Forum on Franchising

The Franchise Lawyer

American Bar Association • Forum on Franchising

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Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

Message from the Chair

As I gaze out my window here in downtown Minneapolis, across a vast white landscape, waiting for a Vikings game that has been postponed because of bad weather all up and down the East Coast, it seems like a long time ago that we were all together on the beach in San Diego. If you are like me, your memories of the 2010 Forum on Franchising at the Del Coronado are of top-notch programming, uniformly good speakers and networking events second to none. A special thank you once again to our Co-Chairs, Deb Coldwell and Kathy Kotel, and to Kelly Rodenberg for putting on one of the most universally well-received Annual Meetings in our 33-year history. ***Read more...***

Annual Forum Community Service Event

Building on the established tradition of giving back to the host community, a group of franchise lawyers volunteered their time and energy to support the San Diego River Park Foundation as part of the Community Service Event at the Annual Forum. ***Read more...***

Letter of Appreciation from Rupert Barkoff and Andy Selden

Congratulations to Rupert Barkoff of Kilpatrick Townsend & Stockton LLP and Andy Selden of Briggs and Morgan PA, who received the Lew Rudnick Lifetime Achievement Award for 2010 at the Annual Forum in San Diego. At their request, the letter of appreciation they sent to the Governing Committee is included in this issue of *The Franchise Lawyer*. ***Read more...***

Tips to Help You Meet That New Year's Resolution Relating to Smoother Franchise Renewals

It is that time of year again! The holidays are over and, yes, the franchise renewal season is, or shortly will be, upon us. To the extent "achieving a smoother franchise renewal process" is on your list of 2011 New Year's resolutions, we are here to help. ***Read more...***

Standard of Review of Arbitration Awards: Has the "Manifest Disregard of the Law" Standard Survived?

In the past two years, the Supreme Court has decided a number of significant cases involving various arbitration issues. Although there was hope that the Supreme Court's resolution of the issues in two arbitration cases, *Hall Street* and *Stolt-Nielsen,* would answer lingering questions, it still remains unclear whether, and under what circumstances, manifest disregard of the law is an appropriate standard to vacate arbitration awards. ***Read more...***

Topsy Turvy Year for Franchising in Canada

The close of 2010 signalled the end of a year (perhaps a decade) of some predictable, more unpredictable, and a few astonishing developments in franchising in Canada. Lawyers advising franchisors who offer franchises in Canada, whether based in Canada, the United States, or another foreign country, need to understand these developments and be prepared to react quickly to make necessary changes to franchise documents and incorporate practices resulting from new franchise laws and court decisions. ***Read more...***

Save the Date

34th Annual Forum on Franchising

Flying the Flag of Franchising

October 19-21, 2011

The Marriott Waterfront Hotel

Baltimore, MD

New Books from the Forum on Franchising

Franchise Litigation Handbook

Dennis LaFiura and C. Griffith Towle, Editors

Annual Franchise and Distribution Law Developments 2010

Bethany L. Appleby and William K. Whitner

International Franchise Sales Laws - 2010 Supplement

Andrew P. Loewinger and Michael K. Lindsey, Editors

Back to Top

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INSIDE THIS EDITION

Message from the Chair

By Ronald K. Gardner
Forum Chair

As I gaze out my window here in downtown Minneapolis, across a vast white landscape, waiting for a Vikings game that has been postponed because of bad weather all up and down the East Coast, it seems like a long time ago that we were all together on the beach in San Diego. If you are like me, your memories of the 2010 Forum on Franchising at the Del Coronado are of top-notch programming, uniformly good speakers and networking events second to none — something for which the Forum has become well known throughout the years. Of course, if you are like me, you will also find that these memories are greatly enhanced by the fabulous surroundings that the Del offered us, including our beach party on Thursday night, which by many accounts, may be the single greatest social event in the history of the Forum. If you were there, please take a moment to reminisce. And, if you were not there, find someone who was and let them share with you the grand tales many of us heard from our franchising colleagues around the campfire.

For me, at least, these warm memories are attributable to the remarkable hard work of our Co-Chairs last year, Deb Coldwell of Haynes & Boone, LLP and Kathy Kotel of Carlson Restaurants Worldwide, Inc. Deb and Kathy, with the extraordinary (although if she does it every year, is it "extraordinary" or simply "unbelievably ordinary"?) assistance of Kelly Rodenberg, put on one of the most universally well-received Annual Meetings in our 33-year history. Please join me in thanking all three of them one last time for going above and beyond the call of duty and making sure that everything was "just so."

One of the things I love about the Forum, however, is that it does not rest on its laurels. Next year's Co-Chairs, Mike Lindsey of Paul Hastings Janofsky & Walker LLP and Karen Satterlee of Hilton Worldwide, Inc., are already hard at work on the 2011 Forum on Franchising to be held at the Baltimore Marriott Waterfront Hotel in Baltimore, Maryland. The Planning Committee has already had its initial visit, and Mike and Karen are well on their way to putting together yet another spectacular program. We hope you will plan on joining us this coming October 19-21 for what promises to be another marquis event.

A few other items of note.

The ABA is on the precipice of rolling out a new and vastly-improved website, which will have a direct impact on the Forum's website. Through this portal, people will be able to quickly access news of upcoming events, purchase Forum publications, register for programs and otherwise interact with the ABA on a technological platform that actually seems like it belongs in the 21st Century! We are thankful that the ABA has undertaken this improvement, and we are looking forward to announcing its official rollout later this year.

The Governing Committee of the Forum is scheduled to meet in February for our mid-winter planning session. Besides working on the Baltimore program (and preparing to extend speaker invitations in mid-March), we will be taking up other questions, including if and how our outreach program for new and young

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Dady & Gardner
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members should be extended. For the 2010 Forum, we took the unparalleled approach of offering new, young members a significant discount off their registration fee. The preliminary results of that program indicate that it was a spectacular success, and we will be discussing whether or not it should be continued, modified, or otherwise revamped for this year, and perhaps beyond. Stay tuned to these pages to learn more as the Governing Committee makes those decisions.

