arbitral, forum.

b. State Law Perspective

i. Forum Selection and the *Kubis* Decision.

Ideally the law abhors results based on parochialism. The American system of justice, state and federal, is premised upon the notion that all men are created equal and regardless of where justice is sought it will be evenly dispensed...except, perhaps, in New Jersey. At least that may be one view of the rationale for the New Jersey Supreme Court's decision in *Kubis & Perszyzk Associates v. Sun Microsystems, Inc.*, 146 N.J. 176, 680 A.2d 618 (1996). Another view may be that few areas of a state's influence remain in matters of forum selection and arbitration and, when given the chance, a state's supreme court will attempt to exercise what muscle remains.

Whatever the underlying rationale may be, the *Kubis* decision has re-opened the debate on forum selection matters thought closed by *Stewart Organization* and *Carnival Cruise Lines* (interestingly, the New Jersey Court barely mentions either case). One can only conclude, however, that had the *Kubis* case been removed to federal court a different result would have been likely. But, this is precisely the anomaly that exists in the handling of forum selection matters--procedural form (or forum) may prevail over substantive law.

The New Jersey Supreme Court's opening reference to its' recently decided choice of law case, *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. 324 (1992), signaled the outcome of the *Kubis* decision. *Id.* at 176. The Court indicated that

it had refused to enforce a California choice of law provision in a franchise agreement subject to the New Jersey Franchise Practices Act, N.J.S.A. 56:10-1 to -15. Enforcement of the California choice of law provision was said to be "contrary to a fundamental public policy of [New Jersey] which has a materially greater interest than [California] in the determination of the particular issue and which***would be the state of the applicable law in absence of an effective choice of law by the parties." (Citation omitted). *Id.* With this opening, Sun Microsystems could have only yearned for the warmth of a federal forum.

It is clear that the *Kubis* court was not going to be denied their opportunity to play "David" to the U.S. Supreme Court's "Goliath". Ignoring both lower courts' opinions, the New Jersey Supreme Court reversed with such populist panache that the parties must have initially thought they were in Wisconsin. The court extensively reviewed the legislative history of the New Jersey Franchise Practices Act, focusing primarily upon the testimony of automobile and service station dealers. Citing its previous observations in *Westfield Centre Service, Inc. v. Cities Service Oil Co.,* 86 N.J. 453 (1981), the court noted that it had found that the Legislature adopted the Act under the following conditions: "Though economic advantages to both parties exist in the franchise relationship, *disparity in the bargaining power of the parties has led to some unconscionable provisions in the agreements." Kubis* at 146 N.J. 182, 680 A.2d 621. More specific to forum selection clauses, the court drew upon the Legislature's 1989 amendment to the Act that made it illegal for *motor-vehicle franchisors* to require a dealer to accept a disadvantageous forum selection clause. The quantum leap was made to the franchise agreement involved in *Kubis* with the following logic: "...the legislative findings persuade us that the Legislature considered such clauses in general to be inimical to the rights afforded all franchisees under the Act. The Legislature apparently elected to limit their express prohibition only to motor-vehicle franchises based on its determination that the use of unequal bargaining power to compel the inclusion of such clauses was largely confined to motor-vehicle franchise agreements." *Id.* at 185.

The court next surveyed both state and federal law and recognized that the modern approach favored enforcement of forum selection clauses. *The Bremen* was cited favorably for this proposition but the New Jersey high court was more intrigued by *The Bremen* exception than its primary holding, specifically commenting that "The Court acknowledged that '[a] contractual choice-of-forum clause should be held unenforceable if enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or judicial decision. [*The Bremen*] at 15, 92 S.Ct. at 1916, 32 L.Ed. 2d. at 523." Following this, however, the court still recognized that *The Bremen* represents the prevailing view, is consistent with the Restatement (Second) of Conflict of Laws, § 80, and that this approach has been generally applied by state and federal courts, specifically citing (for the first and only time) *Carnival Cruise Lines, supra.*

When the final bell had rung, however, the Supreme Court latched onto *The Bremen* exception to conclude that "such clauses are presumptively invalid because they fundamentally conflict with the basic legislative objectives of protecting franchisees from the superior bargaining power of franchisors and providing swift and effective judicial relief against franchisors that violate the Act." *Kubis* at 146 N.J. 193, 680 A.2d 626. As a final blow to franchisors, the court announced that the decision would apply retroactively to existing franchise agreements.

After catching one's breath from reading the tortuous *Kubis* decision one can only conclude what commentators Levin and Morrison did in their recent *Franchise Law Journal* article: "*Kubis* is a prime example of judicially created law." Levin and Morrison, *supra* at 116. There is little doubt of this, even from a neutral point of view, when it is noted, as it was by the *Kubis* dissent, that the New Jersey Legislature considered and failed to pass a 1994 Amendment to the New Jersey Franchise Practices Act designed to extend the forum selection ban to all franchise agreements. *See* 1994 N.J. Assembly Bill No. 1165, 206th Legislature, First Regular Session. Ironically (and perhaps somewhat defensively), the New Jersey Supreme Court began the closing paragraph of its opinion with the following: "Parochialism plays no role in our decision". *Kubis* at 146 N.J. 196, 680 A. 2d 628.

ii. *Jacobson v. Mailboxes, Etc, U.S.A., Inc.*

Before the more celebrated *Kubis* decision hit the newsstands, the Supreme Judicial Court of Massachusetts issued its own franchisee-friendly decision. In *Jacobson v. Mailboxes, Etc., Inc.,* 419 Mass. 572, 646 N.E.2d. 741, 745-746 (1995), the court took a different tack in approaching the enforcement dilemma. Making a distinction between cases sounding primarily in contract and those which sound predominantly in fraud, the court ruled that if the franchisee's claims focused primarily on contract matters, the forum selection clause would be enforced. If the claims centered on the conduct of the franchisor before the formation of the contract, however, then the clause would not be enforced.

