Protecting Franchisees from Abusive Arbitration Clauses

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JEAN R. STERNLIGHT

In two recent articles in this Journal, Edward Wood Dunham suggested that franchisors may wish to use arbitration clauses to achieve ends that are often proscribed by courts and legislatures in the litigation context. Specifically, Mr. Dunham's most recent article urges franchisors to consider the use of arbitration clauses to "manage franchisor risk." He notes that arbitration clauses can be used to eliminate franchisees' right to a jury trial, to select a geographic forum favorable to a franchisor but not necessarily to a franchisee, and to limit available damages. The earlier article advised franchisors that they could use arbitration clauses as a "shield" against class actions, specifically by attempting to eliminate any right that franchisees might have had to join in a class action against a franchisor in either litigation or arbitration.

Why should franchisors be able to accomplish ends that would be proscribed in litigation merely by inserting their ideal language in an arbitration clause? Perhaps they should not. As Mr. Dunham himself admits, "[a]s a theoretical matter, the elevated status of arbitration agreements is difficult to justify." Why should franchisors be able to accomplish ends that would be proscribed in litigation merely by inserting their ideal language in an arbitration clause? Perhaps they should not. As Mr. Dunham himself admits, "[a]s a theoretical matter, the elevated status of arbitration agreements is difficult to justify." Why should franchisors be able to accomplish ends that would be proscribed in litigation merely by inserting their ideal language in an arbitration clause? Perhaps they should not. As Mr. Dunham himself admits, "[a]s a theoretical matter, the elevated status of arbitration agreements is difficult to justify."

Although the pro-arbitration U.S. Supreme Court has issued numerous decisions stating that arbitration is favored, it has never gone so far as to say that putting an otherwise improper or illegal clause inside an arbitration agreement somehow immunizes that clause from attack. Instead, the Court has emphasized that where an arbitration clause can be shown to deprive a claimant of substantive rights, it "would have little hesitation in condemning the agreement as against public policy." Additionally, the Court has repeatedly explained that arbitration is supposed to be merely the substitution of an alternative viable forum for litigation, and that it should not accomplish a denial of substantive rights. The Court has stated that "[i]fby agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." Thus, in Gilmer v. Interstate/Johnson Lane Corp., the Court carefully examined the particular form of arbitration that had been mandated, and stood ready to invalidate the arbitration had it found that the forum was insufficient to protect the plaintiff's rights.

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Abusive Arbitration Clauses

(continued from page 45)

This article sets out a number of legal arguments that franchisees can potentially use to defeat arbitration clauses that seek to accomplish ends that would not be permissible in litigation. Drawing from decisions protecting consumers and employees from unfair arbitration clauses, as well as from opinions in the franchise context, this article analyzes arguments that can be based on the U.S. Constitution, federal statutes, state statutes, and common law. By way of this analysis, it suggests that some courts are misapplying arbitration precedents and preemption arguments to support decisions that allow franchisors to effectively exempt themselves from legislation and even constitutional provisions that would protect franchisees.

This article also calls for legislative reform. To the extent that courts go too far in allowing franchisors and others to use arbitration clauses to insulate themselves from legal liability, Congress will need to take corrective action. Several bills currently pending in Congress are summarized in the conclusion of this article.

Current Use of Arbitration Clauses

The inclusion of arbitration clauses by franchisors in their agreements is a common rather than exceptional event, and these clauses often include far more than a mere requirement of arbitration. Professor Christopher Drahozal recently studied the Uniform Franchise Offering Circulars and franchise agreements filed by seventy-five leading franchisors in Minnesota and found that 45 percent contained arbitration clauses. The vast majority of these arbitration clauses (82 percent) required that arbitration take place in the franchisor’s home location; 75 percent sought to preclude recovery of punitive damages; most clauses required franchisees to arbitrate all claims but allowed franchisors to litigate certain claims; almost half of the clauses explicitly precluded use of class actions, and several others that precluded consolidation might have been intended to accomplish the same end; several clauses provided for de novo hearings if recovery by franchisees (but not franchisors) exceeded a certain amount; and one clause prohibited the arbitrator from awarding attorneys’ fees. Thus, it seems that many franchisors are already heeding the advice provided by Mr. Dunham and others.

Is there any reason to be concerned about franchisors’ use of arbitration clauses to secure apparent advantages over franchisees? Professor Drahozal argues not necessarily, asserting that clauses that appear to be unfairly biased in favor of franchisors may in fact provide benefit to franchisees as well. Perhaps the franchisors pass on their reduced litigation expenses to the franchisees, and perhaps the gains secured by the franchisors exceed the losses imposed on the franchisees. Thus, he asserts that rational well-informed franchisees might voluntarily elect such seemingly unfair clauses in order to secure other advantages such as a cheaper franchise.

Professor Drahozal also contends that many franchisees are experienced and well-informed businesspersons, who are quite capable of reading contracts carefully and tailoring dispute resolution clauses to their own needs.

In comparison with Professor Drahozal, this author is far more pessimistic about the impact that such clauses likely will have on franchisees. I suspect that many franchisees, though certainly not all, do not comprehend the full implications of accepting an arbitration clause. Even assuming that franchisees read all the fine print of the franchise agreement, they may not entirely understand what arbitration is, that their right to a jury trial has been eliminated, that they likely will not have access to as much discovery as they would have had in litigation, and that it is virtually impossible to overturn an arbitrator’s ruling. Such franchisees also may not be cognizant of the implications of clauses that would require them to arbitrate in distant locations, shorten a statute of limitations, prevent them from proceeding in a class action, or preclude their recovery of certain kinds of relief. To use economists’ terminology, such franchisees are very much lacking in the “perfect information” that is necessary for a market to work efficiently. That is, because the franchisees do not possess adequate information to assess the costs that are imposed by the seemingly biased clause, they will not demand an appropriate reduction of price.

Moreover, even assuming that franchisees read the fine print of the dispute resolution clauses and understand their implications, franchisors could still use the clauses to secure an advantage. Psychologists have found that people are predictably overly optimistic and that they are typically more willing to gamble on losses than on gains. In practical terms, this means that even a completely knowledgeable franchisee would predictably underestimate the likelihood of getting into a dispute with the franchisor, and that even a franchisor that accurately estimated the likelihood would typically be irrationally willing to gamble that it would not occur. Given both phenomena, it is likely that a franchisee would not demand an appropriately large concession on other terms, such as price, to compensate for advantages that the franchisor secured through the dispute resolution clause.

In the end, only empirical investigations will yield conclusive answers to such questions as what the typical characteristics of franchisees are, what impact arbitration clauses have on franchisors and franchisees, and whether seemingly unfair clauses actually benefit franchisees as well as franchisors. But, lacking such information, which is not likely forthcoming in the near future, we will all need to make our own best judgments. Those franchisees and their attorneys who determine that a particular arbitration clause is disadvantageous will need to search out legal arguments that might be used to void the clause. Those who believe that legislative reform is appropriate to protect franchisees or others will need to muster their best evidence to convince Congress and state legislators that protection is needed. Once a legislature has concluded that protective legislation is necessary and beneficial, courts should not rely on their own economic theories to
vitiates the law. That is, when courts, attorneys, or commentators suggest that courts should use economic arguments to reject policies set out in legislation, they may be improperly suggesting that judges substitute their own thinking for that of the legislature.

Mandatory Arbitration in Consumer and Employment Contexts

The practice of using standard form contracts to impose mandatory binding arbitration is by no means unique to the franchise arena. Employers are increasingly imposing such clauses on their nonunionized employees. Banks are including them in loan documents and checking account agreements. Credit card companies are sending them out in small print as part of "envelope stuffers" that are intermingled with regular bills. Lenders or car dealers are putting them into car loan contracts. Computer manufacturers are including them in informational booklets sent out with mail-order computers. Medical providers are insisting that patients sign such clauses along with medical consents. Pest exterminators are placing them in the small print on the back of service contracts. Mobile home dealers are inserting them into sales contracts and even inconspicuously placing warranty booklets in a drawer of the mobile home kitchen. According to one report, even a cereal box was found to contain an arbitration provision. 25

As in the franchise context, the arbitration clauses that are imposed on employees and consumers vary dramatically from one another. Some require arbitration before a nonneutral arbitrator or preclude the award of otherwise available punitive damages, compensatory damages, attorneys' fees, and costs. Some shorten the statute of limitations or explicitly prohibit class actions. Still others select a geographic venue that is quite inconvenient to the party on whom arbitration is imposed or impose arbitration costs that are so high that they may realistically preclude the filing of a demand for arbitration.

Although a series of U.S. Supreme Court cases have largely supported business's imposition of mandatory arbitration in the consumer and employment settings, 26 the potentially adverse and unfair effects of such clauses are increasingly being recognized by some courts, policymakers, arbitral organizations, and academic commentators. 27 Thus, in some highly publicized cases, courts have refused to enforce arbitration clauses that were found to have prevented consumers or employees from adequately protecting their federal statutory rights. For example, in Duffield v. Robertson Stephens & Co., 28 the Ninth Circuit held that employers could not use mandatory predispute arbitration clauses to compel employees to arbitrate their claims under Title VII.