Our live webcasts and teleconferences continue this year, with our next one scheduled for February 1, 2011, and sponsored by our International Division. Make sure to plan on attending *Legal Issues with Appointing Franchisees, Distributors or Agents in China*. You can find information on how to get registered for this program on our website at **www.abanet.org/cle/programs/t11afd1.html**.

Finally, I am pleased to report that both the ABA's House of Delegates and Board of Governors have recently reviewed the Forum on Franchising and given us exceptional marks for the quality of our programming, the service we provide to our members and our ability to help the ABA meet its core mission. Let me conclude this particular message with my heartfelt thanks to all of you who give so freely of your time to the Forum in order to allow us to be the outstanding and exceptional organization for which we are recognized.

My best to all of you for a spectacular new year. Stay warm wherever you are!

Back to Top

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Forum on Franchising

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American Bar Association • Forum on Franchising

Vol. 14 No. 1 | Winter 2011

INSIDE THIS EDITION

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At the 2010 Community Service Event in San Diego, a group of franchise lawyers volunteered their time and energy to support the San Diego River Park Foundation (**www.sandiegoriver.org**). The volunteers removed invasive plants and replaced them with native species. They learned about the environment, enjoyed the camaraderie of a team effort and the satisfaction of working with their hands for a worthy cause. Afterwards, the volunteers rested their tired muscles as they enjoyed Mexican food and cold drinks in an open air restaurant.

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Karen Marchiano of SNR Denton gets her hands dirty for a good cause in San Diego.

Back to Top

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Back to Top

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American Bar Association • Forum on Franchising

Vol. 14 No. 1 | Winter 2011

INSIDE THIS EDITION

Tips to Help You Meet That New Year's Resolution Relating to Smoother Franchise Renewals

By Joseph J. Fittante
Larkin Hoffman Daly & Lindgren Ltd.

Theresa Leets*
California Department of Corporations

Rebekah K. Prince
Snell & Wilmer LLP

It is that time of year again! The holidays are over and, yes, the franchise renewal season is, or shortly will be, upon us, depending upon when your company or clients seek to renew their franchise registrations. There is no doubt that "successfully complete all of my franchise renewals with time to spare" topped your list of 2011 New Year's resolutions and, thankfully, we are here to help. We offer the following tips on how to expedite the renewal process, and identify a few of the sometimes overlooked state-specific requirements affecting the renewal process.

First, a few general tips and suggestions for expediting the renewal process.

1. **Send out renewal questionnaires as soon as possible**. Practitioners should not waste any time requesting information from franchisors to be used to update the disclosure document and other agreements. Collecting the information can be a very time-consuming process for both the franchisor and its counsel. Larger franchisors often have to circulate the questionnaires to multiple departments for review and it may take some time to obtain the information. For example, the information needed to update Item 11 may come from no less than four departments of the franchisor: marketing, operations, training and technology. Those of us who have procrastinated in the past know that the failure to get this process started early can make the lives of both the franchisor and its counsel very difficult.

2. **Confirm the audit is underway**. Let's face it, sometimes auditors are not as prompt as we would like. In a worst case scenario, this lack of urgency can result in delayed filings because the franchisor's most-recent audited financial statements have not been completed in a timely manner. In an attempt to avoid this issue, counsel should confirm with the franchisor that its auditors have been engaged and the process is underway.

3. **Check each registration state's website for important information**. Each registration state's website includes information regarding filing fees and requirements, and some (like California) even include tips for expediting registration and renewal. Some states also include forms for initial

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registrations, renewals and notice filings that can be filled out online and downloaded. State websites are also a good resource for determining any furloughs or closures that might be in effect. Given the current economic climate and tightening state budgets, many states have mandatory furlough days. A franchisor could inadvertently miss a filing deadline if its renewal application is received on a furlough day. Make sure your company or clients do not end up in this situation by confirming applicable furloughs or other state office closures.

4. **Check NASAA's 2008 Franchise Registration and Disclosure Guidelines**. For those practitioners who may be relatively new to the renewal process, a great source of guidance can be found in the 2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines) (the "Guidelines"), adopted by the North American Securities Administrators Association, Inc. ("NASAA"). The Guidelines provide forms as well as instructions for filing registrations and renewals in the registration states, and can be found at **http://www.nasaa.org/content/Files/2008UFOC.pdf**. All registration states should be following the Guidelines; however, not all of them require all of the included forms and some of them have specific, additional requirements. Certain states, including California, Hawaii, Minnesota, New York and Virginia, require the application forms to be notarized. Additionally, some states, like Minnesota and Virginia, do not require a CD-ROM with the hard copy. Check each state's specific requirements before filing.

5. **FTC/NASAA Information**. In addition to the Guidelines, new practitioners should also consult the following resources when preparing annual renewals:

   a. FTC Amended Franchise Rule FAQ's – This is a list of frequently asked questions posted by the FTC to assist franchisors in understanding their requirements under the amended FTC Franchise Rule (the "Amended Rule"). It can be found at **http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml**.

   b. Compliance Guide – When the FTC Rule was amended in 2008, the FTC published the Compliance Guide to help franchisors comply with the Amended Rule. It can be found at **http://www.ftc.gov/bcp/edu/pubs/business/franchise/bus70.pdf**.

   c. NASAA Commentary – In 2008, NASAA issued a Commentary on the Guidelines to provide interpretive guidance for filing initial franchise registrations and renewals. It can be found at **http://www.nasaa.org/content/Files/FranchiseCommentary_final.pdf**.

Back to Top

In addition to the foregoing, there are a number of unique state-specific requirements that, if overlooked, can cause various problems for franchisors.