Unfortunately for franchisees looking to carry the *Jacobson* decision into federal court, federal courts have rejected this reasoning and are not likely converts since *The Bremen* itself rebuffed such an argument. In *Nemo Associates, Inc. v. Homeowners Marketing Services International, Inc.,* Bus. Franchise Guide (CCH) ¶ 10,972 (E.D. Pa. July 8, 1996), the federal district court held, after examining a line of cases descending from *The Bremen,* "that to invalidate a forum selection clause on the grounds of fraudulent inducement, the party challenging the clause must show that the *clause itself was procured through fraud....* Were the law otherwise, a party could defeat a validly negotiated forum selection clause merely by alleging fraud in the inducement." *Id.* at 28,426 (Emphasis supplied). *See also Jumara v. State Farm Ins. Co.,* 55 F.3d. 873 (3d.

Cir. 1995) and *Lorenzo v. Electronic Realty Associates, L.P.,* Bus. Franchise Guide (CCH) Para. 10,886 (M.D. Pa. January 17, 1996).

Hence, although the *Jacobson* court's rationale makes good sense in the final analysis, its holding is confined to matters litigated in Massachusetts state courts. In this way, *Kubis* and *Jacobson* have much in common.

iii. State Franchise Statutes/Regulations Dealing with Forum Selection

Whether state franchise laws offer any additional protection against franchisor-imposed choice of forum clauses seems to be an open question. As the preceding review reveals, the outcome of the argument as to whether a forum selection provision is enforceable is largely dependent on where the action is brought or maintained, state or federal court. Nonetheless, the chances of convincing any court, state or federal, that a contractual forum selection clause should be ignored, is vastly improved by the presence of a protective state law, given that *The Bremen, Stewart Organization* and *Carnival Cruise Lines* all at least pay lip-service to the notion.

If the enforcement of a forum selection clause can be shown to contravene a strong state public policy then the resisting party will, at a minimum, have its first foothold to mount the challenge. Of course, in *Kubis*-friendly state courts, the existence of a state law nullifying out-of-state forum selection clauses may all but assure victory to the "resisting party". Further, because some of the franchise registration states may require changes to either or both the UFOC and franchise agreement in advance of any sale, counsel on either side of the franchise relationship must consider the impact of these state laws. A state's requirement concerning the mention of, or incorporation of, a protective state law in the UFOC or franchise agreement itself could give the franchisee a handy argument to overcome the enforcement of a forum selection clause or even an arbitration clause. *See, for example, Alphagraphics Franchising v. Whaler Graphics, Inc.,* 840 F. Supp. 708 (D. Ariz. 1993), where the court ruled that while the FAA preempted Michigan's statutory limitations on out-of state arbitration, the arbitration clause's forum selection provision (for Arizona arbitration) would not be enforced because the franchisor complied with Michigan's registration laws, including an announcement in its' UFOC of the protective Michigan anti-distant forum statute, without disclosing that it may later challenge the provision.

A survey of state laws and regulations will be instructive to counsel on either side of the argument. The following states have either a state statute or regulation governing where franchise litigation and, in some instances, arbitration may occur:

— CALIFORNIA: Cal. Bus. & Prof. Code § 20040.5.

— CONNECTICUT: Conn. Gen. Stat. § 42-133(f)&(g).

— ILLINOIS: Illinois Compiled Statutes, 1992, Chap. 815, § 705/4.

— INDIANA: Indiana Code, Title 23, Article 2, Chapter 2.7, § 1(5)&(10).

— IOWA: Iowa Code § 523 H.3(1).

— LOUISIANA: Louisiana Revised Statutes, Title 12, § 1042.

— MICHIGAN: Mich. Comp. Laws § 445.1527(f).

— MINNESOTA: Minn. R. § 2860.4400(J).

— NORTH CAROLINA: N. C. Gen. Stat. Ch. 22, § 3.

— RHODE ISLAND: General Laws of Rhode Island, Title 19, Chapter 28.1, § 19-28.1-14.

— SOUTH DAKOTA: South Dakota Codified Laws Title 37, Chapter 37-5A, § 37-5A-51.1.

In addition, two franchise registration states, Maryland and North Dakota, administratively require franchisors to delete forum selection clauses written in favor of out-of-state litigation. Further, a number of other states have general anti-waiver provisions which generally prohibit the written or oral relinquishment of any rights granted under the state's franchise law. *See* Ohio Revised Code, § 1334.15 [anti-waiver provision of the Ohio Business Opportunity Purchasers Protection Act], as one example.

III. COMMENTARY UPON FORUM SELECTION AND ARBITRATION CASES

a. Observations of the Rationale Employed by Courts in Both Area

i. Forum Selection— "Parochialism plays no role in our decision."

Ironic as it seems the judicial resolution of choosing the correct forum for contracting parties is itself dependent upon the situs of the action. Federal and state courts employ different philosophies and are governed by different legal canons. Although state courts may deny that parochialism affects their decisions, given the fact that a state's public policy is grounded in parochialism, what other point of embarkation do state courts have when a specific anti-waiver statute has been adopted by the state legislature? Also, state courts and, of course, the "resisting party", tend to believe that the forum

selection clause is the equivalent of the choice of law clause. That is, the forum-state's law will govern the action regardless of the plaintiff's claims or the contractually-selected forum. To some degree this belief has some validity. Thus, one reason state courts are so protective of the forum in which the action is litigated is the underlying belief that the state's laws will be ignored in another forum. *For an expanded discussion of choice of law issues, see generally,* James A. Meaney, *Choice of Law: A New Paradigm for Franchise Relationships,* 15 Franchise L.J. 75 (Winter 1996); Reva S. Bauch, *An Update on Choice of Law in Franchise Agreements: A Trend Toward Unenforceability and Limited Application,* 14 Franchise L.J. 89 (Spring 1995); Thomas M. Pitegoff, *Choice of Law in Franchise Agreeements,* 9 Franchise L.J. 1 (Summer 1989).

