

2nd Civ. No. B198018

**In the Court of Appeal
of the State of California
Second Appellate District, Division One**

Lesa Meyers, *et al.*

Plaintiffs and Respondents,

vs.

Cold Stone Creamery, Inc., *et al.*

Defendants and Appellants.

Los Angeles County Superior Court, Case No. BC358836
Honorable Paul Gutman

**Application and Brief of the International Franchise Association as
Amicus Curiae in Support of Cold Stone Creamery, Inc., et al.,
Defendants and Appellants**

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The International Franchise Association (“IFA”) seeks leave to file a brief as amicus curiae in support of Cold Stone Creamery, Inc., and the other defendants and appellants in the pending appeal.

The IFA is the oldest and largest trade association in the world devoted to the representation of the interests of franchising. The IFA is a membership organization of franchisors, franchisees, and suppliers. Since its inception in 1960, the IFA has represented and protected the interests of the franchise community as well as the American entrepreneurial spirit. The IFA has more than 11,400 members that, collectively, represent a “who’s who” of American industry. The IFA represents over 70% of the registered franchise companies in the United States. Since 1993, when it first invited franchisees to join, the IFA has attracted more than 10,000 franchisee members, a number of whom currently serve in leadership positions, including members of the IFA’s Executive Committee and Board of Directors. The IFA’s members conduct business in virtually all of the 75 industries that choose franchising as a method of doing business.

The IFA’s mission is to enhance and safeguard the business environment for franchising worldwide. In addition to serving as a resource for current and prospective franchisors and franchisees, the IFA and its members work closely with public officials across the country to shape the laws and regulations that govern franchising, with the goals of promoting franchise growth and advancing the interest of both franchisees and

franchisors. The IFA is the only trade association that acts as a voice for both franchisors and franchisees throughout the United States and the world.

Counsel for amicus curiae has read the parties' principal briefs. Having read those briefs, counsel believes that the analysis and policy considerations in the accompanying brief will help to define the considerations that govern the appropriate decision in this case. Accordingly, the IFA respectfully requests permission to file, on its own behalf and on behalf of its members, the attached amicus curiae brief.

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I.

INTRODUCTION

The International Franchise Association (IFA) presents this amicus brief to the Court because of its concern that Judge Gutman’s decision reflects a fundamental misunderstanding of franchising as a method of doing business and is emblematic of a new judicial hostility to arbitration that conflicts with policies underlying the Federal Arbitration Act (FAA). Judge Gutman’s ruling turns on a paternalistic view of franchisees as naïve and unsophisticated in comparison to franchisors. It assumes that franchisees, like consumers and employees, need special protection from opportunistic conduct by large franchisors — franchisors that supposedly present them with one-sided, take-it-or-leave-it contracts that they have little alternative but to sign “as is.” The decision in turn presupposes that arbitration is not an acceptable method for resolving franchise disputes and that the courts alone can properly vindicate the rights of franchisees.

All of these assumptions share one thing in common — they are ultimately just “assumptions.” None are supported by any cogent economic analysis or any empirical data. In fact, the available data indicates that franchisors today are as a whole independent businessmen, businesswomen, and companies perfectly capable of watching out for their own best interests.

“As with most paternalistic endeavors,” Judge Gutman’s view of franchisees as needing special judicial protection carries with it the “seed of great irony.” *Nagrampa v. MailCoups, Inc.* (9th Cir. 2006) 469 F.3d 1257, 1312 (Judge Kozinski dissent). Ironically, the standard form of franchise agreement (the supposed take-it-or-leave-it form of agreement) that Judge Gutman uses as a springboard to his finding of procedural unconscionability actually assures that smaller, supposedly “weaker” franchisees with less bargaining power will enjoy the same contractual protections as “stronger” franchisees. This is true because franchisors must tailor their agreements to meet the demands of the most sophisticated and “powerful” franchisee. Equally ironical is that it is franchising that allows the smaller entrepreneur to hitch its wagon to the star of a successful brand and system to compete with more powerful businesses. Depriving franchisors and their franchisees as a whole of the economies attendant to arbitration flirts with killing the proverbial goose that laid the golden egg.