1. **Annual Reports – Additional Information Required in New York and Hawaii**. When filing annual reports in New York and Hawaii, remember to include the required annual franchise sales information. In New York, the annual report must include the name and address of each franchise sold, the date of the sale, and the name, address and telephone number of the purchaser, the price paid and any credit terms for such sale. Hawaii requires a list of all franchises sold in Hawaii for the prior year, as well as the dollar amount and proceeds derived from such sales.

2. **Trust but Verify (if Possible) in Illinois**. In Illinois, a franchise renewal application is deemed automatically effective on the state's receipt of the annual report; however, franchisors should be aware that Illinois is likely to provide comments at a later date that may require material changes to the disclosure document. This places franchisors in the difficult position of either waiting to sell franchises in Illinois until they hear back from the state (which could be a number of months), or going ahead with sales in Illinois with the understanding that they may have to offer rescission if the state later provides material comments. In an effort to deal with this problem, practitioners should follow up with Illinois after filing to gauge whether comments will be forthcoming.

3. **Beware of the 90-Day Issue**. Although the Amended Rule allows a franchisor 120 days after the close of its fiscal year to complete the annual update of its franchise documents, there are certain

states that require renewal prior to this time (Hawaii), or require inclusion of unaudited financial statements in the franchise disclosure document ("FDD") if the application is made more than 90 days after the franchisor's fiscal year end (California, New York, Minnesota and Maryland). The franchisor filing a renewal application, or in the case of New York, an amendment application, should be prepared to deal with the issues presented by these state laws.

4. **California – Internet Advertising Exemption; Franchise Seller Forms (and a Few Other Tips)**. In California, franchisors must remember to file the Internet Advertising Exemption annually. Also, franchisors should only include franchise seller forms for those individuals actually selling franchises in California and, if a franchisor is not using the NASAA forms, it should be sure to provide a redacted copy for the public portion of the file. Franchisors should also remember to provide their email address in their transmittal letters, and send their renewals to the attention of the attorney who last handled the file and to the same office (either Los Angeles or San Francisco). Sending files to San Diego or Sacramento delays processing.

5. **Indiana and Rhode Island – Effectiveness and Going Green**. Although Indiana has moved away from formally reviewing disclosure documents to more of a notice filing process (similar to Wisconsin), franchisors should be aware that applications for renewal in Indiana are not effective until the expiration date of the prior year's filing, unless the franchisor makes a special request in its cover letter for effectiveness upon receipt. In addition, franchisors should take note that Indiana and Rhode Island have "gone green," meaning they only accept applications on CD-ROM (and not hard copies). Indiana also requires that the CD-ROM include the FDD, application pages and franchise seller forms in three separate files.

6. **Maryland Registration – Additional Disclosure Required**. The Maryland regulations impose additional disclosures on franchisors with respect to sourcing restrictions placed on franchisees. Franchisors must not only disclose the restrictions on sourcing goods and services as required by the Amended Rule, but in certain circumstances, the franchisor must also disclose: (a) any affiliation between the franchisor and the source of the goods or services; (b) if there is an affiliation, the cost to the seller of the sourced items; (c) the prevailing market price for the goods or services; and (d) whether the franchisor or an affiliate ensure the availability of the goods under the terms of the franchise agreement.

7. **Minnesota – Bankruptcy Disclosures**. In Minnesota, franchisors must disclose bankruptcy information for a period of 15 years, compared to the 10-year disclosure period required by the Amended Rule. Although the state may not comment, a franchisor who deletes a bankruptcy disclosures after 10 years may be opening itself up to a claim by a disgruntled franchisee who was entitled to the 15-year disclosure.

8. **Franchisor Representations**. If a franchisor is renewing in a state where its registration has expired, certain states require that, as a condition to re-registration, an officer of the franchisor must swear under penalty of perjury that no offers or sales were made in that state during the time the franchisor's franchise concept was not registered in that state. Specifically, the States of Maryland and California require such a certification. More surprisingly, Michigan, a notice filing state, has recently begun requiring this type of certification as a condition to registration. Failure to provide this certification to Michigan will delay registration.

Hopefully, the above information will help you cross the "smoother franchise renewal process" resolution off of your list for 2011. Now it is time to shed those extra holiday pounds. Unfortunately, *The Franchise Lawyer* might not be your best resource for that.

Good luck and Happy New Year!!!

**The opinions expressed by Ms. Leets in this article are her own and do not necessarily represent the views of the California Department of Corporations or NASAA*

Back to Top

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American Bar Association • Forum on Franchising

Vol. 14 No. 1 | Winter 2011

INSIDE THIS EDITION

Standard of Review of Arbitration Awards: Has the "Manifest Disregard of the Law" Standard Survived?

By Diana V. Vilmenay
Nixon Peabody LLP

Beginning in the 1950s, manifest disregard of the law first became a judicially-recognized ground to vacate an arbitration award. In *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008), the Supreme Court held that the grounds for vacating an arbitration award are exclusively stated in the Federal Arbitration Act and cannot be expanded by contract. The holding created a great deal of confusion as to whether manifest disregard of the law could still be used as a valid ground for vacating an arbitration award. Unfortunately, despite the hope that the Supreme Court would answer this lingering question in *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010), the Court provided little clarification. Currently, there is a split of authority as to whether the manifest disregard of the law standard continues to exist and on what basis. By understanding the historical underpinnings and holdings in *Hall Street*, *Stolt-Nielsen* and subsequent court decisions, practitioners can gain a bit more control in an area where much uncertainty is likely to persist.

I. The Federal Arbitration Act

Depending on the terms of the parties' agreement, the nature of the underlying transaction and the forum, judicial review of an arbitration decision may be governed by state statutes, common law, or the Federal Arbitration Act, 9 U.S.C. § 1, *et seq*. ("FAA"). The FAA governs arbitrations where the underlying contract evidences a transaction involving interstate commerce or where a maritime or international dispute (with a "seat" in the United States) is involved. Arbitrations subject to the FAA are governed by a number of provisions which affect a court's power to review decisions rendered. As a threshold matter, arbitration decisions are generally final and binding, and a court must confirm an arbitration decision unless the court vacates, modifies or corrects it under specifically enumerated grounds. *Hall Street,* 552 U.S. at 587.