Federal courts on the other hand have been essentially instructed by the U.S. Supreme Court, especially in actions airsing under 28 U.S.C. §1404(a), that the enforceability issue is predominantly a federal matter. While saying on the one hand that a forum selection clause "should receive neither dispositive consideration ...nor no consideration, but rather the consideration for which Congress provided in §1404(a)" and, on the other, that "[t]he presence of a forum-selection clause...will be a *significant factor* that figures centrally in [a] District Court's calculus", the Court has weighted the balance in favor of the enforcement of forum selection provisions in federal courts (quoting from *Stewart Organization, supra* at 487 U.S. 31, 108 S.Ct. 2245, 101 L.Ed. 2d 31 and 487 U.S. 29, 108 S.Ct. 2244, 101 L.Ed.2d 30, respectively). Although a few District Courts have refused to validate forum selection provisions, the vast majority routinely enforce them.

Until the guiding principles of state and federal courts reach more common ground it appears that the rift over the enforcement of contractual forum selection clauses is likely to continue.

ii. Arbitration Cases

Unlike the conflict in the forum selection area, state and federal courts have reached an accord on the enforceability of arbitration clauses written into franchise agreements. The reason for this, of course, is that there is a much clearer starting point. The FAA, backed by Congress' most potent authority— the Commerce Clause, is fairly clear in scope and effect. Moreover, the Supreme Court's twin decisions in *Southland Corp.* and *Doctor's Associates* are internally consistent and do not run into as many competing state interests as are found in the forum selection area. And, to a degree, an arbitration may actually be perceived as a more neutral forum since no particular political or parochial influences should be at work. In addition, given that an arbitration referral plucks a matter clean of most procedural contests, the parties may have more success persuading an arbitrator that the choice of forum alone does not control the choice of law on a given issue. In essence, the choice of an arbitration hearing may

have less relationship to the outcome than does a selected choice of a litigation forum.

b. Did Sun Microsystems Miss the Federal Court Off-ramp?

Considering the advantage enjoyed by franchisors when litigating the choice of forum issue in federal court, one wonders if when Sun Microsystems was headed down the New Jersey Turnpike for Trenton it missed the off-ramp for "All Shore Points and Federal Court". Why did Sun Microsystems fail to remove the action to federal district court and seek a transfer to California under 28 U.S.C. §1404(a) in the *Kubis* case? The simple answer is that it could not. Complete diversity of citizenship was lacking.

A thorough reading of *Kubis* reveals that in addition to having Indirect Value Added Dealers like the plaintiff, Sun also maintained company-controlled offices in the Garden State. These offices were staffed by New Jersey residents. Indeed, the main controversy of the case involved these resident-defendants: the plaintiff alleged that Sun's decision to terminate the plaintiff based upon declining sales volume was caused by the individual defendants' interference with a large sale the plaintiff had underway. And, the plaintiff alleged that the resident-defendants induced Sun to terminate its agreement.

As will be discussed in greater detail below, knowing these additional facts is instructive for all litigators who may enter the battle over the battleground.

c. Is There Any Predictability to the Next Case Involving a Forum Selection or Arbitration Clause?

When decisions concerning forum selection and arbitration are viewed on the larger landscape of franchise opinions routinely issued, the results may seem helter-skelter and without consistency. However, once the formula of the different state and federal treatments is cracked, the cases lend themselves to some predictability and congruity. Once that is accepted— that state and federal courts will take almost diametrically opposed positions— it all begins to make sense.

State courts will begin with some measure of parochialism. After all, it is only natural and logical to want to favor a resident by protecting them with a law that your own legislature enacted for that person's direct benefit. But, the first prerequisite is that the state have some protective measure in effect so that the state court can draw from it directly or glean the legislative intent ala *Kubis.* At least on forum selection issues, the more explicit the provision is concerning anti-waiver of the resident's local forum for disputes, the easier it will be for a state court to justify a result in favor the resident. In cases involving challenges to arbitration provisions, absent a very narrow and successful argument of fraud in the inducement of the arbitration clause itself, state courts will have little or no justification to resist enforcement. *See, however,*

Alphagraphics Franchising v. Whaler Graphics, Inc., supra, and *Hampbell v. Alphagraphics Franchising, Inc.*, 779 F. Supp. 910 (E.D. Mich. 1991) for two instances where a *federal* court refused to fully enforce arbitration clauses for differing reasons involving state law and fraud in the inducement; *also see* Levin and Morrsion, *supra* at 116, for a further discussion of these cases.

Notwithstanding the cases noted above and barring unusual facts, federal courts will be commonly consistent in both arbitration and forum selection enforcement. Federal procedural law and federal substantive law combine in these areas to make enforcement a virtual certainty. The twin mandates of the FAA and *The Bremen* seem to require nothing less. While state policy considerations may play some role, when considered on balance with paramount federal concerns, they will always lose out.

IV. THE PRACTICAL ASPECTS OF HANDLING YOUR NEXT CASE

a. The Franchisee's Case (or is this the way to New Jersey?)

i. Introduction

Franchisees seldom have the advantage when it comes to resolving disputes with their franchisors. The uphill battle begins with the execution of the franchise agreement. Falling in the category of "boilerplate clauses", forum selection and arbitration clauses generally receive little attention from eager franchisees. *See, however,* Thomas M. Pitegoff and James M. Fantaci, *Not so Boilerplate: Choice of Law, Conflicts of Law, Forum and Jurisdiction,* American Bar Association, 1990 Annual Forum on Franchising (New Orleans, October 25-26, 1990). Little leverage is available to franchisees looking to associate with established franchisors. The super-heated franchise buying frenzy has provided franchisors with a rising seller's market. Franchisees compete for territories and locations. Franchisors rarely find it necessary to negotiate the terms of their franchise agreements to land a sale.