Several other federal circuits have held that particular arbitration clauses were unenforceable because they unduly restricted employees' opportunities to enforce their rights under federal statutes. 29 As well, federal courts have found that mandatory arbitration can be inconsistent with the federal bankruptcy code 30 or with the Magnuson-Moss consumer protection act. 31 Courts have also refused to enforce a number of arbitration clauses imposed on consumers or employees on a variety of contractual grounds, including unconscionability, 32 lack of an agreement, 33 failure to accord with reasonable expectations, 34 or fraud. 35

Meanwhile, the federal Equal Employment Opportunity Commission has taken a leading role in opposing the use of mandatory arbitration in the employment context. It issued a policy statement enunciating that predispute arbitration agreements are "inconsistent with the [federal] civil rights laws..." 36 This statement emphasized that arbitration would deny claimants a jury trial, limit discovery, deny class relief, and allow repeat player/employers "to manipulate the arbitral mechanism to [their] benefit." 37

The securities industry was attacked so sharply for its practice of compelling employees to arbitrate all employment and other disputes that it backed away from the practice. The change can be attributed to numerous news reports that placed the industry's program in a bad light and to congressional pressure. 38

Finally, in response to growing criticism of mandatory binding arbitration, a number of arbitral organizations have issued "due process protocols." Issued protocols commonly oppose clauses that are unfair and state or imply that these arbitral organizations will refuse to administer such clauses. Arbitral unfairness has been spelled out to include clauses that elect nonneutral arbitrators, deny statutory remedies, eliminate adequate discovery, or impose high costs. The best known of such protocols are the three issued by the American Arbitration Association, in conjunction with other organizations, that deal with employment, consumer claims, and medical care disputes. 39 The health care protocol, which goes the furthest in providing arbitral process protections, permits only postdispute agreements to binding arbitration. 40 It has been endorsed by the American Bar Association. 41

Do Franchisees Need Special Protection?

Franchisees who believe that particular arbitration clauses do not serve their interests may be able to defeat such clauses using some of the same kinds of arguments that have worked in the employment and consumer context. Although courts and policymakers may not all view franchisees as sympathetically as they view employees and consumers, numerous federal and state laws recognize that at least some franchisees should be afforded special protection.
state legislatures, and the courts, after concluding that there is often a significant power disparity between franchisors and franchisees, have all taken steps to protect franchisees against potentially unfair contractual agreements. Such protective legislation and court decisions are typically based on a finding that franchisees often, if not always, are significantly less sophisticated than franchisors. Franchisees may be relatively uneducated persons who are using their life savings to purchase a franchise. Also, franchisees may not always be sophisticated enough to secure legal advice before entering into franchise agreements, particularly when franchisors push them to agree to terms quickly.

At the federal level, several bodies of law are designed to protect franchisees from potential franchisor abuses. Most generally, the Federal Trade Commission’s (FTC) Trade Regulation Rule, Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, requires franchisors engaged in interstate commerce to make specific disclosures to potential franchisees. Failure to make mandated disclosures is labeled an “unfair or deceptive act or practice within the meaning of Section 5 [of the Federal Trade Commission Act].” The report issued by the FTC in connection with the disclosure rule repeatedly referenced such factors as “the relative lack of business experience of most prospective franchisees, the highlighting of unusually successful franchisees by franchisors and the popular press, and . . . the informational imbalance present between prospective franchisee and franchisor . . .”

In addition, Congress has passed legislation geared to protect franchisees from abusive practices in two specific business areas. First, the Automobile Dealer’s Day in Court Act was passed in 1956 “to balance the power now heavily weighted in favor of automobile manufacturers.” This statute, which applies to franchise agreements between automobile manufacturers and dealers, requires franchisors to act in “good faith” in enforcing terms of the agreement or in terminating the franchise. Second, the Petroleum Marketing Practices Act (PMPA) limits the circumstances in which motor fuel suppliers can terminate or fail to renew contracts of their franchisees. Initially passed in 1978 and amended in 1994, the PMPA was deemed necessary to correct the great “disparity of bargaining power” between petroleum franchisors and franchisees. In passing the PMPA, the Senate noted franchisee complaints that petroleum franchise agreements are “contracts of adhesion” and found that such contracts “may translate the original disparity of bargaining power into continuing vulnerability of the franchisee to the demands and actions of the franchisor.”

State laws regarding franchises vary substantially. Some states have concluded that the imbalance of power between franchisors and franchisees is such that franchisees must be provided with special protections. For example, in Electrical & Magneto Service Co. v. AMBAC International Corp., the Eighth Circuit concluded that “the Missouri Legislature created a legislative presumption that franchisees are in an inferior bargaining position with respect to franchisors and thus are entitled to protection from the oppressive use of the franchisor’s superiority.” In light of such findings, some states have restricted the circumstances under which franchises may be terminated, some have prohibited franchisors from mandating out-of-state forums, some have required franchisors to register before selling franchises within their state, some have required that franchisors provide certain disclosures to franchisees, and some have issued court decisions interpreting anti-waiver provisions to prohibit franchisors from using choice-of-law provisions to defeat claims or defenses under local franchise law. On the other hand, a substantial number of states do not have special legislation geared to protect franchisees.

Attacking Mandatory Arbitration Clauses Imposed on Franchisees

U.S. Constitution
The Seventh Amendment’s guarantee of a jury trial in cases brought at common law potentially offers strong protection to franchisees, although to date courts have rarely used it to void privately imposed mandatory arbitration clauses. The U.S. Supreme Court and lower courts have repeatedly enunciated that the right to a jury trial may only be waived knowingly and voluntarily and that courts should “indulge every reasonable presumption against waiver.” As the Court has repeatedly observed, “[t]he trial by jury is justly dear to the American people. It has always been an object of deep interest and solicitude, and every encroachment upon it has been watched with great jealousy.”

Taking into account the importance of the right to a jury trial, courts have frequently held that a jury trial waiver contained in a franchise agreement is not necessarily enforceable. Rather, enforceability depends on such factors as: (1) the parties’ relative bargaining power, (2) the conspicuousness of the waiver, (3) the degree to which the waiver was bargained for, (4) the extent to which the agreement was subject to negotiation, and (5) the disparities between the parties’ business and professional experience. For example, in AAMCO Transmissions, Inc. v. Marino, the district court invalidated a jury trial waiver imposed on a franchisee in a preprinted form contract. Emphasizing that “[n]o [franchisee] . . . was able to negotiate the terms of his franchise agreement or to alter any of its terms,” and that the fran-

Courts have frequently held that a jury trial waiver contained in a franchise agreement is not necessarily enforceable.
franchisees “possessed virtually no bargaining power,” the court concluded that they did not voluntarily waive their right to a jury trial. Similarly, in Dreiling v. Peugeot Motors of America, Inc., the district court refused to enforce a jury trial waiver contained in the dealer agreement signed by the franchisee. It stated:

[Franchisors] have presented no evidence that the waiver provision was a bargained for term of the contract, was mentioned during negotiations, or was even brought to the [franchisees’] attention. In fact, the [franchisors] have failed to show that the [franchisees] had any choice other than to accept the contract as written. The 1978 Agreement appears to be Peugeot’s standardized printed dealer contract, drafted by Peugeot. Obviously, the [franchisees] had little, if any, opportunity to negotiate the provisions. Absent proof to the contrary, such an inequality in relative bargaining positions suggests that the asserted waiver was neither knowing nor intentional.

Other courts have upheld a jury trial waiver contained in a franchise agreement only because the particular franchisees or other businesspersons were relatively knowledgeable and sophisticated. Although it is clear that a binding arbitration agreement necessarily includes a jury trial waiver, courts have not typically treated arbitration clauses as waivers of federal constitutional rights. Parties seeking to challenge arbitration agreements have not frequently made constitutional arguments, and in the few cases in which they have, they have often met with little success.

Thus, courts have frequently enforced arbitration clauses without pausing to consider whether the parties had “knowingly and voluntarily” waived their jury trial right and without taking into account the “presumption against waiver” of constitutional rights. Instead, courts have often cited the Federal Arbitration Act’s “favoritism” toward arbitration in insisting that form arbitration clauses are enforceable. They frequently uphold arbitration clauses without taking into account the factors that would normally be considered in construing a jury trial waiver, such as the clarity of the waiver, its conspicuousness, and the parties’ degree of knowledge, power, and sophistication. Mr. Dunham states that in contrast to jury trial waivers, “arbitration agreements are routinely enforced; even when the clause was inconspicuous and never negotiated, there was clearly disparate bargaining power and the franchisee never had a lawyer review the agreement.”