Section 10 of the FAA specifically states that a district court may *vacate* an arbitration award as follows:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
>
> > (1) where the award was procured by corruption, fraud, or undue means;

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> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

Courts, however, have vacated arbitration awards based on grounds outside of those explicitly listed in Section 10 of the FAA.

II. The Manifest Disregard Standard

Manifest disregard of the law "originated" from *Wilko v. Swan*, 346 U.S. 427 (1953), *overruled by Rodriguez de Quijas v. Shearson/American Express, Inc*., 490 U.S. 477 (1989). In *Wilko*, the Supreme Court determined whether Section 14 of the Securities Act of 1933 negated an agreement's arbitration provision, which required arbitration of securities fraud claims. In what was essentially *dicta*, the Court stated that "the interpretations of the law by the arbitrators *in contrast to manifest disregard* are not subject, in the federal courts, to judicial review for error." *See Wilko*, 346 U.S. at 436 (emphasis added). This statement suggests that, while an arbitrator's erroneous interpretation of the law is not subject to judicial review, his or her manifest disregard of the law *may be* subject to judicial review.

An arbitrator commits manifest disregard of the law when he or she makes an arbitration decision that is completely contrary to clear law that applies to the issue. Manifest disregard of the law contains three elements: (1) the law at issue must be clear and "explicitly applicable to the matter" pending before the arbitrator; (2) the arbitrator must have known of the law's existence and its applicability to the case before him or her; and (3) the arbitrator must have ignored the law resulting in an erroneous outcome which cannot be justified. *See T. Co Metals, LLC v. Dempsey Pipe & Supply, Inc.*, 592 F.3d 329, 339 (2d Cir. 2010).

Courts have applied this standard to cases involving judicial review pursuant to the FAA, state statutory law and common law. For example, the Third Circuit concluded that it could vacate an arbitrator's decision on the grounds that the arbitrator had demonstrated a manifest disregard of the law. *See, e.g., Local 863 Int'l Bhd. of Teamsters v. Jersey Coast Egg Producers, Inc.*, 773 F.2d 530, 533 (3d Cir. 1985). Given the broad latitude generally accorded to arbitration awards, however, courts have historically invoked the manifest disregard standard to vacate an arbitration award only in exceptional circumstances.

Over time, questions have arisen as to whether manifest disregard of the law is an appropriate standard for judicial review. After *Wilko*, it was unclear whether manifest disregard: (1) is an independent, separate ground for vacatur in FAA cases; (2) refers to all of the FAA Section 10 grounds collectively; or (3) refers to one or both of Sections 10(a)(3) and 10(a)(4) of the FAA. Arguably, manifest disregard of the law is a separate standard from the grounds in Section 10 of the FAA because it contemplates an award's substantive merit instead of a procedural deficiency in the arbitration.

III. The Supreme Court's 2008 *Hall Street* Decision

The precise question before the Supreme Court in *Hall Street* was whether the grounds for vacatur contained within the FAA could be expanded by private contract. 552 U.S. at 578. The Supreme Court granted certiorari to resolve a pre-existing split among the circuit courts about the issue. Before *Hall Street*, the First, Third, Fifth and Sixth Circuits had held that parties could expand the grounds for judicial review by private contract, while the Ninth and Tenth

Circuits held they could not. *Id.* at 583. *Hall Street* also presented an opportunity for the Court to clarify the manifest disregard standard and explain its role vis-à-vis the FAA grounds for vacatur.

The underlying *Hall Street* matter involved a dispute between a tenant and a landlord as to the tenant's right to terminate a commercial lease and the tenant's obligation to indemnify the landlord for the tenant's alleged failure to adhere to environmental regulations. The matter landed in Oregon district court and, after mediation on one issue, the parties decided to submit the other issues, including indemnification, to arbitration. One paragraph of the parties' arbitration agreement directed the district court to "vacate, modify or correct any award: (i) where the arbitrator's findings of facts [were] not supported by substantial evidence, or (ii) where the arbitration's conclusions [were] erroneous," in sum, when there was legal error. *Id.* at 579.

Ultimately, both parties sought the district court's review of the arbitration award. When the district court made only a small modification to the award, the parties appealed to the Ninth Circuit. The tenant argued that the Ninth Circuit's decision in *Kyocera Corp. v. Prudential-Bache Trade Servs.*, *Inc*., 341 F.3d 987 (9th Cir. 2003), essentially made the parties' arbitration agreement provision regarding judicial review for legal error unenforceable because the decision stated that the FAA grounds for judicial review were the only grounds parties could rely on to appeal an arbitration award. *Hall Street*, 552 U.S. at 580. In other words, parties could not expand the grounds for vacatur by private contract. Agreeing with the tenant, the Ninth Circuit remanded the case back to the district court to confirm the arbitrator's original decision in the tenant's favor unless the district court found it should be vacated under one of the grounds explicitly set forth in the FAA. Upset with the outcome, the landlord filed a petition for writ of certiorari, which the Supreme Court granted.

The Supreme Court held that the parties could not expand the scope of review authorized by the FAA by private agreement. It rejected the landlord's argument that the Court's decision in *Wilko* recognized judicial review of arbitration agreements subject to the FAA on grounds outside of Section 10 of the FAA, and held that Congress had provided the exclusive grounds for judicial review. *Id*. at 584-86. It is notable that the landlord in *Hall Street* sought to review the arbitrator's decision for legal error and not manifest disregard of the law. The landlord argued that since manifest disregard could be a separate independent ground for vacatur under *Wilko,* so then too could erroneous interpretation of the law be an independent ground for vacatur.