The purpose of this amicus brief is to share concepts about franchising that the IFA has learned from its nearly 50 years in existence. We do not intend to focus unduly on the specific facts of this case, except to the extent that they illustrate the application of important franchising concepts in a real world situation. We will begin by addressing the evolution of franchising into what it is today. We will next consider in general why application of principles of unconscionability are incongruous

with modern franchising. We will focus on the elements of “oppression” and “surprise” as they relate to a commitment to arbitration in a franchise agreement, followed by a discussion of substantive unconscionability. We will conclude with a review of the dangers attendant to the new judicial hostility to arbitration as it impacts alternative dispute resolution between franchisor and franchisee.

II.

THE NATURE OF THE MODERN BUSINESS FORMAT FRANCHISE

A. A Brief History

The COLD STONE CREAMERY® franchise opportunity is a “business format franchise.” This distinguishes it from a traditional (or product distribution) franchise. Under the traditional format, the franchisor manufactures and sells finished or semi-finished products to its dealers or franchisees. The franchisee, in turn, resells the product to consumers or others in the chain of distribution. Classic examples of traditional franchises are automobile dealerships and gasoline service stations.

A business format franchise, in contrast, “includes not only the product, service, and trademark, but the entire business format itself — a marketing strategy and plan, operating manuals and standards, quality control, and continuing two-way communication.” U.S. Department of Commerce, 1998 *Franchising in the Economy* at 3. Under a business

format franchise, the franchisor licenses a franchisee to use an established trade or service mark and proven method of doing business, thus enhancing the likelihood of a franchisee's successful operation of a business. In exchange, the franchisee pays a fee to the franchisor.

Although franchising has existed in one form or another for literally centuries, modern business format franchising as we commonly think of it today developed in the wake of World War II. Two things in particular happened after World War II that culminated in modern-day franchising: the return from the war of millions of servicemen and women looking for career opportunities and ready to spend money on consumer goods, as well as the growth in the United States highway system and the common use of the automobile, making roadside restaurants and hotels popular.

It was not until April 13, 1955, however, that modern-day business format franchising was born. On that day, Ray Kroc opened his first McDonald's hamburger stand in Des Plaines, Illinois. Ten years later, McDonald's had grown to approximately 1,000 units. During that period of time, Kroc and his lieutenants at McDonald's established the business format franchise model that guides all successful business format franchise systems today. McDonald's built a central organization to develop standards of operation, train franchisees, and enforce compliance with standards. *See generally* John F. Love, *MCDONALD'S: BEHIND THE ARCHES* (1995).

B. The Regulation of Franchising

Business format franchising exploded in the United States in the 1950s and 1960s. This explosion inevitably led to franchisee complaints of abusive practices by franchisors. Horror stories surfaced of franchisors stealing the life savings of mom-and-pop franchisees through fraud, precipitous terminations, and other unfair conduct. Some skeptics even questioned whether franchising was a legitimate business method. The Wisconsin Department of Financial Institutions sums up the situation as follows:

Franchising as a means of distributing products and services was not aggressively pursued until the 1950's and 60's. The booming popularity and growth of franchising, the profits which inured to franchisors, and oft-repeated stories of franchisees who "struck it rich" through franchising were accompanied by the abuse of that system by a few fly-by-night, unethical and, often, criminal operators. Futuristic Foods, Holiday Magic, Koscot Enterprises, and other such scams were horror stories of tens of millions of dollars of peoples' life savings invested in what they thought were businesses which would provide income, but which instead turned out to be schemes to defraud.^[1]

State legislatures and the federal government responded by enacting laws in the early 1970s and into the 1980s to protect franchisees.

California led the way in 1971 when it enacted its California Franchise Investment Law (CFIL), a law requiring franchisors to disclose

¹ The State of Wisconsin Department of Financial Institution, Securities & Franchising, Franchising Regulation Overview, <http://www.wdfi.org/fi/securities/franchise>.

specific information to franchisees, as well as register the franchise opportunity with the state. California described the purpose of the CFIL in its preamble law as follows:

The Legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems both from an investment and a business point of view in the State of California. Prior to the enactment of this division, the sale of franchises was regulated only to the limited extent to which the Corporate Securities Law of 1968 applied to those transactions. California franchisees have suffered substantial losses where the franchisor or his or her representative has not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between franchisor and franchisee, and the prior business experience of the franchisor. *It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered.* Further, it is the intent of this law to prohibit the sale of franchises where the sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled and to protect the franchisor and franchisee by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship.

CAL. CORP. CODE § 31001 (2007) (emphasis added). As set forth in the preamble, California concluded that the best way to protect franchisees against opportunistic practices by franchisors was through disclosure — disclosure of nearly every critical element of the franchise relationship.