When negotiation is required, the focus is largely upon the economic aspects of the deal. Most franchisees will not concern themselves with the effect of choice of law, forum selection and arbitration clauses, let alone the potential negative impact of these items. Immediate financial concessions always win out over future "what-ifs". Such esoterica is left for the lawyers and the vast majority of franchisees do not use lawyers at the purchasing stage. Even when counsel is engaged, few are the franchisors who will modify their franchise agreement to allow suit or arbitration in the franchisee's backyard. As a result, interested franchisees must accept the franchisor's terms or look elsewhere.

ii. The Starting Point

Because of this process most disenchanted franchisees will enter the practitioner's office at a contractual disadvantage. If the franchise sale was lucky enough to have taken place in one of the few registration states that require a franchisee-favored change to the "boilerplate" provisions then counsel may have a considerably easier job of keeping the dispute phase of the matter in the franchisee's home arena. Regardless of the specific provisions of the agreement, practitioners should get in the habit of "starting at the end". In other words, before analyzing the substance of the franchisee's claims, the starting point of any contractual review should be the "boilerplate" section. Waiting until after the matter is filed in court to first understand the effect of these provisions could send the entire litigation strategy into a dramatic tail-spin, not to mention counsel's relationship with the client.

The choice of law, forum selection and arbitration clauses are the control mechanisms for the rest of the franchise dispute. Once counsel has mastered these controls they will be better able to predict and gauge the outcome of the dispute and, as a result, define the best dispute-resolution strategy. It is an absolute mistake to wait until opposing counsel files a motion to dismiss, a motion to transfer or worse yet, a motion for sanctions or frivolous conduct, to first understand the effect of these clauses on your case. All other aspects of the case will walk through the "boilerplate" door. So, start at the end.

But, is the end of the franchise agreement back far enough? Generally, no. When preparing a franchise case for formal dispute resolution counsel must treat the Uniform Franchise Offering Circular as part of the franchise agreement. The UFOC must be reviewed in tandem with the franchise agreement to determine the existence of any discrepancies between them. These discrepancies may serve as powerful argument to encourage a court to disregard discordant contractual provisions. Remember that fraud and misrepresentation are the cornerstones of a successful challenge to forum selection and arbitration clauses. *See* FAA, 9 U.S.C. § 2 ("...save upon such grounds as exist at law or in equity for the revocation of any contract.") and *Nemo Associates, Inc., supra.* ("...the party challenging the [forum selection] clause must show that the clause itself was procured through fraud."). The first evidence of "fraud" may arise from the representations, or lack thereof (since the information required to be disclosed under the UFOC Guidelines is mandatory), made in the UFOC. *For an excellent analysis of the application of fraud theories in franchise litigation see,* Robert T. Joseph and J. Michael Dady, *Franchisees and the Law: Paradise Won or Paradise Lost?,* American Bar Association, Forum on Franchising (San Diego, October 26-28, 1994).

iii. Strategic Considerations

Before reactively condemning and challenging the contractual choices of a selected forum and mandatory arbitration, franchisee counsel should consider the cost of the

challenge, the chances of success, the benefits of maintaining the action on the franchisee's turf and the possible advantages of litigating or arbitrating in the distant forum. Say what? Advantages in a distant forum? A review of the franchisor's state's law may reveal the existence of a franchise disclosure or franchise relationship law not available in the franchisee's state, or which are more protective than those in the franchisee's home state. While it is often difficult to predict if a court will apply its special franchise laws extra-territorially to a non-resident franchisee, some courts have. *See generally,* Thomas M. Pitegoff, *Choice of Law in Franchise Agreements,* 9 Franchise L.J., Summer 1989 at 1, 20; *Dep't of Motor Vehicles v. Mercedes-Benz,* 408 So.2d 627 (Fla. 1981); and, *Mon-Shore Management v. Family Media,* 584 F. Supp. 186 (S.D.N.Y. 1984). And, although this line of reasoning blurs the line between choice of law and forum selection, it must be remembered that the two issues are interrelated and that forum courts will seek to apply their own law, especially when the parties have agreed to it in the contract. All that may remain for franchisee-counsel to argue is that "what's sauce for the goose is sauce for the gander."

The same analysis should pertain when the franchisee faces mandatory arbitration. While the majority of franchisee-counsel frown on arbitration because of its inherent discovery limitations, not all arbitration is bad, nor is it decidedly weighted in favor of franchisors. Indeed, employing the correct strategic approach in an arbitration setting may save the franchisee-client tens of thousands of dollars and accomplish the same result. And, while many litigators bemoan the unpredictability of arbitrators' decisions, the fact of the matter is that judicial litigation against franchisors can be so littered with all manner of pre-trial motions, some of which may short-circuit the substantive challenge altogether, that a franchisee may fare better in an arbitration if getting to the merits is the goal. In short, franchisee-counsel should not dismiss arbitration, even in the franchisor's arena, as the best alternative. The issues in dispute and the financial wherewithal of the client may better lend themselves to speedy arbitration rather than protracted litigation.

iv. Advancing the Challenge

The most typical situation facing franchisee-counsel is a dispute where the franchise agreement contains boilerplate forum selection and arbitration clauses, and the client or counsel do not wish to accept the mandate. The determination is made that a lawsuit is required, and that it must be filed in the franchisee's home state. What alternatives are av1.ailable and how can counsel best take advantage of them? A checklist is often helpful when thinking through litigation strategy:

What court should the case be filed in — state or federal?

What causes of action are involved — state statutory or common law claims, federal anti-trust claims or other federal causes of action i.e.

RICO?

Does the franchisee's state have a franchise registration and/or relationship law? If so, does the law contain any anti-waiver language and did state law require the disclosure of this language?

What are the prevailing judicial policies on enforcement of forum selection clauses / arbitration provisions in state and federal courts where the case may be filed?

