

**REPRESENTING FRANCHISEES AND FRANCHISORS
IN MULTI-FRANCHISEE DISPUTES**

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I.

INTRODUCTION

It is common in franchise systems for multiple franchisees to have similar complaints, both business and legal, regarding their relationships with the franchisor. For this reason, both franchisor and franchisee must decide whether multiple franchisees should band together in some way to negotiate or litigate with the franchisor. The considerations for both franchisor and franchisee range from the practical to the strategic to the legal.

From a practical standpoint, whether and how franchisees join together will have a great effect on the time and expense that a business or legal dispute imposes on both the franchisor and franchisees. For example, there are several ways that franchisees can join together to increase their bargaining power and to reduce the expense involved in asserting business or legal complaints against the franchisor. However, a franchisee may be reluctant to join a group for various reasons – it does not want to be lumped in with franchisees whose claims appear less meritorious than its own, it has individual issues that the rest of the group does not share, or it fears retaliation from the franchisor.

From a strategic standpoint, each franchisee and franchisor must determine whether its goals are best served by consolidated or separate actions. For example, a franchisor facing complaints – whether business or legal – may be able to achieve a global resolution (and peace of mind) when negotiating with a single consolidated group of franchisees. On the other hand, the franchisor may find that the franchisees' complaints have less weight and effect when asserted individually instead of in a consolidated manner ("divide and conquer"). The franchisees will have to make parallel decisions. The decisions of both franchisor and franchisee will be affected by whether a dispute is being negotiated or is in a litigation, arbitration, or mediation proceeding.

Finally, from a legal standpoint, the law is evolving regarding the circumstances under which franchisees can join together either through class actions or through formation of a franchise association. Both franchisor and franchisee must consider these evolving bodies of law when deciding whether group or individual action will be most successful.

The competing considerations for both franchisors and franchisees are discussed below.¹

II.

PRACTICAL CONSIDERATIONS IN FORMING A GROUP OF FRANCHISEES

Franchisees can choose to join forces for various reasons and in various ways. One of the purposes for which franchisees often join together is to address system-wide issues and to communicate shared grievances with their franchisor. Resolving these issues may require franchisees to litigate (in state or federal court), commence arbitration, or participate in mediation. To this end, franchisees can form an independent franchisee association (or they can join together informally) in order to work toward a shared goal and hire counsel to represent their interests.

Often, the issues and problems that individual franchisees face in connection with their relationship with their franchisor are not unique and are shared by other franchisees in the system. Joining forces, whether as an association or as an informal group, may enable franchisees to pursue their goals more effectively than if they were to act independently. From the franchisees' perspective, the benefits of group representation for dispute resolution with the franchisor, whether achieved through mediation, litigation, or arbitration, are numerous. Most significant among the benefits is the ability to share the costs associated with legal representation that may not be affordable to individual franchisees. This allows franchisees to pursue a litigation or negotiation strategy with the franchisor and allows franchisees to level the playing field, especially when it comes to resources. Further, addressing an issue with the franchisor as a group may improve the franchisees' negotiating position and force the franchisor to see a united front of franchisees seeking resolution of the same issue.

A. Joining Together as an Association

A franchisee association is generally formed as a not-for-profit corporation. The corporation's bylaws set forth the method by which the association is governed, including, for example, procedures for selecting leadership. Independent franchisee associations often establish a committee of franchisees to maintain direct contact between counsel and association members. The legal committee would be authorized to act on behalf of the members in accordance with the association's by-laws. Such a committee can streamline communications with counsel, and the committee's work in compiling documents or information from members and providing the same to counsel will keep costs down. Similarly, the committee can also serve as a conduit to the franchisee community about the status of negotiations and/or litigation.

B. Joining Together as an Informal Group

Where franchisor/franchisee issues are not system-wide or where franchisees choose not to form an independent association to redress grievances, they may still join together informally. With this method, a group of franchisees with common issues and goals can hire counsel and share the costs associated with legal representation.

C. Retainer Agreement

It is essential for franchisee associations and groups to have a detailed retainer agreement with counsel that sets forth in clear language the nature and scope of the representation. Additionally, the retainer agreement for an independent franchisee association should identify the legal committee and its authority. It should set forth how the individual members of the association (or group) can obtain general information about the status of litigation or arbitration and with whom they should communicate. The retainer agreement also should disclose any possible issues of conflict. Finally, it should address issues regarding state statutes or common law that may impact individual members of the group depending on where the association or individual members are located.