Upon reflection, in those cases where a federal jury trial would otherwise have been available, courts’ refusal to treat contracts to binding arbitration as waivers of the jury trial seems unjustified. Clearly, the federal Constitution trumps any “favoritism” contained in a federal statute. Nor is it proper for courts to simply sidestep the constitutional arguments, by concluding that an “agreement” to arbitrate necessarily waives the jury trial right, without considering whether in fact the jury trial right was properly waived. Were courts to treat arbitration clauses properly as jury trial waivers, they would not be compelled to void all such waivers. Numerous cases within and without the franchise context have established that jury trial waivers can be permitted in the commercial context. However, courts would be required to make a determination of whether or not the arbitration agreement had been entered into knowingly and voluntarily. In doing so, they would need to consider factors such as the clarity of the waiver and the relative knowledge and sophistication of the parties. Thus, where franchisees are relatively knowledgeable and sophisticated or where they secure legal representation, courts will likely find that their jury trial right has been knowingly and voluntarily waived. By contrast, in a situation where a form contract is used to impose binding arbitration on an unsophisticated franchisee, and particularly where that franchisee has no legal representation or is given limited time to review the contract, the Seventh Amendment argument should often prevail.

**Federal Statutes**

The U.S. Supreme Court has explained that arbitration clauses are unenforceable when they prevent persons from enforcing their rights under a federal statute. As the Court has repeatedly stated, courts should compel arbitration only “so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum [such that] the statute will effectively may vindicate [his or her] statutory cause of action in the arbitral forum [such that] the statute will continue to serve both its remedial and deterrent function.” Moreover, it is clear that Congress has the power to provide that claims brought under a particular statute are not arbitrable. To determine whether Congress has provided that claims under a particular statute are nonarbitrable, the Court has directed lower courts to consider not only the text and legislative history of the statute, but also whether there might be “an inherent conflict” between arbitration and the statute’s underlying purposes.

Therefore, depending upon the language and legislative history of the particular federal statute under which they brought a claim, franchisees might be able to argue that a given federal statute entirely prohibits mandatory arbitration. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc. held in 1985 that car distributors had failed to show that Congress intended to preclude arbitration of antitrust claims brought in an international context, but left open the possibility that courts might interpret other federal legislation to preclude arbitration altogether. Outside the franchise context, several courts have found that mandatory arbitration of particular claims was entirely precluded by a federal statute.

Alternatively, franchisees might present the more narrow
eral rule, nonarbitrable, the Ninth Circuit struck the clause as
violating the PMPA. It stated:

[T]he fact that franchisees may agree to an arbitral forum for the res-
olution of statutory disputes in no way suggests that they may be
forced by those with dominant economic power to surrender the
statutorily-mandated rights and benefits that Congress intended them
to possess. This is certainly true in cases arising under the PMPA,
which was enacted to shield franchisees from the “gross disparity of
bargaining power” that exists between them and franchisors. If fran-
chises could be compelled to surrender their statutorily-mandated
protections as a condition of obtaining franchise agreements, then
franchises could use their superior bargaining power to deprive
franchisees of the PMPA’s protections. In effect, the franchisors
could simply continue their earlier practice of presenting prospective
franchisees with contracts of adhesion that deny them the rights and
benefits afforded by Congress. In that way, the PMPA would quick-
ly be nullified.97

The Graham Oil rationale can be extended to protect fran-
chises’ rights under other federal statutes such as the
antitrust laws or the Racketeer Influenced and Corrupt Orga-
nizations Act when the arbitration clause is particularly egre-
gious. Courts have recognized that federal statutes may
potentially render arbitration clauses unenforceable where
the clause calls for a biased arbitrator,98 where it eliminates
certain types of relief,99 or where it imposes excessive costs.100

Plaintiffs also might argue that they cannot be compelled to
arbitrate their claims under a particular federal statute
because arbitration would deprive them of their right to pro-
cceed in a class action. In some cases, the viability of class
actions is critical to allow franchisees to bring their claims
against franchisors. A claim that might be too small or too
complex to be litigated by an individual franchisee may more
practically be pursued by a group of franchisees in a class
action. Class actions may be used where franchisees’ factual
or legal claims are sufficiently similar to warrant class certifi-
cation and have been approved by the courts in the franchise
context for certain antitrust, fraud, or other claims.101

In a case where the class action seems critical, franchisees
may seek to argue that the right to proceed by class action is
guaranteed by the language, legislative history, or purpose of
a particular federal statute. One Delaware district court deci-
sion, albeit one recently reversed on appeal, concluded that
the language, legislative history, and overall intent of the
Truth in Lending Act (TILA) precluded a court from comp-
elling arbitration of a putative class action brought under that
statute.102 In so doing, the court focused on the legislative his-
tory of the TILA and, specifically, the damage cap for class
actions set out in section 1640. It stated that “[t]he intended
purpose of the TILA “was to encourage class actions in the
truth-in-lending context because of the apparent inadequacy
of the Federal Trade Commission’s enforcement resources
and because of a continuing problem of minimum compli-
ance with the Act on the part of creditors.”103 Although this
argument was rejected on appeal and has been rejected by
several other courts,104 it provides an important example for
franchisees who might hope to prove the importance of pro-
cceeding by way of class action under the TILA or other
statutes. Note also that the U.S. Supreme Court may conceiv-
ably address the question of whether the TILA guarantees a
right to proceed by class action when it decides Green Tree
Financial Corp.—Alabama v. Randolph.105

The question of whether arbitration clauses can be voided
for eliminating class actions is particularly important in that a
number of federal courts have, albeit without adequate analysis,
rejected the possibility of proceeding by class action in arbitra-
tion, unless the arbitration clause specifically allows for arbitral
class actions.106 These decisions have led some franchise attorney
soys to suggest that arbitration is a shield against class
actions.107 However, these decisions fail to adequately explain
why a silent clause should be deemed to proscribe rather than
permit arbitral class actions108 and ignore significant differences
between consolidated arbitrations and class actions.109 Signifi-
cantly, both California and Pennsylvania state courts have
reached a contrary conclusion to the federal courts by holding
that class actions may proceed in arbitration.110 Both the Cali-
ifornia and Pennsylvania decisions have required the judge to
play a very active role in such class issues as certification and
notice,111 and attorneys who have handled arbitral class actions
in California report that active judicial participation is the
norm.112 Although the U.S. Supreme Court has not ruled on
whether class actions might be handled in arbitration, it has
suggested in dicta that such a proceeding might be possible.113

State Constitutions and Statutes
Many state constitutions and state statutes contain provisions
that franchisees might use to defeat mandatory arbitration
provisions. State constitutions often guarantee rights to a jury
trial or access to the courts, and a few courts have made men-
tion of such rights in striking mandatory arbitration clauses.114 State statutes may provide for nonwaivable substantive
remedies, may regulate the way in which arbitration clauses
are provided to franchisees, or may purport to eliminate arbi-
tration altogether in certain contexts. In addition, many state
legislatures and state courts have prohibited franchisors from
requiring franchisees to file their claims in distant forums,
concluding that such clauses may impose an unfair and
sometimes impassable burden on franchisees who attempt to
protect their legal rights.115

However, franchisors are increasingly using arbitration
clauses to avoid these limitations. Several courts have explic-
ity held that state legislatures have no right to prohibit forum selection clauses contained in arbitration agreements, even though they may restrict the use of forum selection clauses in litigation. Specifically, these courts have concluded that the application of the prohibition on forum selection clauses to the arbitration context is preempted by the Federal Arbitration Act (FAA).106 Where a state law is found to target arbitration clauses for elimination, the U.S. Supreme Court and lower courts have consistently found the provision to be preempted. For example, in Doctor’s Associates, Inc. v. Casarotto,107 a 1995 case involving a Subway sandwich shop franchise, the Court held that the FAA preempted a Montana statute that regulated the placement of an arbitration provision in a contract.108 Ten years earlier, in Southland Corp. v. Keating,109 the Court held that California’s franchise statute was preempted to the extent that it was interpreted to prohibit arbitration of claims brought under that statute.110

Nonetheless, it should be possible for franchisees to argue that certain state constitutional provisions or state statutes may void an arbitration provision without being preempted under the FAA. Not all state laws that might invalidate an arbitration clause are necessarily preempted. Rather, the U.S. Supreme Court has repeatedly stated (as does the FAA itself) that arbitration clauses may be voided using general contract defenses such as unconscionability, fraud, or duress. Moreover, the Court has emphasized that the problematic state laws are those that target arbitration clauses, and has never said that a law that seeks to protect franchisees or others in both litigation and arbitration would be preempted. Thus, where an arbitration clause contains provisions that would prevent franchisees from exercising their rights under a particular state constitution or law, courts should be able to void at least those aspects of the clause. Congress never intended for arbitration to be a shield that companies could use to impose egregious terms that would be impermissible in the litigation context. Rather, Congress merely sought to ensure that courts would not, on a general basis, refuse to enforce arbitration provisions.

For example, despite several federal appellate decisions to the contrary,111 franchisees should be able to void a forum selection clause contained in an arbitration agreement where state law prohibits clauses that mandate a foreign forum in both litigation and arbitration.112 The Montana Supreme Court so held in 1998 in Keystone, Inc. v. Triad Systems Corp.,113 concluding that state provisions barring Montana residents from being required to litigate claims out of state were not preempted by the FAA, and that an arbitration clause imposed on an automotive parts distributor was enforceable to the extent that it mandated out-of-state arbitration.114 It explained:

In some cases, the viability of class actions is critical to allow franchisees to bring their claims against franchisors.