Today, 20 states and Puerto Rico have separate legislation requiring pre-sale disclosure of specified information by a franchisor to a potential franchisee. These states in turn break down into registration and

nonregistration states. Thirteen states, including California, impose some form of franchise registration obligation on the franchisor (a requirement that the franchisor file the disclosure document with the state) before the offer or sale of a franchise.²

In 1979, the federal government stepped into the fray of franchise regulation when the Federal Trade Commission (FTC) adopted its “FTC Rule” — “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures.” 16 C.F.R. Part 436.1. Like California, the FTC concluded that the best way to protect prospective franchisees is through disclosure. According to the FTC’s “Statement of Basis and Purpose” supporting its adoption in 2007 of its “Amended Franchise Rule”:

To prevent deceptive and unfair practices in the sale of franchises and business opportunities and to correct consumers’ misimpressions about franchise and business opportunity offerings, the Commission adopted the original Franchise Rule, which is primarily a pre-sale disclosure rule. The original Rule did not purport to regulate the substantive terms of the franchise or business opportunity relationship. Rather, it required franchisors and business opportunity sellers to disclose material information to prospective purchasers on the theory that informed investors can determine for themselves whether a particular deal is in their best interest.

72 Fed. Reg. 15445.

² David A. Beyer & Scott P. Weber, *Perilous Prospects — Part I: Lawsuits to Get Into the System* (Spring 2003) FRANCHISE L.J. 224, 232.

As a result of these regulations, prospective franchisees in California have had for more than 30 years now ready access to all information the state has deemed “necessary to make an intelligent decision regarding franchises being offered.” Franchisors like Cold Stone have filed with the state of California and presented to prospective franchisees disclosure documents with a broad variety of information ranging from the history of the franchisor, litigation and arbitration filed against the franchisor, the terms of the franchise agreement, and the identity of existing franchisees.³

C. Franchising Today

In the 50 or so years since it first appeared in the United States in a big way, business format franchising has established itself as a proven method of doing business. Today, franchising is ubiquitous. The IFA estimates that there are approximately 1,500 franchisors doing business in the United States today.⁴ Respected names like Hilton, Holiday Inn, McDonald’s, Avis, and Wendy’s are in the franchise business. There are

³ California at the time of the sale to Meyers required that franchisors comply with the Uniform Franchise Offering Circular (UFOC) guidelines, CAL. CODE REGS., tit. 10, § 310.114.1. The guidelines are available at <http://www.nasaa.org/content/files/UniformFranchiseOfferingCircular.doc>.

⁴ See World Franchise Council, IFA Fact Sheet, http://www.worldfranchisecouncil.org/control/product?product_id=FC_US.

now multiple franchise concepts competing with each other in almost every segment of the retail and business-to-business industry.⁵

A study conducted by Price Waterhouse Coopers of economic data from 2005 sought to measure the “direct impact” on the U.S. economy of franchise businesses, the “total impact” of franchise businesses on the economy, and the employment generated by franchising according to various economic sectors. The report concluded that franchise businesses generate jobs for 21 million Americans, and 909,000 franchise businesses generate an annual economic output of \$2.3 trillion, or 11.4 percent of the total private U.S. sector output.⁶

Accompanying the growth in the number and size of franchisors has been an ever-increasing number of sophisticated and well-capitalized franchisees. Multi-unit franchisees owning not only several units in one franchise system but also several units in several systems are commonplace today.

⁵ The IFA invites the Court to visit the website of *Entrepreneur Magazine* devoted to franchising. The website identifies the various market segments within which franchisors do business. <http://www.entrepreneur.com/franchises/categories/index.html>. The website portrays the many alternatives a prospective franchisee has in choosing a franchisor.

⁶ This study was funded by the IFA. The IFA will make the results of the study public in March 2008. The IFA funded a similar study in 2001. This study showed that franchise businesses generate jobs for more than 18 million Americans, and more than 706,000 franchise businesses generate a total economic output of more than \$1.53 trillion, or nearly 10 percent of the U.S. private sector economy. The results of this study are available at: <http://www.franchise.org/franchiseesecondary.aspx?id=3206>.

III.