If the franchisee's state's laws are of no assistance, does the franchisor's state have any protective franchise measures and can the laws be applied to a non-resident franchisee?

What evidence of fraud, misrepresentation or overweening bargaining power exists to show that either the forum selection clause or the arbitration provision are the result of that behavior?

What evidence exists under state law to challenge the "the validity, revocability, and enforceability of contracts generally"?

Developing the appropriate answers to these questions will guide franchisee-counsel when making this all important decision. Being prepared at the outset—before suit is filed— will better enable counsel to face the challenge ahead.

The best strategy will arise from the application of the answers to the above questions to the facts and circumstances of the particular matter. Nevertheless, some general guidelines and trends may be gleaned from available case law.

Franchisees are better off in state court. This does not take an advanced degree in franchise law to decipher. Federal courts, especially in the areas of forum selection and arbitration, are more certain to enforce contractual boilerplate than state courts. Accordingly, state courts are more inclined to apply state protective measures through any creative means available. Federal courts follow policies that are mainly franchisor-oriented while state courts tend to adopt pro-franchisee policies. Parochialism at its best. The real trick for franchisee-counsel, however, is not in making the decision to file in state court but rather in how to keep the case there. The lesson in *Kubis* is hard to ignore.

When filing in state court, franchisee-counsel must include an in-state defendant in the action, keeping all frivolous conduct and Rule 11-like statutes firmly in mind. Likewise, where possible or justifiable, franchisee-counsel should avoid federal causes of action. Following these guidelines will, of course, avoid removal to federal court under 28

U.S.C. § 1441(a) or (b) since both diversity of citizenship and federal question jurisdiction will be lacking. An additional tack, when an attempted termination or non-renewal is underway, is to seek injunctive relief *only* and avoid a claim for monetary damages. This will possibly eliminate the franchisor's ability to remove the action since the $75,000.00 amount in controversy threshold required by 28 U.S.C. § 1332(a) may not be met. This strategy has limitations, however. When injunctive or declaratory actions are filed without a stated amount in controversy, the amount in controversy is measured by the value of the right that is sought. *See* Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d, § 3708, *Proceedings for Injunctive and Declaratory Relief; also see, Hampbell v. Alphagraphics Franchising, Inc., supra.* Generally speaking, the value of the entire franchised business will be involved when termination or non-renewal is at issue. As such, the injunctive strategy may have limited applicability.

Nonetheless, while many state courts are likely to enforce forum selection and arbitration clauses, the chance to persuade otherwise seems best in state tribunals. *See Kubis and Doctror's Associates v. Casarotto.* As noted previously, the franchisee's argument on this score is clearly improved when the forum state has a specific anti-forum selection waiver provision, a general anti-waiver provision or a modern judicial policy against the enforcement of forum selection clauses resulting from protective state measures or policies. And, a better argument can be advanced in registration-type states when the law or the examiner requires a disclosure of a protective measure and the franchisor does not obtain an advance contrary judicial declaration or announce its' intention not to abide by the mandated disclosure. *See Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc., supra.*

Even in state court, however, it would now take the most unusual of franchise cases to turn the tide on the enforcement of an arbitration clause. The U.S. Supreme Court has made it bluntly clear in *Doctor's Associates, Inc v. Casarotti* that no state haven against the enforcement of an arbitration clause is left under the mandate of the FAA. As a result, challenging the enforcement of a contractual arbitration clause seems to be mainly an utter waste of time. Only one argument remains to contest the enforceability of arbitration clause: "...generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2 [of the FAA]." *Doctor's Associates, Inc. v. Casarotti, supra at*__U.S.__, 116 S.Ct. 1656, 134 L.Ed.2d 906; *see also, Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc., supra,* and *Stirlin v. Suprecuts, Inc., supra.* This strategy will be discussed in tandem with forum selection challenges below.

Unless the circumstances of a particular matter are such that an in-state defendant can be found or an injunctive (or declarative) action can be filed and the value of the franchise business is below the $75,000.00 jurisdictional threshold of 28 U.S.C. § 1332(a), franchisee-counsel is most likely to find themselves in federal court facing a

motion to transfer the matter to the franchisor's home arena for arbitration or litigation. This scenario is the most difficult for a franchisee to contest. Counsel must have anticipated this stage of the proceedings from the start in order to have a realistic chance of prevailing on a motion to transfer under 28 U.S.C. §1404(a). Under the *Stewart Organization* decision, the Supreme Court has left only the slightest crack in the door: "Though state policies should be weighed in the balance, the authority and prerogative of the federal courts to determine the issue, as Congress has directed by §1404(a), should be exercised so that a valid forum selection clause is given controlling weight *in all but the most exceptional cases.* See *The Bremen, supra,* at 10." Thus, the argument to be made is that your client's case is "exceptional". This is no simple task.

"Exceptional" has generally come to mean that the presumptive validity of a forum selection clause can be overcome only if one of the following is properly demonstrated:

> The incorporation of the clause *itself* was the result of fraud, undue influence or overweening bargaining power;
>
> A strong showing is made that the selected forum is so seriously inconvenient that the resisting party will be deprived of their "day in court";
>
> Application of the clause violates concepts of fundamental fairness;
>
> Enforcement would contravene a strong public policy of the forum in which the action is commenced or deprive the resisting party of some statutorily-created substantive right.
> (*See* Levin and Morrision, *supra* at 113 and footnote 19 therein, for a further distillation of these "exceptions").

When these exceptions are reviewed in light of *Carnival Cruise Lines,* however, the only one which has any substance and meaning is the first: the clause itself was the result of fraud, undue influence or overweening bargaining power. When considered further in tandem with the modern UFOC Guidelines which now require the cover page disclosure of the previously hidden boilerplate forum selection clause, few practical arguments appear to remain for franchisee-counsel in federal court. To effectively demonstrate that a forum selection clause resulted from fraud, undue influence or overweening bargaining power in this day and age will take nothing less than a developmentally disabled client and a magician's wand.

