Fair Franchising Is Not An Oxymoron: No. 7

By Stanley Turkel, MHS, ISHC

In 1998, the Asian American Hotel Owners Association identified a set of standards called the 12 Points of Fair Franchising by which to judge the actions of franchise companies. Now, nine years later, AAHOA has updated the 12 points and has embarked on a survey of franchisors to assess their compliance with these fair franchising standards. In this Hotel Interactive article, I highlight Point 8:

Point 8: Dispute Resolution.

In all franchise agreements, Franchisors and Franchisees should commit to establishing an independent and fair process for the resolution of any disputes concerning the terms of an franchise agreement itself, or the relationship between the parties. Specifically, Franchisors and Franchisees should agree in good faith to participate in an informal, in-person meeting between the authorized representatives of the parties in an attempt to resolve a dispute.

If the informal meeting is unsuccessful, the parties should agree to participate in a non-binding mediation, before a mediator who is neutral and mutually acceptable to the parties, including a mediator associated with the National Franchise Mediation Program.

If the mediation is unsuccessful, the dispute should not be submitted to binding arbitration unless and until all parties agree to do so, including mutually agreeing on the arbitrator who will hear the dispute, the location of the arbitration proceedings, and the corresponding rules and procedures for the arbitration.

Absent an agreement by the Franchisor and Franchisee to use binding arbitration to resolve their dispute, any party should be entitled to pursue its claims against another party in a court of law. There should be no waiver of the right to a jury trial by any party. There also should be no caps or limits on the amount of damages that a party can seek or recover against another party, including a cap or limit on the amount of punitive damages that can be recovered against a party as allowed by law.

Turkel Comment

Many hotel franchise agreements stipulate arbitration over litigation. At first glance, this may appear to be more beneficial to franchisees but nothing could be further from the truth. Compulsory arbitration protects franchisor interests while diluting franchisee remedies.

What are the disadvantages of arbitration?

First, in court you can obtain a jury trial assuming that you have not waived this right elsewhere in the agreement. Having a dispute resolved by a jury of your peers is a valuable right which should not be underestimated. Arbitrators are usually lawyers who may be friendly with your franchisor or its attorneys since arbitration clauses typically require arbitration to take place in the city where the franchisor's headquarters are located.

Second, arbitration is very expensive, even as compared to litigation. Unlike state and federal courts where judges are compensated by taxpayer's dollars, you must pay the arbitrators by the hour (from approximately $250 to 500 per hour), and must pay significant additional filing and administrative fees for the arbitration process.

Third, the discovery process, during which each side gathers its evidence (depositions, documents, etc.) for a trial, is very limited. This aspect hurts a franchisee disproportionately because he or she has the "burden of proof," and usually needs additional facts and documents in possession of the franchisor to build the case.

Fourth, the normal rules of evidence and procedure do not apply in the same way as they would in federal or state court. Instead, the law affords the panel a great deal of flexibility and discretion in conducting the arbitration hearing, and a reviewing federal court will rarely, if ever, reverse the panel's decision – even if it is legally and/or factually incorrect.

The bottom line is – do not agree to arbitration if you can possibly avoid it.

A close cousin of the arbitration clause, the "no jury" clause, requires that the franchisee waive what would otherwise be its right to a trial by jury. Franchise companies believe that jurors may be "sympathetic" to a franchisee who has been mistreated. At the very minimum, the franchisee should be the one to decide whether to have a jury trial. Do not forfeit this option unknowingly when the franchise agreement is signed.

Who are the arbitrators?

Usually, each side selects an arbitrator and then the two arbitrators pick the third one. Arbitrators are usually certified by a Bar Association committee. They are local business people and/or lawyers who have at least two major drawbacks:

1) Since the arbitration usually takes place in the headquarter city of the franchisor, the arbitrators are likely to know the franchisor's attorneys.

2) While the pool of arbitrators may have general business experience, very few have knowledge of the hotel franchise format.

A December 4, 2006 decision by the Ninth Circuit Court of Appeals (Nagrampa v. MailCoups, Inc.) found that an arbitration clause in a franchise agreement was unenforceable under California law. Some observers believe that if the arbitration clause in this case is unenforceable, then no arbitration commitment is safe. This decision calls into question all arbitration clauses. Be sure to have your attorney check it out.

Is there a better way to resolve problems?

Yes there is and it's called mediation. It can solve many business problems quickly, cheaply and on terms acceptable to all sides.

Unlike arbitration, mediation is non-binding. Because the mediator doesn't decide anything, the parties can, if they choose, ignore anything he or she says. A mediator is a go-between who tries to help the parties come to an agreement, not to tell them who is right or wrong. Mediations usually last one day and either result in agreement between the parties or continuation of the dispute, not an award, decision or judgment. Either party is free to file a lawsuit. Mike Amin, former Chairman of the Asian American Hotel Owners Association said, "Fostering dialogue is a necessity in the pursuit of a healthy system and non-binding mediation between the franchisor and franchisee could be a "win-win" situation. Not only is it a less costly process, but it's also a system that could foster a stronger partnership between the parties rather than the adversarial roles that can come with legal intervention."

The Senior Vice President of the CPR Institute for Dispute Resolution says "Mediation works almost every case. Of the franchise disputes that have been formally submitted to the National Franchise Mediation Program, more than 80 percent were resolved amicably."

The NFMP has earned the endorsement of the International Franchise Association, the American Association of Franchisees and Dealers, the National Franchise Council and the Asian American Hotel Owners Association.

Here's how mediation works: With CPR's help, the parties decide who the mediator will be, how much the mediator will be paid, when the mediation will take place, how long it will take and other details. Control of the process is a key feature of mediation. Parties can use a mediator listed with the program or pick one of their own choosing who is not affiliated with it.

Disputing parties who decide to use the program split the administrative fee and usually also split the fee of the mediator. In the course of negotiation and mediation, the parties may agree to reallocate the fees.

In actual practice, a mediator will typically meet with both parties separately to get their complaints or points of view and then bring the two parties together to attempt to reach compromise that will result in a solution. A good mediator will listen to both sides of the story and try to discern common threads among the arguments. Mediators are free to devise solutions that a judge or even an arbitrator might not be able to suggest. Judges are bound by legal precedent and arbitrators by the terms of arbitration agreement. But mediators have much more latitude.

Ronald K. Gardner, Jr. of Dady & Garner, a well-known Minneapolis law firm, warns that in order for mediation to be successful, the decision makers from both sides have to be present. For the franchisee that's not usually a problem but franchisors do not always send a decision maker to an individual mediation. "You need someone high enough up, that they don't have to make a call to the home office," Gardner said.

You can find out more about this important program by logging on to www.franchisemediation.org.

Stanley Turkel, MHS, ISHC operates his hotel consulting office as a sole practitioner specializing in franchising issues, asset management and litigation support services. If you need help with a hotel franchising problem such as encroachment/impact, termination/liquidated damages or litigation support, call Stanley at 917-628-8549 or email stanturkel@aol.com.

Stanley will be speaking on the program of the CHOC Owner's Summit in Dallas, TX April 6-8, 2008.