APPLICATION OF PRINCIPLES OF UNCONSCIONABILITY TO FRANCHISING

A. The Franchise Relationship as a Business Relationship

Judge Gutman’s decision reflects a basic misunderstanding of modern business format franchising. The judge’s opinion embraces what one study describes as the “naïve-franchisee view.” See James A. Brickley, Sanjog Misra & R. Lawrence Van Horn, *Contract Duration: Evidence From Franchising* (2006) 49 J. LAW & ECON. 173. This view equates franchisees with consumers and employees — a special class of individuals in need of special protection by the courts from opportunistic practices of third parties.

Courts typically embrace the naïve franchisee view at the invitation of franchisee advocates. The respondents’ brief is a classic example of the hyperbole that often characterized their arguments. The respondents claim that Cold Stone had “vastly superior bargaining power” over Meyers. As evidence of this “inequity of bargain power,” respondents claim that “Meyers never had any real ‘opportunity’ to negotiate or revise either clearly adhesive agreement.” Resp. Br. at 6-7.

The fundamental flaw in the naïve franchisee view advocated by the plaintiffs here and accepted by the judge is that it focuses on only two specific parties (Meyers and Cold Stone) to one specific franchise

relationship. It concludes that just because this specific franchisor used a standard franchise agreement from which it was presumably not prepared to negotiate changes for a single franchisee, it must follow that the agreement reflects “vastly superior bargaining power” on the part of the franchisor leading to terms that are decidedly one-sided. In reality, standard franchise agreements are the product of franchisors competing head-to-head to attract franchisees — franchisees who have a wealth of information at their disposal as a result of federal and state regulations. Gone are the days when unscrupulous franchisors could hoodwink unsuspecting franchisees into signing one-sided franchisee agreements that left them with no rights. When viewed from the larger perspective of franchisors competing to secure multiple, well-informed and capitalized franchisees, franchise agreements are anything but the product of unequal bargaining power.

The naïve view of the franchisee is simply at odds with the present-day realities of franchising. Professors Blair and Lafontaine in their recent treatise, *THE ECONOMICS OF FRANCHISING*, identify “four popular misconceptions about franchising,” one of which is that “franchisees all operate small mom-and-pop ventures, and are inexperienced and unsophisticated in business matters,” a misconception the authors say leads to a “perception of imbalance of power between franchisors and franchisees” Roger D. Blair & Francine Lafontaine, *THE ECONOMICS OF FRANCHISING* 49 (2005). According to Blair and Lafontaine:

The main conclusions to draw from the data are that a very large number of franchisees, most likely the majority of them, to this day are single-unit owners, but multi-unit ownership is present at least to some degree in almost all franchised chains, and a large proportion of franchised units belong to multi-unit franchisees. Moreover, many multi-unit franchisees are large and sophisticated companies. In fact, the data imply that the largest 200 franchisees are larger on average than the typical (median) franchisor.

Id. at 50. It is these sophisticated franchisees that franchisors like Cold Stone must direct their franchise opportunity, including the franchise agreement that will govern the franchisor-franchisee relationship.

Professors Brickley, Misra, and Van Horn in their study published in 2006 in the University of Chicago *Journal of Law and Economics* also debunk the naïve franchisee view. 49 J. LAW & ECON. 173. They first explain the difference between the “standard economic view” of franchising and the “naïve franchisee view.” *Id.* at 174. According to the authors, the economic view “casts the marginal franchisee [the franchisee who is “relatively well informed”] as a rational individual who adjusts his reservation price for a franchise on the basis of the terms in the contract.” *Id.* “The naïve franchisee view, by contrast, implies that the contracts of larger, better-known companies will not reflect the concerns of the franchisee (the contracts are one-sided).” *Id.* Studying the contracts of over 1,000 franchisors, the authors conclude that the naïve view is inconsistent with reality. They find that large franchisors do cater to the interests of franchisees by issuing franchise agreements of long duration, one of the

most critical elements of any agreement for any franchisee. The franchise agreement issued by Cold Stone to Meyers is consistent with the findings from this study. It has an initial term of ten years and renewal rights to the franchisee for four consecutive five-year terms. With a potential term of 30 years, the franchise agreement at issue here is anything but “one-sided.” The Cold Stone agreement reflects that this franchisor must compete for franchisees and must tailor its agreement to attract desirable franchisees. The ultimate beneficiary is every franchisee that receives the standard form of agreement, including Meyers

B. The Standard Franchise Agreement As a Method for Protecting Smaller Franchisees

Ironically, when courts punish franchisors for utilizing uniform, supposed take-it-or-leave-it franchise agreements by finding procedural unconscionability, they ultimately do a disservice to smaller, supposedly “weaker” franchisees. As reflected in the study published by the University of Chicago, standard franchise agreements, particularly those of larger franchisors, like Cold Stone, benefit all franchisees, regardless of size. The franchisors must craft their agreements so as to entice the most sophisticated of franchisees into purchasing their franchise opportunity.