The other handicap facing franchisee-counsel is the limitation of the pre-trial procedural setting in which this battle will be fought. The charge is to *prove*, at the earliest possible stage of the proceedings, that the forum selection clause, which the court is about to enforce to remove the case to Poughkeepsie, resulted from some fraudulent behavior. Merely alleging general fraud is not enough (*See Nemo, supra* at

28,426, "Were the law otherwise, a party could defeat a validly negotiated forum selection clause merely by alleging fraud in the inducement."). As a practical matter, unless a "smoking gun" is left on the table or some lightening-speed discovery produces some startling admissions, franchisee-counsel is left with self-serving client affidavits to win the day. Bereft of the emotional drama which counsel would be sure to generate if the client could testify live, the affidavits are likely to obtain a much worse result than David's slingshot and stones. It is obvious that franchisee-counsel's chances of success are bleak indeed. But, it only gets worse.

Simultaneously mounting the twin peaks of forum selection and arbitration appears to be legal impossibility. Similar to the proof required to defeat a forum selection clause, to overcome the enforcement of an arbitration clause the proof must zero-in on fraudulent inducement of the arbitration clause itself. The Supreme Court cleanly settled this issue in *Prima Paint Corp. v. Flood & Conklin Mfg. Co., supra, and* effectively buried it in *Allied-Bruce Terminex, supra,* when the Court announced that:

> "...§ 2 gives States a method for protecting consumers against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.' 9 U.S.C. §2" (emphasis in original). What states may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration provision." *Allied-Bruce Terminex, supra* at 281.

In essence, a consumer may overcome the enforcement of an arbitration clause only by demonstrating some common law challenge to the formation of a contract and specifically apply that principle to the arbitration clause itself.

Considering the cards now stacked against ordinary consumers to obtain a jury trial or to even see the inside of a courtroom, business-franchisees stand less of a chance of having their matters heard by judge or jury. Viewing the controlling language of the significant decisions in these areas brings home the point:

ARBITRATION	FORUM SELECTION
Accordingly, if the claim is fraud in the inducement of the arbitration *clause itself*—an issue which goes to the "making" of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language [of §4 of the FAA] does not permit the federal court to consider claims of fraud in the inducement of the *contract generally.* Prima Paint, supra at 403-404 (Emphasis supplied).	The cases cited above make clear that to invalidate a forum selection clause on the ground of fraudulent inducement, the party must show that *the clause itself* was procured by fraud. Fraudulent inducement as to the entire contract will not invalidate an otherwise valid forum selection clause. Were the law otherwise, a party could defeat a validly negotiated forum selection clause merely by negotiation of the forum selection clause itself. *Nemo, supra* at 28,426 (Emphasis supplied).

So, in either area, forum selection or arbitration, arguing that the contract itself was fraudulently induced is of no value in saving the matter from an arbitrator's reach or a distant forum. *Prima Paint* sent the issue of fraudulent inducement of a contract, which contained an arbitration clause as one of its provisions, to an arbitrator for decision. The fact that the entire contract may have been fraudulently induced was of little moment. Likewise, *Nemo* clearly holds that a resisting party may not prevail on a forum selection challenge by alleging (and perhaps proving) that the entire contract is a product of fraud. Hence, accepting the language of both courts suggests that a franchisee must independently establish that each clause was the specific result of fraud or is otherwise unenforceable as a result of some other common law contractual defense. Given that most franchisees pay scant attention to these boilerplate clauses to begin with, proving that they each arose from independent sources of fraud, or that the same fraud specifically induced both, will be truly difficult indeed. Perhaps some creative franchisee-counsel will bring the case which will instruct the rest on to how to accomplish this great feat. But, until then, it is likely franchisees will be packing their bags for arbitration in distant cities.

On the arbitration front, however, the ever-persistent California courts have issued a recent decision that may be of some assistance to franchisee-counsel. While the case involved a franchisor, Supercuts, it did not involve a franchise agreement. In *Stirlen v. Supercuts, supra,* an arbitration clause in an employment contract was at issue. In

addition to mandating arbitration, however, the clause sought to limit the employee's remedies while, at the same time, carving out of the arbitration venue certain remedies judicially available to the employer. The trial court's finding that the one-sided clause was unconscionable was upheld on appeal. After acknowledging that the Supreme Court has found the FAA preempted many California statutes addressing arbitration and after recognizing the Court's recent decision in *Doctor's Associates, Inc. v. Casarotta*, the appellate court indicated that "[j]udicial refusal to enforce an arbitration clause clearly unconscionable under a general contract law principle not at all hostile to arbitration presents no obstacle to the objective of the FAA or any other congressional purpose." *Id.* at 1997 Cal. App. LEXIS 18. While it is questionable that a similar holding would be duplicated in a franchise case, the *Stirlen* court supplies a fair road map showing the detour around the FAA.

At bottom, franchisees will fare best when they have their "day in court" in a state court of their residency. To achieve this, franchisee-counsel must painstakingly analyze the available methods of keeping the matter out of federal court. Keeping the matter from arbitration may be even more difficult. Perhaps the best that can be done is to develop a strategy to maximize an arbitration result.

b. The Franchisor's Case (Where can I go wrong?)

i. Keeping the Advantage

The road to "battleground" success is considerably easier for franchisors than franchisees. It is of little wonder when one bears in mind the advantages available to franchisors: they draft the franchise agreement, they insert arbitration and forum selection provisions, they insist that all agreements be generally uniform, they require their state law to apply, courts are generally willing to enforce contractually-selected provisions, NASAA requires choice of law, forum selection and arbitration clauses to be displayed in neon lights and, of no little weight, franchisees usually agree to the boilerplate clauses without a whimper.