The Court was careful to limit its holding to cases involving judicial review of arbitration awards under the FAA. While the Court reiterated its unequivocal statement that Section 10 of the FAA provides the exclusive grounds for vacating an arbitration award, its decision declined to clearly define manifest disregard of the law or to clarify its relationship with FAA Section 10 (*i.e.*, whether it encompasses all of the Section 10 grounds, only covers the grounds in Section 10(a)(3) and/or 10(a)(4), or is completely separate from Section 10). *Id*. So, while the Supreme Court answered one question, it left unanswered the question of whether manifest disregard of the law is one of the grounds contemplated by the FAA or an independent ground which cannot be considered after *Hall Street*.

Back to Top

IV. The Supreme Court's 2010 *Stolt-Nielsen* Decision

When the Supreme Court granted certiorari in *Stolt-Nielsen,* there was hope that the Court would provide clarification to the manifest disregard of the law standard or determine whether it was still an appropriate ground for judicial review of arbitration awards. Unfortunately, that did not happen. The underlying issue in *Stolt-Nielsen* was whether an arbitration panel had committed a manifest disregard of the law when it submitted the parties, including shipping companies and their customers, to class arbitration when the underlying arbitration agreement was silent regarding the issue. The district court determined that the panel's decision was made in manifest disregard of the law because it failed to identify and apply a rule of decision

derived from the FAA, maritime or New York state law, which would have required the agreements to be interpreted by custom and usage.

The Second Circuit noted that the manifest disregard of the law standard was still viable after *Hall Street* as a "judicial gloss" on the grounds listed in FAA Section 10. 548 F.3d 85, 94 (2d Cir. 2008). It disagreed with the district court, however, and held that the arbitration panel's decision was neither in manifest disregard of federal maritime law nor New York state law, since the shipping companies had failed to cite any federal maritime rule of custom or usage, or any New York case law, that barred class arbitration. The shipping companies petitioned the Supreme Court for review on the question of whether imposing class arbitration on parties whose arbitration clauses were silent on the issue was consistent with the FAA.

The Supreme Court determined that imposing class arbitration on parties who had not agreed to authorize class arbitration was inconsistent with the FAA. However, it did not discuss whether manifest disregard of the law, the standard through which the district court had vacated the panel's decision, was still viable in light of the *Hall Street* decision. *Id*. at 1768, n.3.

V. Subsequent Decisions

After *Hall Street* and *Stolt-Nielsen*, it remains unclear whether manifest disregard of the law stands firm as a valid ground for vacating arbitration awards since the circuit courts still appear divided on the issue. The Fifth, Eighth and Eleventh Circuits have determined that manifest disregard of the law is an invalid ground for vacatur post-*Hall Street*. *See Maureen A. Weston, The Other Avenues of Hall Street and Prospects for Judicial Review of Arbitral Awards,* 14 Lewis & Clark L. Rev. 929, 940 (2010) (*citing Hicks v. Cadle Co.*, No. 08-1306, 2009 U.S. App. LEXIS 26523, at *24-25 (10th Cir. Dec. 7, 2009)).

The First Circuit, in *dicta*, in *Ramos-Santiago v. United Parcel Serv.,* 524 F.3d 120, 124 n. 3 (1st Cir. 2008), acknowledged that the Supreme Court's holding in *Hall Street* abolished manifest disregard of the law as a valid ground for vacating an arbitration award in cases brought under the FAA. However, the First Circuit in a subsequent case backtracked, stating it had "not squarely determined whether [its] manifest disregard case law can be reconciled with *Hall Street*." *Kashner Davidson Sec. Corp. v. Mscisz*, 601 F.3d 19, 22 (1st Cir. 2010).

The Second, Sixth and Ninth Circuits continue to recognize manifest disregard as a valid mechanism to vacate arbitration awards. *See* 14 Lewis & Clark L. Rev. 929, at 941. These circuit courts have used various ways to explain how the manifest disregard of the law standard continues to apply after *Hall Street*. For example:

- In *T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc.*, 592 F.3d 329 (2d Cir. 2010), the Second Circuit reiterated its position that manifest disregard remained a valid ground for vacating arbitration decisions "as a judicial gloss on the specific grounds for vacatur" under Section 10 of the FAA. However, in the underlying dispute, it declined to find that an arbitrator had committed manifest disregard of the law where it determined the arbitrator had reasonably interpreted New York law. *Id.* at 339-340.

- In *Coffee Beanery, Ltd. v. WW, LLC*, 300 F. Appx. 415 (6th Cir. 2008), *cert. denied,* 130 S. Ct. 81 (2009), the Sixth Circuit reversed a district court's confirmation of an arbitration decision and vacated the award on the grounds of manifest disregard of the law when the arbitrator declined to apply the required state franchise law. *Id.* at 415-16. In so holding, the court stated that while *Hall Street* prohibited private agreements to expand the scope of FAA review, it did not affect the judicially-recognized standard of manifest disregard of the law as an independent standard of review under the FAA.

- In *Comedy Club, Inc. v. Improv West Assocs.*, 553 F.3d 1277, 1290 (9th Cir. 2009), the Ninth Circuit reiterated that it found manifest disregard to be shorthand for Section 10(a)(4), which provides that an award can be vacated when an arbitrator has

exceeded his or her powers.

The Third and Tenth Circuits have currently declined to take a position, while the remaining circuit courts have yet to consider the issue. *See* 14 Lewis & Clark L. Rev. 929, at 941; *Bapu v. Choice Hotels Int'l Inc.*, No. 09-1011, 2010 U.S. App. LEXIS 5540, at *3 (3d Cir. Mar. 16, 2010) ; *Hicks*, No. 08-1306, 2009 U.S. App. LEXIS 26523, at *23.