[We read Casarotto to stand for the proposition that a state law may not "place arbitration clauses on an unequal 'footing' ... As we stated above, § 28-2-708, MCA, invalidates choice of forum provision[s] in contracts generally. Section 27-5-323[,] MCA, does the same to arbitration agreements. Montana law, therefore, does not distinguish between forum selection clauses which are part of contracts generally and forum selection clauses found in agreements to arbitrate. ... The lack of such a distinction is evidence that the statute does not conflict with the FAA.115

Similarly, state constitutional or statutory provisions that protect generally against unknowing or involuntary loss of the jury trial right, or against mandatory forum selection clauses including arbitration, should not be held preempted. Such provisions are not targeted against arbitration, but rather are geared to protect certain rights in all contexts, including arbitration. Outside the franchise context, several courts have refused to enforce arbitration provisions that did not comply with policy encompassed in state laws and have held that the FAA did not preempt such provisions. For example, in Srawn v. AFC Enterprises, Inc.,116 a Texas federal district court recently held that an employer that opted out of the Texas workers’ compensation plan and also imposed mandatory arbitration had acted inconsistently with the policy underlying that state’s workers’ compensation statute, that the arbitration clause was therefore void, and that this conclusion was not preempted by the FAA.117

Contract Law

It is well recognized that standard contractual defenses can be used to void or at least reform an arbitration clause. Thus, franchisees who have strong arguments of unconscionability as to the arbitration clause should not be compelled to arbitrate their claims. Courts have accepted unconscionability arguments with respect to clauses that mandate a potentially biased arbitrator,118 that impose excessive costs,119 or that limit available remedies.120 Two courts have also held that the fact that a clause denies claimants access to a class action may contribute to a finding of unconscionability.121 Franchisees who are relatively less sophisticated or experienced will often have stronger unconscionability claims than those who are experienced businesspersons.

Other contractual arguments have worked as well. For example, several franchisees have defeated forum selection clauses contained in franchise agreements using the contractual argument of no “meeting of the minds.”122 In addition, franchisees should be able to defeat a clause where they can make a showing of fraud123 or duress.124 Note however that a franchisee who attacks the contract in general, rather than the arbitration clause in particular, may be required to make his or her arguments to the arbitrator rather than to a court.125
Countering Franchisors’ Forum Shopping Strategies

When franchisees and franchisors battle over the validity of an arbitration clause, the location of the battleground may prove critically important. For reasons that are not entirely clear, both advocates and opponents of mandatory arbitration agree that the federal courts tend to be more enthusiastic than the state courts in enforcing mandatory arbitration provisions.\(^{126}\) Thus, franchisor attorneys use forum shopping as an additional procedural tool to assist them in employing arbitration clauses to secure strategic advantages over franchisees. Mr. Dunham has recommended that when franchisees file suit against franchisors in state court, franchisors should often file a separate suit in federal court, and then seek not only an order compelling arbitration of the dispute, but also an antisuit injunction barring the state court from further considering the matter.\(^{127}\) Despite arguments that enjoining state courts often violates federalism principles, impinging on the legitimate authority of state courts, a number of federal courts have acceded to both requests.\(^{128}\)

Where franchisors seek to have federal courts enjoin franchisees’ claims in state court, franchisees should be prepared to use a number of federal jurisdiction statutes and doctrines to prevent such forum shopping.\(^{129}\) Franchisees can potentially make arguments citing the federal Full Faith and Credit statute,\(^{130}\) the Rooker-Feldman doctrine,\(^{131}\) the Anti-Injunction Act,\(^{132}\) traditional equitable principles,\(^{133}\) and various types of abstention.\(^{134}\) In general, these doctrines provide that the further the state court action has progressed, the less subject it should be to antisuit injunction by a federal court.

The Necessity of Legislative Reform

Legislation is currently pending in both houses of Congress that is geared to protect at least some franchisees and distributors from mandatory arbitration. In the House of Representatives, the proposed Fairness and Voluntary Arbitration Act\(^{135}\) would permit postdispute rejection of arbitration in any “sales and service contract.” It defines these as “a contract under which any person (including any manufacturer, importer, or distributor) sells any product to any other person for resale to an ultimate purchaser and authorizes such other person to repair and service such product.” The bill currently has 212 cosponsors.\(^{136}\) In the Senate, the Motor Vehicle Franchise Contract Arbitration Fairness Act of 1999\(^{17}\) is geared to protect motor vehicle franchisees from mandatory arbitration imposed by manufacturers and would allow them to reject such arbitration after the dispute.\(^{138}\) This bill has thirty-seven Republican and Democratic cosponsors.\(^{139}\) Franchisees may wish to support this pending legislation or to lobby for broader protections for franchisees and perhaps others. Note that legislation has also been introduced to protect consumers and employees from mandatory binding arbitration.\(^{140}\)

Conclusion

The use of binding arbitration clauses in franchise agreements is controversial. There would be no consensus among readers of this Journal as to whether or how often such clauses are harmful to franchisees. Moreover, many debate the empirical question of whether franchisees are typically relatively unsophisticated individuals, deserving of protection from powerful franchisors, or whether instead they tend to be experienced and sophisticated businesspersons who should be held to the fine print of their contracts.

Consensus need not be reached on these issues in order for legislatures and courts to protect franchisees. Legislatures that conclude that franchisees are entitled to protection can pass legislation geared to achieve those ends. Once a legislature has concluded that franchisees are entitled to protection, courts should enforce such a provision unless the state legislation is tailored so narrowly to arbitration that it is found to be preempted by the FAA. Moreover, to resolve questions as to whether franchisees have voluntarily and knowingly waived their jury trial rights, whether a particular arbitration clause is inconsistent with federal statutes, or whether that clause is void for unconscionability or other contractual reasons, courts need not make a general determination as to the nature of franchisees. Instead, courts need only focus on the litigants who appear before them. Where a particular franchisee is relatively unsophisticated, lacks adequate legal counsel, and has been overwhelmed by a powerful franchisor, courts should be more willing to refuse to enforce an arbitration clause on the ground that the franchisee did not knowingly or intelligently waive its jury trial right or on the ground that the clause is unconscionable. Where the terms of a particular arbitration clause are such that the franchisee would be denied its rights under federal law, the court should hold the clause unenforceable in whole or in part, even where the court believes that arbitration is, as a general rule, permitted or even favored. In short, courts must get beyond pro-arbitration rhetoric and examine economic realities to determine whether particular arbitration clauses are enforceable under existing law.

Endnotes

1. This article expands upon the ideas presented in an article written earlier by the author: Jean R. Sternlight, Fighting Arbitration Clauses Designed to Limit Franchisor Liability, Trial (forthcoming Oct. 2000). The author extends her gratitude for the help provided by her research assistant, Brian Beatte, and for the research stipend pro-
vided by the University of Missouri-Columbia School of Law.


3. Id. at 91.


5. Dunham, supra note 2. Of course, Mr. Dunham does not admit that the arbitration cases are wrongly decided, but, rather, argues that the protections that have been eliminated within arbitration should also be eliminated in the litigation context. He uses a “freedom of contract” argument. Id. at 99, citing L&H Realty v. Connecticut Nat’l Bank, 715 A.2d 748, 753 (Conn. 1998) (“Arbitration agreements illustrate the strong public policy favoring freedom of contract and the efficient resolution of disputes. These policies are also furthered by a jury trial waiver clause.”).

6. The “favored” language itself is somewhat puzzling. The Court has never explained whether it simply means that arbitration is looked upon with favor, or whether it actually means that arbitration should be favored over litigation. Furthermore, if the latter position is taken, it is difficult to see from whence such a favoritism of arbitration over litigation would derive. Certainly neither the language nor the legislative history of the Federal Arbitration Act (FAA) would seem to support such a view. In passing the Act, Congress simply expressed a desire to allow businesses to enter into a mutually desirable and enforceable contract to arbitrate future disputes. Congress never enunciated the more extreme position that arbitration should be preferred over litigation. Indeed, although the FAA was enacted in 1925, the Court never mentioned a federal policy “favoring” commercial arbitration until it decided Moses H. Cone Memorial Hospital v. Mercury Construction, 460 U.S. 1, 24-25 (1983). Yet, as attorney Cliff Palefsky has observed: “There is a big difference between eliminating a hostility and stating a preference, with a whole lot of room in between.” Cliff Palefsky, Arbiterary Arbitration: The Founders Would Frown on Mandatory ADR, S.F. DAILY, Mar. 1, 1995, at 4. See also Jean R. Sternlight, Panacea or Corporate Tool?: Debunking the Supreme Court’s Preference for Binding Arbitration, 74 WASH. U. L.Q. 637, 660-62 (1996) (discussing emergence of “favoritism” for binding arbitration).

7. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 n.19 (1985) (noting that “in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of [the plaintiff’s] right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy”).


10. Gilmer, 500 U.S. at 30-32. The Court found that a registered securities representative could be required to arbitrate his age discrimination claim where he had failed to show the process to be lacking in such respects as neutrality, available discovery, potential appeal, use of a written decision, or the availability of classwide relief. Id. However, while rejecting Mr. Gilmer’s “generalized attacks,” id. at 30, the Court recognized that other claimants who could make a stronger factual showing would be able to defeat certain arbitration clauses. Id. at 33.