Nonetheless, pitfalls remain, and the one-sidedness of the transaction is generally the reason. It is the genesis of any effective contest. State legislatures and courts seem driven by the edge franchisors enjoy at the bargaining table. Always wanting to "level the playing field" or "change the rules entirely", these paternal, parochial big brothers seek to intervene where possible. (As an example of what may be perceived as overreaching, see *Stirlen v. Supercuts, Inc., supra,* where an employer loaded up the arbitration provision to gain certain procedural and remedial advantages). Fortunately for franchisors, state influence continues to diminish in the world of national and international franchising. Crossing state and international boundaries has become commonplace. And with it, the luxury of being protected by the Commerce Clause and federal tribunals. It seems no mere coincidence that the Supreme Court's innovative

philosophy concerning modern commercial trade (in the context of forum selection clauses) and the rise of modern franchising awakened at the same time. As noted previously, the 1972 *Bremen* decision was based in large part on the belief that the world was indeed growing smaller ("in 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". *Id.* at 407 U.S. at 15, 92 S.Ct. at 1916). And so it is for the modern day franchisor, enjoying the benefit of having first crack at choosing the battleground, but still exposed to the risk losing the advantage if they take a wrong turn.

ii. Making a Pre-emptive Strike

The first, and perhaps the only, obstacle to keeping the advantage is an uncooperative state franchise examiner who refuses to register the franchise for sale unless franchisor-favorable boilerplate clauses are diluted or removed entirely. As noted above, a number of states have anti-waiver clauses and still others have "policies" designed to assist local franchisees. Fortunately for franchisors, not all states require the insertion of these clauses into the franchise documents, apparently relying on enforcement by their state tribunal. Considering the methods available to franchisors to avoid state court review, states that have these laws or policies regarding forum selection or arbitration but which do not affirmatively require that they be placed in any of the franchise documents, should be of little or no concern. The greater issue arises when the state examiner, or the applicable regulation itself, intrudes into the franchise document. (*See for example, Alphagraphics Franchising v. Whaler Graphics, Inc.,supra,* and *Hampbell v. Alphagraphics Franchising, Inc.,supra,* where two different federal district courts, one in Michigan and the other in Arizona, clipped back the effect of the arbitration clause in the franchise agreements when confronting the effect of the Michigan Franchise Investment Law's prohibition against out-of-state arbitration and litigation). Can a franchisor do anything at this point--at the registration stage--to effectively resist the required change?

The answer may depend on whether the resistance is to an arbitration clause or a forum selection clause. Some recent commentators have suggested that to effectively challenge a prohibition on out-of-state arbitration, like the one involved in the *Alphagraphics* cases, a franchisor should bring a declaratory judgment action "seeking to invalidate the state statute prospectively." Dunham, Darrin, & Levin, *Choice of Forum in Litigation and Arbitration,* International Franchise Association's Legal Symposium, p. 48 (May, 1997). This advice was based, in part, on two reported instances where the declaratory judgment strategy was successful, *Saturn Distribution Corp. v. Williams,* 905 F.2d 719 (4th Cir. 1990) and *Securities Industry Association v. Connolly,* 883 F.2d 1114 (1st Cir. 1989), and on the pronouncement made in *Alphagraphics Franchising v. Whaler Graphics, Inc.,supra,* that it was essentially fraud for a franchisor to comply with state law which required disclosure of a protective provision without informing the

franchisee of the franchisor's "intention to insist on the enforcement of the forum selection clause [of the arbitration provision] if a dispute arises." *Id.* at 710. The *Alphagraphics* court held that even though the FAA preempted state law prohibiting out-of-state arbitration, the FAA savings clause came into play when a franchisor showed compliance with state law and did not advise the franchisee that it may or would challenge the law, if and when a dispute arose. Even at this, however, the court did not sweep aside the arbitration clause altogether, only the forum selection portion.

Based on this guidance it appears franchisors may have two available methods to prospectively turn the corner on "intrusive" state laws that affect arbitral forum selection clauses:(1) commence a declaratory judgment at the time of registration (or perhaps before) or (2) reveal their intention **not** to comply with a state protective provision even though the state may require disclosure. Although the last method sounds entirely silly it may be used effectively in states such as Michigan, and now Wisconsin, where no document review is undertaken. In other registration states where document review has become an industry in itself, franchisors will be hard-pressed to persuade an examiner to allow the additional, inconsistent disclosure. In those states, however, commencement of a declaratory judgment action should do the trick. Although the Supreme Court has not addressed this issue head-on (that is, the enforcement of language specifying the locale of an arbitration), it would require a complete reversal of direction for the Court to rule otherwise. Actually, some of the Court's past decisions have already indicated that an arbitral forum selection clause is enforceable. In *Scherk v. Alberto-Culver Co.,supra,* the Court announced that an agreement to arbitrate in a specific forum was "in effect, a specialized kind of forum-selection clause that posits not only the situs of the suit but also the procedure to be used in resolving the dispute." *Id.* at 519, 94 S.Ct. at 2457. *See also Volt Info. Sciences v. Board of Trustees of Leland Stanford Junior Univ., supra,* and Dunham, Darrin, & Levin, *Choice of Forum in Litigation and Arbitration,* International Franchise Association's Legal Symposium, *supra* at 30-48, where this issue is discussed in detail.