VI. Practical Implications

These varying outcomes underscore the problems some practitioners may encounter until an ultimate resolution of the manifest disregard standard is reached. It is important for practitioners to pay attention to subsequent circuit court decisions after *Hall Street* since most franchise agreements with arbitration clauses are subject to the FAA. Some potential suggestions for negotiating arbitration agreements include the following:

- Limit appeals to an arbitration appeal panel. For example, the American Arbitration Association and the CPR Institution for Dispute Resolution provide helpful appeal procedures.

- Specifically list the types of disputes the client does not want subject to arbitration to avoid having to arbitrate those disputes.

- Determine if there is a way to make state arbitration laws apply rather than the FAA. Note that certain state courts, like that of California, have held that the *Hall Street* decision does not apply to state arbitration law.

- Be mindful of jurisdiction and forum selection clauses when drafting arbitration provisions as these may impact the judicial review of arbitration awards.

VII. Conclusion

After *Hall Street* and *Stolt-Nielsen*, private parties to an agreement subject to the FAA have lost some of the flexibility and freedom to contractually define the scope of judicial review. It is clear from *Hall Street* that the Supreme Court believes parties cannot contractually expand the grounds for vacating arbitration awards subject to the FAA. It is not clear, however, whether manifest disregard of the law fits, if at all, within the FAA Section 10 grounds. It seems unlikely that the Supreme Court will revisit this issue any time soon, especially since it declined to address whether the manifest disregard of the law standard was still viable post-*Hall Street* in *Stolt-Nielsen*, and denied a petition for certiorari in *Coffee Beanery*. Consequently, it appears that practitioners will have to get used to living with some level of uncertainty on this issue for the foreseeable future.

Back to Top

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INSIDE THIS EDITION

Topsy Turvy Year for Franchising in Canada

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The close of 2010 signalled the end of a year (perhaps a decade) of some predictable, more unpredictable, and a few astonishing developments in franchising in Canada. Lawyers advising franchisors who offer franchises in Canada, whether based in Canada, the United States, or another foreign country, need to understand these developments and be prepared to react quickly to necessary changes in franchise documents and practices resulting from new franchise laws and court decisions.

In addition, while perhaps the subject of a future article, there have been new laws in many commercial areas that impact standard business practices and documents of most franchisors in Canada. These include changes in price maintenance laws, minimum advertised prices, value added taxes, gift card legislation, pre-authorized deposit agreements, withholding taxes, class action certifications and summary judgment rules.

I. Legislative Developments

Canadian franchise disclosure laws are provincial, not federal, statutes and are self-regulatory in the sense that they are not approved by or registered with any governmental authorities. Ambiguities or uncertainties in the legislation are left to the courts to resolve. Occasionally, the results have led to bizarre interpretations forcing franchise practitioners to redraft agreements containing standard clauses previously thought to be state of the art.

Through the end of 2010, the only provinces in Canada which had enacted franchise legislation were Alberta, Ontario and Prince Edward Island. *Franchises Act*, R.S.A. 2000, c. F-23 (Alta.); *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 (Ont.); and *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1 (P.E.I.). The differences in these laws were minor but manageable. New Brunswick's franchise legislation, *Franchises Act*, S.N.B. 2007, c. F-23.5 (N.B.), is scheduled to come into force on February 1, 2011. However, New Brunswick's law contains some significant departures from that of the other provinces.

For example, the New Brunswick statute explicitly states that the duty of good faith and fair dealing extends to the performance and enforcement of the franchise agreement, which includes the exercise of a right under the franchise agreement, in contrast to the Ontario statute, which does not specifically include the exercise of a right under the franchise agreement. Similar to the legislation in Alberta and P.E.I. , but unlike the legislation in Ontario, the New Brunswick statute provides that a confidentiality agreement does not qualify as a "franchise agreement" for the purposes of the timing of the 14-day disclosure period. This permits franchisors to enter into limited confidentiality agreements with franchisees before disclosure.

The most unique feature of the New Brunswick statute is the prescribed party-initiated dispute resolution process. If there is a dispute, one party may notify the other of the nature of the dispute and the desired

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outcome, in which case the parties must resolve the dispute within 15 days of receiving the notice. If the parties are unable to resolve the dispute, a notice to mediate may be delivered, in which case the parties must follow the mediation rules or the party that received the notice may decline mediation.

The New Brunswick disclosure regulation, *Disclosure Document Regulation,* N.B. Reg. 2010-92 (Can.), generally requires disclosure similar to that in the other regulated provinces; however, there are some noteworthy differences.

- Delivery by courier or electronic means is specifically permitted.
- Disclosure documents prepared for use in other jurisdictions can be used, provided additional disclosure is given as required by the Act.
- The disclosure document must include the table of contents of any manual or a statement specifying where in New Brunswick the manual, if any, is available for inspection.
- A description of the franchisor's policies and practices regarding internet or distance sales must be provided.
- In addition to a list of current franchisees, the franchisor must provide a list of current businesses of the same type as the franchise that the franchisor operates in New Brunswick.

The fifth province in Canada to enter into the franchise legislation arena is Manitoba. The Manitoba *Franchises Act* (*Franchises Act*, C.C.S.M. c. F156 (Man.)) received Royal Assent on June 17, 2010, and the province is now working on draft disclosure regulations. While the legislation is substantially similar to Ontario's *Arthur Wishart Act*, there are some important differences.

Some differences will be well received by franchisors.

- A substantially complete disclosure document satisfies the delivery requirement, even if the disclosure document contains a "technical irregularity or mistake not affecting the substance of the document."
- A franchisor can update a previously delivered disclosure document as there is no requirement that the disclosure document be delivered in "one document at one time" (as there is in the *Arthur Wishart Act*).
- The legislation does not apply to any arrangement arising out of an agreement for the purchase of a reasonable amount of goods or services at reasonable wholesale prices, similar to Alberta's *Franchises Act* and P.E.I.'s *Franchises Act*.
- The disclosure document may be delivered by facsimile.
- Franchisors will be able to use deposit, site selection and confidentiality agreements (under limited circumstances) within the 14-day disclosure period.