12. Id. at 43, 51.

13. Id. at 47.

14. Id. at 49-50. Such clauses, for example, allowed franchisors to litigate trademark disputes, actions seeking equitable relief, the recovery of money due under the franchise agreement, termination of the franchise agreement, repossession of real or personal property, and the enforcement of covenants not to compete.

15. Id. at 41.

16. Id.

17. Id. at 46, 68.

18. Id. at 36, 42, 44-47. Note that Professor Drahozal found that those franchisees that were not using arbitration clauses to secure favorable forums and other advantages were often trying to accomplish similar results without requiring arbitration. The most common of the nonarbitration provisions that he studied were forum selection and fee-shifting clauses. Franchise agreements containing forum selection clauses often placed time limits on the filing of claims and restricted the available relief. In “virtually every franchise agreement” studied by Professor Drahozal, the franchise agreement “contained at least some provisions of the sort arbitration critics have identified as unfair.” Id. at 42.

19. Id. at 51.

20. Id.

21. Id. at 76-77.

22. See Sternlight, supra note 6, at 689-93. See also Paul D. Carrington, The Dark Side of Contract Law, TRIAL, May 2000, at 73 (pointing out that whereas the argument that consumers benefit from seemingly unfair form contracts depends on assumptions that “the market works,” in fact “market failure” is far more likely given profound disparities of information and given the impossibility of adequately predicting future events).

23. Instead, [E]conomists generally recognize that where one party lacks information as to the cost of a non-price term in a contract, there will be two inefficiencies: a quantity effect and a quality effect. The quantity effect will cause the consumer to purchase too much of the item because she will not recognize its full cost. The quality effect will cause the parties to enter into the wrong contract—one containing a binding arbitration clause—even in circumstances where a fully knowledgeable consumer would have refused to accept such an agreement.


26. See, e.g., Allied-Brace Terminix Cos. v. Dobson, 513 U.S. 265, 270-82 (1995) (holding that purchaser of termite protection services could be compelled to arbitrate claim against company, even though Alabama statute precluded enforcement of such clauses, because the FAA preempted the Alabama statute); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24-35 (1991) (determining that securities industry employee could be compelled to arbitrate age discrimination claim against employer).

27. Two of the most frequently cited academic critiques of mandatory binding arbitration are Paul D. Carrington & Paul H. Haagen, Contract and Jurisdiction, 1996 SUP. CT. REV. 331, 401 (1997) (discussing the U.S. Supreme Court’s interpretation of arbitration law that will allow “birds of prey” to “sup on workers, consumers, shippers, passengers, and franchisees”), and David Schwartz, Enforcing Small Plaint to Protect Big Business: Employee and Consumer Right Claims in An Age of Compelled Arbitration, 1997 WIS. L. REV. 33, 36 (proclaiming that “[t]he Supreme Court has created a monster”). See also Sternlight, supra note 6.

28. 144 F.3d 1182, 1189-90 (9th Cir. 1998).

even though such timely appointment had occurred in only one percent
reasoning that waiver of jury right was not conspicuous or explicit and
was provided among other preliminary forms and where it stated that
P.2d 1013, 1016-17 (Ariz. 1992) (holding unenforceable a binding
did not mandate arbitration of subsequent tort action based on common
that agreement to arbitrate contained in purchase and sale agreement
company, in part because elimination of class action remedy con-
mission of Health Care Dispute Resolution, July 27, 1998) (on file with
standards of procedural fairness and due process. In addition, the
process imposed on employees, in part because clause deprived employees of opportunity to bring class actions, rev’d, 94 Cal. Rptr. 2d 1 (Cal. 2000); Powers-
33. See, e.g., Badie v. Bank of Am., 79 Cal. Rptr. 2d 273, 287-91 (Cal. Ct. App.1998) (finding that bank customers had not consented to arbitration merely by agreeing that the bank could unilaterally change any “term, condition, service, or feature” of the account); Seifert v. U.S. Home Corp., 750 So. 2d 633, 642-43 (Fla. 1999) (taking note of policy arguments opposing deprivation of jury trial rights in holding that agreement to arbitrate contained in purchase and sale agreement did not mandate arbitration of subsequent tort action based on common law duties).
34. See, e.g., Broemmer v. Abortion Servs. of Phoenix, Ltd., 840 P.2d 1013, 1016-17 (Ariz. 1992) (holding unenforceable a binding arbitration clause that all patients were required to sign where clause was provided among other preliminary forms and where it stated that arbitrators must be physicians specializing in obstetrics/gynecology, reasoning that waiver of jury right was not conspicuous or explicit and clause exceeded reasonable expectations of patient).
35. See, e.g., Engalla v. Permanente Med. Group, 938 P.2d 903, 922 (Cal. 1997) (concluding that evidence supported claim that the health maintenance organization (HMO) fraudulently induced plan participant to enter arbitration agreement where arbitration agreement called for appointment of neutral arbitrator within sixty days of filing of claim, even though such timely appointment had occurred in only one percent of cases during previous years, and where substantial delays were attributable to HMO).
ing as "void and unenforceable" any "provision requiring that arbitra-

tion or litigation be conducted outside this state"); P.R. LAWS ANN. tit. 10 § 278-2 (1997) (proclaiming that any provision obligating a "dealer" to "adjust, arbitrate or litigate any controversy that comes up regarding his dealer's contract outside Puerto Rico, or under foreign law or rule of law . . . violat[es] public policy . . . and therefore is null and void"); R.I. GEN. LAWS § 19-28.1-14 (1989) (providing that "[a] provision that [sic] a franchise agreement restricting jurisdiction or venue to a forum outside this state or requiring the application of the laws of another state is void"); S.D. CODEFED LAWS § 37-5A.5.11 (1994) (same).

55. One author recently reported that approximately fifteen states regulate the offer and sale of franchises, typically by presale registration of franchise offerings and presale disclosure to prospective franchisees. Gilbert, supra note 53 at 58, 59. For examples, see CAL. CORP. CODE § 31110 (West 1977) (making it unlawful to offer or sell a franchise without registering); 815 ILL. COMP. STAT. ANN. 705/5(1), 705/10 (West 1999) (requiring registration with the state); IND. CODE ANN. § 23-2-2.59(1) (Michie 1999) (prohibiting sale or offer of franchise without registration); MD. CODE ANN. BUS. REG. § 14.113 (1998) (same); MICH. COMP. LAWS §§ 445.1507(a) (1989) (mandating that notice must be provided to the state, along with a $250 fee, prior to offering or selling any franchise); MINN. STAT. ANN. § 80C.01 (West 1999) (requiring registration with the state); VA. CODE ANN. § 13.1-560 (Michie 1999) (prohibiting franchising without registration); WASH. REV. CODE ANN. § 19.100.020 (West 1999) (requiring registration).


57. See generally Reva S. Bauch, An Update on Choice of Law in Franchise Agreements: A Trend Toward Unenforceability and Limited Application, 14 FRANCHISE L.J. 91 (1995) ("Most courts hold that franchise and distribution statutes represent the fundamental policy of their respective states. As a result of such a finding, most courts conclude that choice of law provisions are unenforceable if they would defeat claims or defenses under otherwise applicable franchise or distribution laws."); Thomas M. Pitegoff, Choice of Law in Franchise Relationships: Staying Within Bounds, 14 FRANCHISE L.J. 89 (1995).


61. See, e.g., Hendrix, 565 F.2d at 258 (refusing to enforce jury trial waiver imposed on borrower by lender where waiver was inconspicuous, where borrower had no choice but to accept contract as written to obtain badly needed funds, and where there was a gross inequality in bargaining power); Marino, 1990 WL 100254, at *1, *2 (refusing to enforce provision that was no more or less conspicuous than other provisions in ten-page standard form contract, because franchisees possessed virtually no bargaining power and waiver provision was not subject to negotiation); Dreiling, 539 F. Supp. at 403 (refusing to enforce jury trial waiver where there was no evidence that waiver was either bargained for or brought to franchisees' attention, where franchisees had little if any opportunity to negotiate clause, and where there was inequality in the relative bargaining positions of the parties); Sullivan v. Ajax Navigation Corp., 881 F. Supp. 906, 910–11 (S.D.N.Y. 1995) (refusing to enforce waiver on grounds that the presumption against waiver is strong, and the burden of proving that the waiver was "knowingly and intentionally" made rests on the party seeking to enforce it). Note that there is a split regarding whether it is the party seeking waiver or the party opposing waiver who carries the burden of proof on these factors. Compare Leasing Serv. Corp. v. Crane, 804 F.2d 828, 833 (4th Cir. 1986) (placing burden on party seeking enforcement of waiver), and Hendrix, 565 F.2d at 258 (same) with K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 758 (6th Cir. 1985) (placing burden on party seeking to invalidate waiver). See generally MOORE'S FEDERAL PRACTICE § 38.52[3] (3d ed.) (surveying contractual waiver of jury trial).