Trying to take the declaratory judgment approach on a litigation forum selection clause (outside of arbitration clauses), however, may not be as productive. In fact, it may be downright destructive. This is because of the difference in the source of federal occupation in these closely-aligned areas. From our review we know that the FAA preempts all state law except that which may be advanced to argue that the arbitration clause itself was fraudulently induced. The same, however, is not true of the general area of forum selection. The federal policy of generally enforcing forum selection clauses, as we learned in *Kubis*, does not directly bind state courts. Furthermore, even a federal court sitting in diversity is compelled to consider state policy in this area. *See Stewart Organization, Inc., supra.* And, if the action is unsuccessful, as it may well be, the franchisor has created an impenetrable wall for all franchisors and, perhaps, even strengthened prospective franchisees' challenges in federal court. The result is obviously not as predictable as a declaratory action involving the FAA. As such, it is

better to "let sleeping dogs lie" and wait for a live case to either side-step the state forum altogether or make an argument in light of favorable facts. In addition, the track record of franchisees before state tribunals on the forum selection issue is not unblemished. *See Smith, Valentino & Smith v. Superior Court of Los Angeles Cnty.*, 17 Cal.3d 491, 551 P.2d 1206, 131 Cal. Rptr. 374 (1976) and *Jacobson v. Mailboxes, Etc., Inc., supra.*

iii. Following the Formula

Beyond the pre-emptive strikes a franchisor can take, the formula for success on the issues relating to arbitration and forum selection clauses is easy to follow: get to federal court as fast as possible. As we have explored, federal tribunals will apply principles in both areas that are more franchisor-friendly. Franchisees are clearly at a disadvantage in federal court. As Dunham, Darrin & Levin noted in their recent presentation to the International Franchise Association's Legal Symposium:

> Whenever franchisees sue in their own state courts, the franchisor's first question should be whether the cases can be removed. Again, there are always exceptions, but compared to most state courts the typical federal court will be more sympathetic to a judicial forum selection clause. In addition, a federal court considering a judicial forum selection clause has the option of transferring the case to another district, whereas a state court can only dismiss the action under the doctrine of *forum non conveniens*. Many state courts will be reluctant to dismiss, especially if the plaintiff may have a statute of limitations problem, and *forum non* is, in any event, always a flexible doctrine that leaves much to the individual court's discretion. Dunham, Darrin, & Levin, *Choice of Forum in Litigation and Arbitration,* International Franchise Association's Legal Symposium, *supra* at 4, note 3.

In fact, absent overriding and articulated reasons against removal to federal court, a franchise litigator representing a franchisor who does not attempt to remove a case to federal court may end up at the other end of a malpractice action.

Once in federal court, making the right moves will bring victory closer. The tried and true method of moving the case to the franchisor's selected forum is by filing a motion to transfer under 28 U.S.C. §1404(a). Although other procedural avenues may be open, none are quite as smooth and well-worn as §1404(a). Paved with the Supreme Court approval in *Stewart Organization, supra,* moving for transfer under §1404(a) seems a sure bet.

In this process, however, do not overlook the need to also move the matter to arbitration if an arbitration clause is available. Filing simultaneous motions for transfer and for arbitration is one option. Filing a motion to dismiss with a request to refer the matter to arbitration in the chosen locale is another. A final choice is to first move for transfer under 28 U.S.C. §1404(a), obtain the transfer to the desired forum, and then move for a referral to arbitration. While this last method requires two steps, it may be cleaner and more efficient in the long run. The chosen forum court may be more inclined to enforce the arbitration clause once the matter has been transferred to the situs of the arbitration and to follow the lead of the transferring court in specifically enforcing the terms of the parties' agreement. Also, should the need arise to return to court for instructions, to deal with non-arbitral matters or to later enforce the arbitrator's decision, franchisor-counsel will have the action exactly where they want it—on the home court.

When making the motion to transfer, counsel should not overlook an important tool: the UFOC's Risk Factors section. It seems a highly persuasive argument to tell the Court that the exact items of which the franchisee complains are the subject of a specialized disclosure fashioned by NASSA, that the disclosure itself removes the "boilerplate" effect of the clauses by moving them to the front page of the disclosure document, and that the franchisee had to be aware of the effect of the clauses. Although NASSA sought to help franchisees, it is clear that the Risk Factors section can be turned to the advantage of the franchisor once the agreement is signed. In the past less sophisticated franchisees could argue that forum selection and arbitration provisions were hidden in legalese and enforcement would be unfair and unconscionable. This argument will now fall flat in most instances. Chalk up one more advantage for franchisors. Maybe that is why state courts lean heavily in favor of franchisees, the advantages are few and far between.

iv. The Arbitration Weapon in Class Actions

One final practice tip for franchisor-counsel comes in the area of class action matters. Although class actions are more thoroughly dealt with elsewhere in this paper, the use of an arbitration clause to fend off a class action suit is of great procedural importance to franchisor-counsel and worthy of mention here. Federal courts have held that the FAA may be used to shield a franchisor from class actions brought by a group of franchisees who have entered into franchise agreements containing arbitration clauses which do not call for class arbitration. The rationale is that "there can be no consolidated or class action arbitration without the express consent of the parties." *See* Edward Wood Dunham, *Arbitration Clause as Class Action Shield,* 16 Franchise L.J. 141 (Spring 1997) and the cases referred to therein at note 4. By virtue of the arbitration clause, a franchisor can arguably close down class action certification and compel franchisees to arbitration. This can be a very effective tool to protect a franchisor from the combined force of the class action juggernaut.

V. CONCLUSION

Although the Crystals and Microwaves are fictional players, the problem they faced is all too real in the world of franchising. Sometimes the "litigation game" cannot get underway until the "battleground" is selected. As we know, franchisors invariably have more control over this aspect of the franchise litigation. Franchisees are not completely unarmed, however. Usually firing the first volley, franchisees generally "select" the forum most convenient to them, often ignoring the mandate of a franchise agreement. Franchisors battle back by filing a barrage of pre-trial motions intended to derail the franchisee's action and move it to the franchisor's track. Once on the track, the franchisor hopes to use this advantage to win the day.

Some argue that franchisors have too great an advantage. Others complain that judge-made law protective of franchisees goes too far. Whatever your position on these matters, knowing the pre-battle rules is imperative when considering franchise litigation. Clients do not like surprises, especially costly ones. Preparing your client for the battle over the battleground is a step that should not be overlooked. Some predictability exists for both sides of a franchise dispute in the areas of forum selection and arbitration. Learning the road signs is the best guide to predicting the correct path. Study them well.