Other changes will not be well received.

- The disclosure period is different than in any other province. All other franchise legislation provides that a franchisee must receive the disclosure document 14 days before the earlier of the signing of any agreement and the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or franchisor's associate relating to the franchise. In Manitoba, a franchisee must receive the disclosure document 14 days before the signing of any agreement and the payment of any consideration relating to the franchise by the prospective franchisee. The absence of any requirement that the consideration be paid to the franchisor or its associate could be construed to mean that the franchisor must ensure that a prospective franchisee does not pay any consideration to third parties (*e.g.* , a landlord's lease deposit) that relates to the franchise until the franchisee has been properly disclosed. It would be surprising, however, if the legislature meant to impose an onerous and

challenging obligation on franchisors to police prospective franchisees' activities.

- The "sophisticated franchisee" exemption has not been included. In Ontario, this exemption relieves a franchisor's disclosure obligations with respect to a franchisee who will invest more than $5,000,000 a year in the franchise.

It is expected that Manitoba's draft disclosure regulations will be released for public commentary in early 2011, with the goal of proclaiming the legislation in force by the end of 2011.

With only four provinces left in Canada to introduce franchise legislation (Quebec being the fifth, but having declared that it does not feel that franchise legislation is necessary as it is adequately covered by the general contract requirements of the province's *Civil Code*, L.R.Q. , c. C-1991 (Que.)), Canada has slowly but surely fallen into the trap of having consistent but subtly different franchise legislation among its provinces.

As a result, franchisors are required to ensure that their agreements and disclosure documents comply with these subtle differences.

Back to Top

II. Judicial Developments

On the judicial front, there have been a number of cases which have interpreted important provisions of provincial franchise legislation. These decisions have forced franchise lawyers to consider whether changes to disclosure documents and franchise agreement provisions need to be made. Because franchise disclosure laws in Canada require a disclosure document to be current at the time of delivery and are not based on an annual registration with periodic updates, all franchisors in Canada must review the accuracy of their documents on a regular basis, particularly at the time of each disclosure.

The following is a summary of some of the key judicial decisions in 2010. Readers must review these decisions in their entirety in order to understand their significance, as well as their application to franchise documents in Canada.

A. Interlocutory Injunctions

In *1318214 Ontario Limited et al v. Sobeys Capital Inc.* , [2010] O.J. No. 3211 (O.S.C.J. Sept. 13, 2010), the Ontario Superior Court granted an interlocutory injunction restraining Sobeys (a large grocery chain) from terminating the franchise agreements and taking possession of the franchisees' stores, and requiring the franchisees to comply with the franchise agreements while the injunction is in effect. The Court also ordered the franchisees to not withdraw any further amounts from their businesses or bank accounts for legal and/or accounting fees without the prior order of the Court.

Franchisors who pursue interlocutory injunctions to protect their franchise systems should get some comfort from the Ontario Divisional Court's dismissal of the franchisees' motion for leave to appeal in *Bark & Fitz Inc. v. 2139138 Ontario Inc. et al*. , [2010] O.J. No. 1428 (O.S.C.J. Mar. 4, 2010). In *Bark & Fitz Inc.* , the franchisor sought to enjoin 17 franchisees from breaching their franchise agreements by refusing to accept core products, failing to pay advertising and marketing fund contributions and royalties, and from terminating their franchise agreements and continuing as independent operations. The franchisees claimed that the franchisor's changes to products and inventory, misuse of the advertising and marketing fund, failure to remit rebates and the imposition of delivery charges deprived them of the benefit of the franchise system and therefore amounted to a fundamental breach of their agreements. The Court held that even if the franchisees could prove their claims, those claims did not amount to a fundamental breach of their franchise agreements. The Court also held that the franchisees' failure to pay royalties caused irreparable harm to the franchisor and created a risk to the good will and reputation of the franchise.

B. Ambiguities in Franchise Agreements

Franchisors must be extremely careful when drafting franchise agreement provisions as any ambiguity in the franchise agreement could be interpreted in favor of franchisees. In the Ontario Superior Court of Justice's decision in *1230995 Ontario Inc. v. Badger Daylighting*,

[2010] O.J. No. 2166 (O.S.C.J. Apr. 25, 2010), a franchisee brought a successful action against a franchisor for breach of contract based on the franchisor's decision to take away territories to which the franchisee believed it was entitled. The Court found that the franchise agreement was a contract of adhesion that was drafted solely by Badger and presented to the franchisee on a take-it-or-leave-it basis. As such, any confusion or ambiguity in the terms of the agreement was to be resolved in favor of the franchisee. The Court found that there was confusion and ambiguity in the description of the territory in the agreement, and determined that certain territories that were reassigned by Badger were in fact part of the franchisee's territory.

Many franchisors have found the Ontario Superior Court of Justice's decision in *405341 Ontario Ltd. v. Midas Canada Inc.* , [2009] O.J. No. 4354 (O.S.C.J. Oct. 16, 2009), troubling as it called into question some fundamental practices common in franchising. The Ontario Court of Appeal's July 6, 2010 ruling, [2010] O.J. No. 2845 (Ont. Ct. App. 2010), upheld the lower court's decision on all points.

First, the decision cast into doubt the enforceability of releases that franchisors commonly require franchisees to provide upon renewal or transfer of the franchise agreement. Not only did the Court of Appeal confirm that such releases are *prima facie* unenforceable, it also found that the provisions in the franchise agreement requiring such releases "offend and are contrary" to the non-waiver section of the *Arthur Wishart Act*. The Court of Appeal further upheld the lower court's finding that requiring franchisees to provide such releases on renewal or transfer of the franchise agreement violated the franchisees' statutory rights of association.