64. Id.

65. Id.


67. Dreiling, 539 F. Supp. at 403.

68. See, e.g., Telum Inc. v. L.F. Hutton Credit Corp., 859 F.2d 835, 837 (10th Cir. 1988) enforcing contractual waiver of jury trial where both parties were sophisticated and provisions was in normal print size of contract); Leasing Serv. Corp. v. Crane, 804 F.2d 828, 833 (4th Cir. 1986) (enforcing jury trial waiver where agreement was only two pages long; where parties were not manifestly unequal in bargaining positions in that lessees, while lacking in formal education, were successful and shrewd businessmen; where parties engaged in protracted negotiation over contract; and where lessees insisted on handwritten modification to proposed contract); Westside-Marrero Jeep Eagle, Inc. v. Chrysler Corp., 56 F. Supp. 2d 694, 705-09 (E.D. La. 1999) (upholding jury trial trial, despite evidence of some inequality of bargaining power, where parties to dealership agreement were experienced businesspeople and were represented by counsel, though counsel did not review the contracts containing the jury trial waiver); Smly v. Hyundai Motor Am., 762 F. Supp. 428, 430 (D. Mass. 1991) (enforcing jury trial waiver imposed on dealer that the court found was a "sophisticated businessman," where clause was set out in capital letters in an introductory table of contents, and where dealer admitted that he would have accepted clause had he realized that it was there); Bonfield v. AAMCO Transmissions, Inc., 717 F. Supp. 589, 594–96 (N.D. Ill. 1989) (enforcing parties were sophisticated and provision was in normal print size of contract); Hendrix, 565 F.2d at 258 (same).

69. See Persson v. Dean Witter Reynolds, Inc., 742 F.2d 334, 339 (7th Cir. 1984) ("[T]hough perhaps not contemplated by the [plaintiffs] when they signed the contract, loss of the right to a jury trial is a necessary and fairly obvious consequence of an agreement to arbitrate.") (emphasis omitted).

70. See infra text accompanying notes 107–20 for a brief discussion of the preemption issues that will be raised when franchisees seek to assert arguments under state constitutions.

71. See, e.g., Geldermann, Inc. v. Commodity Futures Trading Comm' n, 836 F.2d 310, 316–24 (7th Cir. 1987) (holding that large brokerage house agreed to submit to arbitration claims brought by customers when it agreed to membership in Chicago Board of Trade and also agreed to arbitrate certain disputes, and that it thereby waived any rights that it may have had to appear in an Article III court or to secure a jury trial in such court); Cremin v. Merrill Lynch Pierce Fenner & Smith, Inc., 957 F. Supp. 1460, 1470–71 (N.D. Ill. 1997) (dismissing registered securities representative's claims implicating Article III and the Seventh Amendment on grounds that agreement to arbitrate was
voluntarily made and holding that no constitutional protections are at risk if arbitration agreement is found to be valid); Illyes v. John Nuveen & Co., Inc., 949 F. Supp. 580, 583–84 (N.D. Ill. 1996) (concluding that plaintiff had consented to arbitration, thereby waiving rights to Article III forum and Seventh Amendment jury trial).

72. See, e.g., Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282, 286–88 (9th Cir. 1988) (upholding arbitration agreement imposed on securities customers and stating:

We know of no case holding that parties dealing at arm’s length have a duty to explain to each other the terms of a written contract. We decline to impose such an obligation where the language of the contract clearly and explicitly provides for arbitration. . . .

We are unable to understand how any person possessing a basic education and fluent in the English language could fail to grasp the meaning of that provision [i.e., that they were waiving right to go to court].

McCarthy v. Providential Corp., No. C94-0627 FMS, 1994 WL 387852, at *5 (N.D. Cal. July 19, 1994) (enforcing mandatory arbitration clause imposed on group of senior citizen homeowners who entered into “reverse mortgage loans” whereby they received cash advances secured by equity in their homes, although plaintiffs may well not have understood that they were waiving rights to trial, and stating that defendants had no duty to inform plaintiffs of the ramifications of a contract clause).

73. Dunham, supra note 2, at 96.

74. The Seventh Amendment provides that “the right of trial by jury shall be preserved in all ‘[s]uits at common law, where the value in controversy shall exceed twenty dollars.’ U.S. Const. amend. VII. To assess whether an action is ‘at common law,’ courts perform a historical analysis and, where the history is not determinative, examine the nature of the remedy sought, ordering a jury trial where the claim is ‘legal’ as opposed to equitable. Teamsters Local No. 391 v. Terry, 494 U.S. 558, 564 (1990). To date, the Seventh Amendment has not been applied to actions brought in state courts. Curtis v. Loether, 415 U.S. 189, 192 n.6 (1974).

75. This, in essence, is the approach taken by the decisions discussed supra in note 71.

76. See supra note 68. See also Herman Miller, Inc. v. Thom Rock Realty Co., 819 F. Supp. 307, 308 (S.D.N.Y. 1993), off’d. 46 F.3d 183 (2d Cir. 1995) (relying on New York statute to enforce jury waiver provision in action between commercial tenant and landlord); Phoenix Leasing, Inc. v. Sure Broad., Inc., 843 F. Supp. 1379, 1383–85 (D. Nev. 1994) (enforcing jury waiver against borrower in a lending agreement where borrower was sophisticated and represented by counsel, where waiver was not inconspicuous, wherein there was no evidence to suggest that the waiver was nonenforceable, and where the disparity of bargaining power was “not the kind or degree necessary to invalidate the waiver”); National Westminster Bank, U.S.A. v. Ross, 130 B.R. 656 (S.D.N.Y. 1993) (holding jury waiver provision in loan agreements enforceable by lender against guarantor where guarantor was a sophisticated businessperson and was represented by counsel, and waiver was not inconspicuous); Connecticut Nat’l Bank v. Smith, 826 F. Supp. 57, 59–61 (D.R.I. 1993) (citing guarantor’s business sophistication and expertise as an attorney, the fact that guarantor was also represented by counsel, the lack of evidence of “gross disparity in bargaining power,” and the fact that the jury waiver was not inconspicuous in enforcing provision against lender); Tolland Getty, Inc. v. Getty Petroleum Co., No. 3:93-CV-1040 (JAC), 1993 WL 402802, at *4–5 (D. Conn. Oct. 1, 1993) (upholding waiver of jury trial as between franchisee and franchisor where waiver was clearly visible in each of the three contracts and where there was an apparent absence of “gross inequality of bargaining power, where franchisee was represented by counsel, and where franchisee initialed every page of the contracts”); ARH Distrib., Inc. v. ITT Commercial Fin. Corp., No. 87-C-511, 1988 WL 17628, at *1–2 (N.D. Ill. Feb. 19, 1988) (enforcing jury waiver contained in loan agreement where the distributor signed the agreement without reading it and the waiver was nonenforceable).

77. Note that because the Seventh Amendment has not yet been held incorporated into the Fourteenth Amendment, see supra note 74, this argument would have little chance of success in state courts. The question of whether state constitutional rights might be used to defeat arbitration clauses, or whether the state constitution would instead be preempted by the FAA, is discussed infra at accompanying notes 104–17.


80. Gilmer, 500 U.S. at 26–29. The Court determined that nothing in the text, legislative history, or purpose of the Age Discrimination in Employment Act precluded mandatory arbitration on a general basis.


84. 43 F.3d 1244 (9th Cir. 1994).


87. Id. at 1247.

88. See, e.g., Baron v. Best Buy Co., 75 F. Supp. 2d 1365, 1370–71 (S.D. Fla. 1999) (holding arbitration clause unconscionable in part based on potential bias of arbitrator organization, the National Arbitration Forum, which the party seeking enforcement of the clause did not demonstrate to be a forum that was “neutral, inexpensive and efficient”); Hooters of Am., Inc. v. Phillips, 39 F. Supp. 2d 582, 618–19 (D.S.C. 1999) (noting biased procedures in holding clause unconscionable, calling the arbitration dictated by the clause mere “sham arbitration” in part because clause precluded election of the arbitrator by both parties); Broemmer v. Abortion Servs. of Phoenix, Ltd., 840 P.2d 1013, 1017 (Ariz. 1992) (holding unenforceable a binding arbitration clause mandated by an abortion provider in part because it provided that arbitrators must be physicians specializing in obstetrics/gynecology). See also Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 30–31 (1991) (refusing to strike down arbitration clause due to general allegation of bias, but recognizing that specific evidence of bias could be considered when evaluating the enforceability of clause); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 634–37 & n.19 (1985) (declining “to indulge the presumption that the parties and arbitrational body conducting a proceeding will be unable or unwilling to retain competent, conscientious, and impartial arbitrators,” but implying that showing of actual bias would be sufficient to void clause as to claims brought under antitrust statute).

89. See Paladino v. Avnet Computer Techs., Inc., 134 F.3d 1054, 1060 (11th Cir. 1998) (refusing to compel arbitration of Title VII claims where clause limited arbitrator to awarding only contract damages).