D. Written Agreement

A written agreement among franchisees is a helpful tool for governing the conduct of the association or specific group members in the context of the dispute resolution process. Upon retaining legal representation, all members of the group should enter into an

agreement setting forth their understanding of the issues for which representation is required; the strategy that will be undertaken in seeking to resolve any disputes with the franchisor, including litigation, if necessary; the cost-sharing arrangement of the parties; and other similar matters. A statement authorizing the board of directors or other representative body to determine a strategy and make decisions for the group should also be set forth. Additionally, a method of dispute resolution for intra-group disputes should be established to minimize and address potential conflict.

E. Determining Cost Allocation

One of the greatest benefits to proceeding as a group in an effort to resolve issues with a franchisor (whether as an association or informally) is the ability of the franchisees to share the costs of legal representation. At the outset, the group members will need to determine the method for cost allocation. For instance, costs can be assessed to members based on the number of units owned or on the monetary value of each member's claims.

F. Individual Group Member Issues

A problem resulting from group representation may occur where the individual members of the association or group have different claims than other members. For example, this may arise where disclosure claims are available to franchisees in registration states, but not available to other franchisees or where an individual member of the group has a dispute with the franchisor that affects only his or her franchise. This is especially of concern where there is a franchisee with individual claims and the case is filed in a jurisdiction where all claims a party has must be brought in any lawsuit it files, as in the case under New Jersey's Entire Controversy Doctrine. This doctrine requires a party to assert all claims that it may have against an adverse party in the initial lawsuit; if it does not do so, the unasserted claims may be waived forever. *See* N.J. Court Rule 4:30A; *Cogdell v. Hosp. Ctr.*, 560 A.2d 1169, 1172-74 (N.J. 1989). Should these types of issues arise, the affected franchisee group member must decide whether to (1) proceed with the group and waive the claim; (2) proceed with the group and seek to have the group fund the claim; (3) proceed with the group and fund the claim; or (4) opt out of the group and pursue claims against the franchisor in an individual capacity.

III.

**STRATEGY CONSIDERATIONS OF LITIGATING, ARBITRATING, AND
MEDIATING AS AND WITH A GROUP OF FRANCHISEES**

A. Considerations By The Franchisees

1. Litigate, Arbitrate, or Mediate?

Depending on the dispute resolution clause contained in the franchise agreement, a franchisee group may be limited in the choices available to it in proceeding with its claims against the franchisor. Many franchise agreements contain a requirement that disputes be resolved by arbitration or that matters be first submitted to mediation. Even if an agreement does not mandate mediation, the parties can mutually agree to attempt to resolve issues in mediation. The potential benefits and detriments of either arbitration or mediation affect franchisees acting in concert in much the same way as they do individual franchisees.

From a franchisee perspective, juries are better than arbitrators and verdicts are generally higher than awards. A franchisee has a much better chance of making his case to jurors, who can relate to the franchisee's effort to establish his business, than to an arbitrator, who is more likely to identify with the larger, corporate franchisor. Notwithstanding these considerations, as a practical matter, where the franchise agreement mandates arbitration, it is unlikely that a franchisee group will be able to pursue its claims in court.

Aside from the fact that franchisees may prefer to have a case heard in court, arbitration has several other disadvantages for franchisees. Filing fees for large claims may be as high as \$10,000.00, depending on the amount of the claim, whereas the filing fees in most courts is in the low hundreds. Arbitrator and administrative fees must be considered in addition to the filing fees. When the arbitration clause in an agreement requires three arbitrators, the franchisees will be footing the bill for their own lawyer, plus the expense of half a panel (another lawyer and a half). When it comes to arbitration filing fees and arbitrator fees, the franchisor, with its deep pocket, has the advantage.

Mediation may be a benefit to both parties. From a franchisee perspective, the question is whether the franchisor is really interested in resolving the dispute or mandates mediation simply to delay a lawsuit or arbitration demand. Franchisees should also be careful that the time spent in the mediation process does not result in delays that push a claim outside of an applicable statute of limitations.

2. Association Claims/Class Actions

In addition to the question of the forum for the franchisor/franchisee disputes, there are several strategic and procedural issues that relate specifically to litigation or arbitration involving franchisee groups. Before deciding whether or not to commence litigation or arbitration on behalf of the association, an association must take into account the fact that the franchisor is likely to argue that the association does not have standing to pursue the claim. Whatever the merits of such an argument, which is discussed in more detail below, franchisees must realize that a substantial portion of their litigation budget is going to be spent on this preliminary procedural issue. Thus, the likelihood of success of pursuing a case in this manner must be weighed against the cost and a determination must be made as to whether there are alternatives that address system-wide issues in a cost effective manner.