The lower court found that selecting Ontario as the governing law in franchise agreements for franchises operated outside of Ontario effectively expanded the jurisdictional application of Ontario's legislation to such provinces despite Section 2 of the statute, which states that the legislation applies only to franchises operated wholly or partly within the province. The Court of Appeal upheld the lower court's finding on this issue, meaning that franchisors who use Ontario as the governing law for franchises operated in other provinces do so at the risk of having the Ontario legislation apply, a startling result for provinces without franchise legislation.

C. Franchise Class Action Certification

On June 24, 2010, the Ontario Court of Appeal released its decision in *Quizno's Canada Rest. Corp. v. 2038724 Ontario Ltd*. , [2010] O.J. No. 2683 (Ont. Ct. App. 2010). In short, the Court of Appeal unanimously affirmed the Divisional Court's certification of a competition and franchise class action against a national franchisor for a range of contractual and antitrust claims arising from the franchisor's vertical supply and pricing arrangements. The decision is significant since: (i) the Court embraced a line of reasoning that will make it easier to seek certification of class proceedings in Canada, particularly with respect to claims that require proof of harm or damage as a component of liability; (ii) the Court appears to have endorsed a lower threshold for the certification of antitrust class actions in Canada; and (iii) the Court found that franchise disputes represent "exactly the kind of case for a class proceeding." The Court's decision suggests that franchisors that implement vertical pricing and exclusive supply arrangements may be exposed to class action litigation in Canada.

D. Deficiencies in a Disclosure Document

There is a difference between deficient disclosure and no disclosure under Canadian franchise laws. If there was disclosure, but the disclosure was deficient, a franchisee has 60 days after execution of the franchise agreement to rescind the agreement. If there was no disclosure or what amounts in law to no disclosure, the franchisee has a period of two years after execution to rescind.

Melnychuk v. Blitz Ltd., [2010] O.J. No. 306 (O.S.C.J. Jan. 27, 2010), a decision of the Ontario Superior Court of Justice, illustrates the types of deficiencies in a disclosure document which will cause a court to declare that a franchisor never provided a disclosure document. The case also shows the magnitude of damages which can arise when a franchisee is successful on a claim for rescission resulting from no disclosure.

The Court made a number of relevant observations and determinations. The financial statements provided to the plaintiff were not audited and were not prepared in accordance with the required standards. The franchise agreement was incomplete with respect to the location of the license and the territory. There was no indication of the purchase price, the franchise fee, any required deposits or the closing date of the franchisee's purchase of the business. The relevant lease and sublease were not contained in the disclosure document. The disclosure document did not contain any description of the non-competition covenant nor an option to purchase a new location within the territory, although these items were mentioned in the franchise agreement. The disclosure document omitted the form of indemnity agreement, and the general security agreement was incomplete.

The Court concluded that the deficiencies were material and therefore the franchisor never provided a disclosure document. Accordingly, the franchisee had the right to rescind the franchise and related agreements within the two-year period. In considering liability, the Court noted that the sub-landlord (or tenant under the head lease) was a company affiliated with the franchisor and held that its liability should be joint and several. In addition, the two directors and officers of the franchisor who signed the disclosure certificate were also determined to be jointly and severally liable along with the corporate franchisors. The damages award of $266,690 illustrates the significant risk that franchisors take in not complying strictly with the disclosure document requirements of the Act, particularly if there is potential for multiple rescission claims by numerous franchisees.

E. Other Notable Decisions

In *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd*. , [2010] O.J. No. 3071 (O.S.C.J. June 29, 2010), the Ontario Superior Court rejected the theory that a vendor franchisee could be responsible for providing a disclosure document to a purchasing franchisee on a resale or transfer.

Salah v. Timothy's Coffees of the World Inc. , [2009] O.J. No. 4444 (O.S.C.J. Oct. 18, 2010), involved a claim by an individual and his corporate franchisee for breach of a renewal clause in the franchise agreement. The Ontario Superior Court of Justice held that despite a standard assignment and guarantee from the individual franchisee to his corporation, the individual and the corporation were both entitled to damages, as franchisees, for the franchisor's breach of the franchise agreement, and both were entitled to further damages for the franchisor's breach of its duty of good faith and fair dealing. The Court also awarded the individual franchisee damages for mental distress suffered as a result of losing his livelihood. The case was affirmed on all claims by the Ontario Court of Appeal, [2010] O.J. No. 4336 (Ont. Ct. App. 2010).

III. A Word of Warning

As stated at the outset of this article, the close of 2010 signalled the end of a year of some astonishing developments in franchising in Canada. As franchisees are frequently advised to follow the classic warning, "buyer beware," franchisors (and their advisors) in Canada would be equally well advised to follow another classic warning, "seller be aware."

Back to Top

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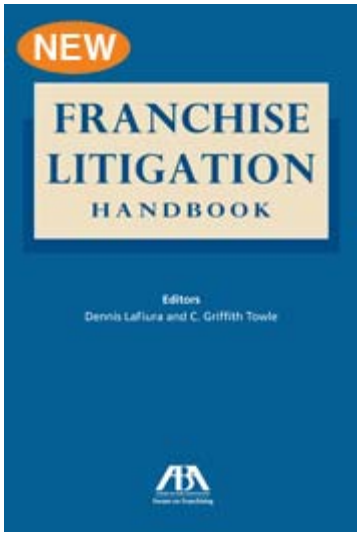

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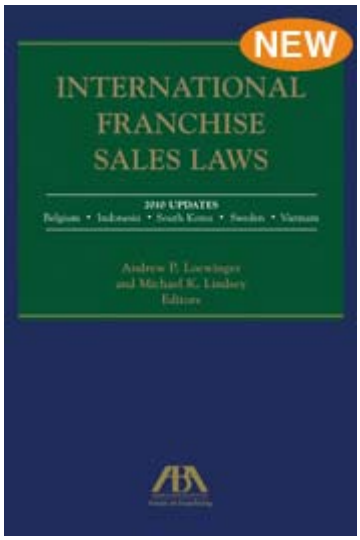

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