90. See, e.g., Cole v. Burns Int’l Sec. Servs., 105 F.3d 1465, 1467–69 (D.C. Cir. 1997) (holding that race discrimination claim brought under Title VII was arbitrable only so long as the employer paid the cost of arbitration and meaningful appeal was afforded); Randolph v. Green Tree Fin. Corp.—Ala., 178 F.3d 1149, 1157–59 (11th Cir. 1999) (refusing to compel arbitration, under Truth in Lending Act, as it was unclear how costs would be divided), cert. granted, 120 S. Ct. 1552 (2000).

cation in case where franchisee class had won substantial verdict at trial). 92. See Johnson v. Tele-Cash, Inc., 82 F. Supp. 2d 264, 270 (D. Del. 1999) (refusing to compel arbitration of claim brought under Truth in Lending Act where it would eliminate class action remedy, reasoning that class action was critical to enforcement of TILA); rev'd Johnson v. West Suburban Bank, No. 00-5047, 2000 U.S. App. LEXIS 22151 (3d Cir. Aug. 29, 2000).


95. Randolph, 178 F.3d at 1149. Although the class action issue is not among the “questions presented” set out by the Court when it granted certiorari in Green Tree, and although it was not addressed in the decision issued by the Eleventh Circuit, the district court opinion did reject plaintiffs' argument that their claim under the Truth in Lending Act was exempt from arbitration because it was brought as a class action. 991 F. Supp. 1410, 1417–19 (N.D. Ala. 1998). Still, it is rather unlikely that the Court will reach out to decide this issue. First, one of the questions that the Court is considering is whether or not it was appropriate for the Eleventh Circuit to consider an appeal from the district court's grant of the motion to compel arbitration. If the Court decides that the appeal was not appropriate, it presumably would not go on to consider whether or not the district court erred. Second, even if the Court determines that the appeal was permissible, it likely would not choose to decide a question that was not addressed by the appellate court and thus arguably not adequately developed in the record.

96. See Champ v. Siegel Trading Co., 55 F.3d 269, 374–75 (7th Cir. 1995) (refusing to certify class action where clause was silent, citing to body of law barring consolidation of arbitral proceedings absent permissive language in clause); Herrington v. Union Planters Bank, No. CV4-A-98CV231GR, 2000 WL 424223, at *7 (S.D. Miss. Jan. 21, 2000) (finding that arbitration agreement lacking express language providing for class arbitration precludes class action); Howard v. Klyneveld Peat Marwick Goerdeler, 777 F. Supp. 654, 665 n.7 (S.D.N.Y. 1993) (stating that employee who agreed to arbitrate all claims “may not avoid arbitration by pursuing class claims”); McCarthy v. Providential Corp., No. C 94-0627 FMS, 1994 WL 387852, **8–9 (N.D. Cal. July 19, 1994) (noting that “the Ninth Circuit, and most other circuits that have considered the issue, have held that a district court is without power to consolidate arbitration proceedings absent an authorizing provision in an arbitration agreement”); Gammaro v. Thorp Consumer Discount Co., 828 F. Supp. 673, 674 (D. Minn. 1983) (refusing to allow class arbitration where agreement does not provide for class treatment); Lopez, 1996 WL 210073, at *2–3 (disallowing class arbitration where clause only allows for individual arbitration). For a detailed discussion of issues relating to class actions and arbitration, see Jean R. Stermlight, As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?, 42 WM. & MARY L. REV. 1 (forthcoming Oct. 2000) (manuscript on file with author).

97. Dunham, supra note 4; Kaplinsky & Levin, supra note 4.

98. This tendency seems unwarranted given the federal policy favoring arbitration that should be interpreted to allow class actions in arbitration just as it allows punitive damages in arbitration; the common law rule of contract interpretation requiring courts to construe ambiguous language against the drafter; the lack of any policy justification for why courts should disfavor arbitral class actions; and given the courts' inability to explain why they would be justified in prohibiting arbitrators from choosing to permit class actions. (For a more detailed discussion of these points, see Stermlight, supra note 96, at 179–81).

99. The analogy is not given: (1) the much greater consequence of disallowing class actions as opposed to consolidations; (2) the fact that whereas consolidation orders may well cause conflict in interpreting multiple arbitration agreements, an order for class arbitration need not; and (3) the fact that because arbitrators arguably need court participation to handle class actions consistent with the Due Process Clause, court referrals to assist again have much greater consequences than do referrals to consolidate, which can be remedied by the arbitrators. These points are discussed in more detail in Stermlight, supra note 96, at 174–79.


101. See, e.g., Keating, 645 P.2d at 1209 (stating that “[w]ithout doubt a judicially ordered classwide arbitration would entail a greater degree of judicial involvement than is normally associated with arbitration,” and specifying that court would have to make numerous class decisions); Dickler, 596 A.2d at 866 (concluding that trial court would need to certify class, ensure that notice was provided, review proposed settlement, and deal with potential conflicts among class representatives).

102. For a summary of interviews with such attorneys, see Stermlight, supra note 96, at 79–83.

103. See Gilner v. Interstate/Johnson Lane Corp., 500 U.S. 20, 32 (1991) (implying that arbitrators might have the authority to allow for class actions under New York Stock Exchange rules).

104. See Broerunner v. Abortion Servs. of Phoenix, Ltd., 840 P.2d 1013, 1016–17 (Ariz. 1992) (holding unenforceable a binding arbitration clause that all patients were required to sign where clause was provided among other preliminary forms and where it provided that arbitrators must be physicians specializing in obstetrics/gynecology, reasoning that waiver of jury right was not conscious or explicit and clause exceeded reasonable expectations of patient); Badie v. Bank of Am., 79 Cal. Rptr. 2d 273, 288–91 (Cal. Ct. App. 1998) (requiring that jury trial waiver must be “unambiguous and unequivocal” and refusing to uphold waiver in contract offered by bank in absence of showing that customers intended to waive such a substantial right); Seifert v. U.S. Home Corp., 750 So. 2d 633, 642 (Fla. 1999) (taking note of right of access to courts in refusing to interpret arbitration clause, emphasizing that clause lacked express language compelling arbitration of particular dispute). See also GTFM v. TKN Sales, No. 00CV0235BSJ, 2000 WL 364871, at *3–5 (S.D.N.Y. Apr. 10, 2000) (holding that Minnesota statute mandating binding arbitration violated disputer’s right to jury trial under Seventh Amendment); Nationwide Mutual Fire Ins. Co. v. Pinnacle Medical, Inc., 753 So. 2d 55 (Fla. 2000) (holding that state statute mandating that medical providers arbitrate disputes with health insurance providers violates the Florida Constitution in denying providers’ right of access to courts).


106. KKW Enter., Inc. v. Gloria Jean’s Gourmet Coffees Franchising

110. 465 U.S. at 15–16.
111. See supra note 106.

113. 971 P.2d 1240 (Mont. 1998).
115. Id. at 1245.
117. Strawn, 70 F. Supp. 2d at 721, 725–28. The court explained that “[t]he FAA by its own terms allows some arbitration agreements to be rendered unenforceable by neutral principles applicable to contracts generally.” Id. at 721. If then found that “where employers offer minimal benefits and unilaterally impose an arbitral forum on their injured employees, such a forum is sufficiently dissimilar to a judicial forum as to undermine Texas public policy with respect to the workers’ compensation system.” Id. at 726. The court specifically found arbitration dissimilar to litigation in that it denies a jury trial, applies relaxed rules of evidence, relies on arbitrators who generally have significantly different legal perspectives than judges to make decisions, and involves only limited judicial review. Id. at 724–25. See also Aveden Eng’g, Inc. v. Seatex, 126 F.3d 1279, 1288–88 (10th Cir. 1997) (holding that FAA does not preempt a New York law treating arbitration clause as “material alteration” to contract that was not enforceable without express agreement); Broughton v. Cigna Healthplans of Cal., 988 P.2d 67, 75–80 (Cal. 1999) (interpreting California’s Consumer Legal Remedies Act to prohibit arbitration of claims for public injunctive relief under that Act, and concluding that such prohibition was not preempted by FAA); Keystone, Inc., 971 P.2d at 1244–45 (holding that general provision protecting Montana citizens from mandatory out-of-state forums was applicable to arbitration clause and was not preempted by FAA). Cf. Cline v. H.E. Butt Grocery Co., 79 F. Supp. 2d 730, 735 (S.D. Tex. 1999) (noting that arbitration clause linked to employer’s benefit plan in lieu of workers’ compensation did not violate state public policy because employee was given choice between plan requiring arbitration and plan allowing litigation of disputes).


119. See, e.g., Knepp v. Credit Acceptance Corp., 229 B.R. 821, 838 (Bankr. N.D. Ala. 1999) (refusing to enforce arbitration clause in part based on finding of unconscionability where debtor would be required to pay for arbitration); Patterson v. ITT Consumer Fin. Corp., 18 Cal. Rptr. 2d 563, 565–67 (Cal. Ct. App. 1993) (refusing to enforce arbitration clause imposed by financing organization on California consumers where clause apparently required arbitration to be heard in Minneapolis and required plaintiffs to pay substantial filing fees); Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569, 573–75 (App. Div. 1998) (striking portion of arbitration clause that designated a “financially prohibitive forum” to be unconscionable where expense was so great as “to deter the individual consumer from invoking the process”).