With certain types of claims, the group may choose to commence a class action lawsuit. However, as is the case when asserting a claim on behalf of the association, class action lawsuits often result in extensive litigation over a threshold issue, in this case, the question of class certification pursuant to Rule 23 of the Federal Rules of Civil Procedure. Again, the franchisees must weigh the benefits of proceeding in this manner, the cost involved, the likelihood of obtaining class certification and whether alternatives exist. Class actions in arbitration proceedings are discussed further below.

3. Joinder and Consolidation

One way a franchisee association or group can proceed is to join franchisees in one action against the franchisor. Pursuant to Rule 20 of the Federal Rules of Civil Procedure, franchisees may be joined as plaintiffs if their claims against the franchisor arise out of the same

transaction or occurrence and if a common question of law or fact arises in the action. Thus, the group members may be able to proceed as co-plaintiffs if they have substantially related claims against the franchisor.

Another method for pursuing litigation against a franchisor in a group format is to start separate actions and then consolidate them into one action pursuant to Rule 42 of the Federal Rules of Civil Procedure. This provision allows for the consolidation of actions involving common questions of law or fact. Consolidation of arbitration proceedings is discussed further below.

Where claims are joined or pending actions are consolidated, franchisees acting in concert should be able to achieve significant savings over proceeding individually. There may, however, be contractual restrictions on proceeding with either strategy. If the franchise agreement in issue does not restrict joining or consolidating claims, these procedural tools may be a cost effective method of dispute resolution for franchisees. In addition to saving money, proceeding in this manner will likely impact the ultimate trier of fact, who will see a system-wide dispute and the effect that it has on all franchisees.

One issue that should be considered is discovery. Where a number of franchisees are joined as plaintiffs, their right to obtain discovery may be more restricted than if they proceed separately and consolidate later. For example, in a case filed with multiple plaintiffs, the assigned judge or the court rules may limit the number of depositions taken or the number of interrogatories propounded. If cases are filed separately, the individual plaintiffs should be able to obtain more discovery cumulatively than plaintiffs joined in a single case. This information can then be used in the matter when the cases are consolidated at a later date.

4. The "Test Case" Approach

As indicated, pursuing litigation on behalf of numerous franchisees has many potential problems. One alternative is a test case approach where the independent franchisee association or franchisee group supports a claim filed by one franchisee relating to system-wide issues. Here, the benefits of the cost sharing are available and the question of standing as well as other procedural matters is eliminated. If that franchisee is successful in the litigation, the ruling may have a collateral estoppel effect on the franchisor in subsequent actions. In arbitration, the impact of a ruling is less certain. In many jurisdictions, courts have held that arbitration proceedings and their findings are considered final judgments for the purposes of collateral estoppel. *See Witkowski v. Welch*, 173 F.3d 192, 198-205 (3d Cir. 1999); *Dyer v. Travelers*, 392 Pa.Super. 572 A.2d 762, 764 (Pa. Super. Ct. 1990) ("An arbitration award from which no appeal is taken has the effect of a final judgment on the merits"); *Konieczny v. Micciche*, 702 A.2d 831, 836-837 (N.J. Super. Ct. App. Div. 1997). However, other jurisdictions have held that a private arbitration award has no collateral estoppel effect in favor of third persons. *See, e.g., Vandenberg v. Superior Court*, 982 P.2d 229, 240 (Cal. 1999).

The cost of litigation also plays a major role in determining whether to engage in litigation. Indeed, the cost of pursuing a single litigation on behalf of a single plaintiff will be substantially less expensive than asserting claims on behalf of all franchisees. Moreover, if the test case is successful, the result may be a resolution of the system-wide problems that caused the case to be filed in the first instance.

Several issues should be considered before proceeding with a test case. The most significant problem may be the applicable statute of limitations. If the test case takes time to wend its way through the court system, the other franchisees may find their claims time-barred. Another concern is the limitation on discovery that may be applicable to a single case; as noted above, if cases are consolidated after discovery, plaintiff-franchisees may be able to obtain substantially more disclosure than otherwise available.

5. Group Mediation

Where a franchise agreement requires mediation of disputes (and even when mediation is voluntary), independent franchisee associations and less formal franchisee groups should consider group mediation. Presenting system-wide issues in one mediation proceeding has obvious economies of scale, but more importantly, may help to resolve issues more readily. In such a group mediation, the franchisor will see that the franchisees have formed a united front and are intent on pursuing their claims. The mediator will see that the issue is not simply the concern of one franchisee, but that it impacts the system as a whole, and hopefully, this will result in a beneficial settlement. From the franchisor's perspective, group mediation may be attractive. It would avoid multiple mediations and the attendant costs and may be an effective way to deal with issues the franchisor would like to see resolved.