122. See Laxmi Invs., LLC v. Golf USA, 193 F.3d 1095, 1097 (9th Cir. 1999) (finding no meeting of minds as to forum selection provision where offering circular stated that California law required Californians to arbitrate all franchise agreements dispute resolution, and that out-of-state forum provision might not be enforceable under California law); Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc., 840 F. Supp. 708, 711 (D. Ariz. 1993) (holding in part that there was no meeting of minds as to forum selection portion of arbitration clause notice provided with franchise agreement where notice stated that clauses inconsistent with Michigan law would not be enforceable and where Michigan law purported to prohibit out-of-state forums).

123. See Engel v. Permanente Med. Group, 938 P.2d 903, 922 (Cal. 1997) (concluding that evidence supported claim that HMO fraudulently induced plan participant to enter arbitration agreement where arbitration agreement called for appointment of neutral arbitrator within sixty days of filing of claim, even though such timely appointment had occurred in only 1 percent of cases during previous years, and where substantial delays were attributable to HMO).

124. See Gilmer v. Interstate/Johnson Lane Co., 500 U.S. 20, 33 (1991) (“Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract.”) (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 627 (1985)).


127. Kravitz & Dunham, supra note 126, at 40.

128. See, e.g., Specialty Bakers, Inc. v. HallRob, Inc., 129 F.3d 726, 727 (3d Cir. 1997) (affirming, as modified, the district court’s injunction proscribing further actions by the state court, which had refused to stay action pending arbitration); Doctor’s Assocs., Inc. v. Distajo, 107 F.3d 126, 136–39 (2d Cir. 1997) (affirming district court’s grant of injunctions against state courts, despite arguments that they were improper given Rooker-Feldman doctrine or abstention principles); Doctor’s Assocs., Inc. v. Distajo, 66 F.3d 438, 438 (2d Cir. 1995) (affirming district court’s stay of several state court actions in which state courts had already entered judgment, but denying a stay of those state courts where state res judicata principles would treat state rulings as a final judgment).

129. Of course, it should be recognized that franchisees, as well as franchisors, may well engage in forum shopping. See Distajo, 66 F.3d at 441 (“This case is about forum-shopping, by one and all.”).

130. Federal courts are statutorily required to give state judicial pro-
ceedings full faith and credit. 28 U.S.C. § 1738 (1994). This statutory requirement should not be confused with the Constitution’s Full Faith and Credit provision provided in article IV, which requires states to honor other states’ public acts, records, and judicial proceedings. See U.S. CONST. art. IV. The U.S. Supreme Court has interpreted this statute to require federal courts to apply to state court judgments the same claim preclusion and issue preclusion treatment that those judgments would be afforded by the courts within the state. Matsushita Elec. Indus. Co. v. Epstein, 516 U.S. 367, 369 (1996). Thus, once a state court has progressed far enough in its own action, a federal court is precluded from enjoining that action. See Distajo, 66 F.3d at 446–51 (determining that some state court rulings, but not others, were entitled to full faith and credit); Towers, Perrin, Forrester & Crosby, Inc. v. Brown, 732 F.2d 345, 347–50 (3d Cir. 1984) (holding that district court erred in granting petition to compel arbitration and in staying California state court action where, prior to the district court’s ruling, the state court had denied the company’s petition to compel arbitration, and where this denial had already been refused review by the state supreme court); Ultraschamhere House, Ltd. v. Meyer, 664 F.2d 1176, 1183–84 (11th Cir. 1981) (holding that lower court’s grant of summary judgment was entitled to preclusive effect in federal court), overruled on other grounds by Baltin v. Alaron Trading Corp., 128 F.3d 1466 (11th Cir. 1997). See generally Sterlighet, supra note 126, at 130–37.

131. This doctrine derives from two cases: Rooker v. Fidelity Trust Co., 263 U.S. 413 (1923), and District of Columbia Court of Appeals v. Feldman, 460 U.S. 462 (1983). In essence, the doctrine provides that federal courts lack jurisdiction to hear appeals from state courts. Courts applying this doctrine to arbitration disputes have reached mixed results. Compare Brown & Root, Inc. v. Breckenridge, 211 F.3d 194, 199–203 (4th Cir. 2000) (affirming dismissal, based on Rooker-Feldman doctrine, of company’s federal action seeking to compel arbitration, following rejection of motion by state court); International Cement Aggregates, Inc. v. Antilles Cement Corp., 62 F. Supp. 2d 412, 414–16 & n.3 (D.P.R. 1999) (dismissing federal claim, based on Rooker-Feldman doctrine, on ground that federal court lacked jurisdiction to hear what was effectively an appeal from a state court decision), with Distajo, 107 F.3d at 136–38 (determining that the Rooker-Feldman doctrine was inapplicable because the federal action, having been filed prior to the state court ruling, could not properly be characterized as an “appeal” from the state court ruling). See generally Sterlighet, supra note 126, at 138–46.

132. 28 U.S.C. § 2283 (1994). The Anti-Injunction Act (AIA), initially passed in 1973, currently provides that “A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.” Id. Its “basic purpose is to prevent ‘needless friction between state and federal courts.’” Mitchell v. Foster, 407 U.S. 225, 232–33 (1972) (quoting Oklahoma Packing Co. v. Oklahoma Gas & Elec. Co., 309 U.S. 4, 9 (1940)). Clearly, the AIA does not preclude federal courts from enjoining parties from filing actions in state courts. Dombrowski v. Pfister, 380 U.S. 479, 484 n.2 (1965). As to pending state court actions, note that an argument can be made that none of the exceptions to the AIA justify allowing a federal court to enjoin a state court to support an order compelling arbitration. See Sterlighet, supra note 126, at 150–78. However, most courts considering the question have concluded that such injunctions are not barred by the AIA. Some have relied on the “in aid of jurisdiction” exception. See, e.g., Specialty Bakeries, Inc. v. RobHal, Inc., 961 F. Supp. 822, 829–31 (E.D. Pa. 1997) (permitting injunction where federal court had, in previous decision, ordered the contractual dispute between two sets of bagel companies proceed to arbitration), aff’d as modified and remanded sub nom. Specialty Bakeries v. HalRob, 129 F.3d 726 (3d Cir. 1997). See also TranSouth Fin. Corp. v. Bell, 149 F.3d 1292, 1297 (11th Cir. 1998) (observing, in dicta, that district court might be justified in enjoining state court action if it chose to issue an order compelling arbitration). Other courts have relied on the “relitigation” exception to the AIA. See, e.g., Snap-On Tools Corp v. Vetter, 838 F. Supp. 468, 473 (D. Mont. 1993) (“Because the petition to compel arbitration should be granted, any further proceedings in state court between [the parties] should be stayed as inconsistent with this order. This stay thus falls within the third exception contained in the Anti-Injunction Act . . . .”). See also In re Arbitration Between Nuclear Elec. Ins. Ltd. & Central Power & Light Co., 926 F. Supp. 428, 436 (S.D.N.Y. 1996) (holding that an order staying a pending state court action is justified “when issued subsequent to or in conjunction with an order compelling arbitration concerning the same subject matter as the state court proceeding” under either the second or third exception to the AIA). But see TranSouth Fin. Corp. v. Bell, 975 F. Supp. 1305, 1310 (M.D. Ala. 1997), aff’d in part, vacated in part on other grounds and remanded, 149 F.3d 1292 (11th Cir. 1998) (“An injunction staying the state-court suit by Bell could not be properly issued as a means to protect or effectuate a judgment of this court, as none has been entered. The court is not tempted to put the cart before the horse by first deciding the arbitrability question, and then strapping an injunction onto that decision.”).

133. See Sterlighet, supra note 126, at 147–50 (observing that “[t]raditional equitable constraints prohibit federal courts from issuing injunctions, including arbitral antisuit injunctions, absent a showing of prospective irreparable injury and lack of an adequate remedy at law” (quotation omitted)).


136. See Bill Summary and Status for the 106th Congress (visited July 26, 2000) <http://thomas.loc.gov> (search H.R. 534 from the homepage for current cosponsorship). The bill was reported from the subcommittee to the full committee on July 13, 2000. Id.


Section 2 of the bill states that “[w]henever a motor vehicle franchise contract provides for the use of arbitration to resolve a controversy arising out of or relating to the contract, each party to the contract shall have the option, after the controversy arises and before both parties commence an arbitration proceeding, to reject arbitration as the means of settling the controversy” (visited July 26, 2000) <http://thomas.loc.gov> (search S. 1020 from the homepage for current cosponsorship).

140. The Civil Rights Procedures Protection Act of 1999, S. 121, would “amend certain Federal civil rights statutes to prevent the involuntary application of arbitration to claims that arise from unlawful employment discrimination based on race, color, religion, sex, national origin, age, or disability, and for other purposes” (visited July 26, 2000) <http://thomas.loc.gov> (search 106th Congress, S. 121 from the homepage). The Consumer Fairness Act of 1999, S. 2020, would “amend certain Federal civil rights statutes to prevent the involuntary application of arbitration to claims that arise from unlawful employment discrimination based on race, color, religion, sex, national origin, age, or disability, and for other purposes” (visited July 26, 2000) <http://thomas.loc.gov> (search 106th Congress, S. 2200 from the homepage).