Not only is a standard form of franchise agreement good for all franchisees, the law encourages its use by franchisors. At the time of the sale of the franchise opportunity by Cold Stone to the plaintiffs, California

law required that franchisors comply with the Uniform Franchise Offering Circular (UFOC) Guidelines. Item 22 of the Guidelines required that Cold Stone “attach a copy of all agreements proposed for use or in use in this case regarding the offering of a franchise, including, the franchise agreement” *See* footnote 3.

This did not mean that Cold Stone and the Meyers could not negotiate terms inconsistent with the standard form of agreement as contained in the Cold Stone UFOC, but California law discouraged such negotiations. Section 31125 of the California Corporations Code makes it unlawful for a franchisor to solicit the modification of an agreement without giving the franchisee five business days’ notice of the modification or a right to rescind by reason of the modification for a specified period of time after execution. Further, the California franchise regulations state that where a franchisor offers or sells a franchise on terms different than those contained in its standard form of agreement, it must file a “negotiated sales notice” with the state of California and must attach to its UFOC all such notices it has filed within the prior 12-month period. *See* § 310.100.2 of the CALIFORNIA ADMINISTRATIVE CODE. In short, California takes steps to assure that smaller, supposedly “weaker” franchisees will enjoy the same protections in a franchise agreement as their larger, more “powerful” counterpart.

There are a number of other reasons that franchisors are slow to negotiate off of their standard form of agreement. Contract administration becomes more complex as franchisors issue agreements with different terms. Franchisees tend to become upset upon learning that other franchisees have negotiated more favorable terms. Finally, the whole point of franchising is uniformity in the presentation of a product or service, and the creation of agreements with consistent rights and obligations contributes to this uniformity.

IV.

PROCEDURAL UNCONSCIONABILITY

The parties have addressed at length the elements of procedural unconscionability under California law. The IFA will not restate the law. The IFA is concerned, however, with the application to franchising of legal principles of unconscionability designed to protect the likes of consumers and employees. Franchisees are not typically subject to the sort of “oppression” or “surprise” that triggers procedural unconscionability as defined by the California Supreme Court. Nor do the facts here suggest that Meyers was any more vulnerable to such oppression or surprise than the typical franchisee.

A. Oppression

California courts define “oppression” for purposes of procedural unconscionability as arising “from an inequality of bargaining power that

results in no real negotiation and an absence of meaningful choice.” *Flores v. Transamerica HomeFirst, Inc.* (2003) 93 Cal. App. 4th 846, 853. As stated above, the standard franchise agreements are not the result of “inequity of bargaining power” simply because they are generally not subject to negotiation. They are the byproduct of franchisors operating in a competitive market for franchisees. As a consequence, standard franchise agreements actually benefit the supposedly “weaker” party to the franchise transaction. Because franchise agreements do not typically vary from one franchisee to the next, the smaller franchisee gets the same benefits of the same agreement as larger franchisors. Favorable contract terms added by franchisors to their standard agreement to attract larger, more sophisticated franchisees incur to the benefit of all franchisees, regardless of their economic wherewithal.

Because franchisors compete for franchisees, franchisees have meaningful alternatives when comparing one franchise opportunity with another. The court observed in *Dean Witter Reynolds, Inc. v. Superior Court* (1989) 211 Cal. App. 3d 758, 771, that “even though a contract may be adhesive, the existence of ‘meaningful’ alternatives available to such contracting party in the form of other sources of supply tends to defeat any claim of unconscionability.”

Franchising is highly competitive. With approximately 1,500 franchisors in the United States, franchisees have a number of choices when

it comes to buying a franchise opportunity. Franchise opportunities are particularly abundant in the fast food and treat side of franchising. *Entrepreneur Magazine* identifies some 30 franchisors offering frozen dessert franchises, a number of which, like Cold Stone, offer high-end ice cream products.⁷ In addition to Cold Stone, other such franchisors include Ben & Jerry's, Haagen-Dazs, Marble Slab, Baskin-Robbins, and 31-Flavors.

If a particular franchisee does not like the terms of a franchise agreement offered by a particular franchisor, it has the option to purchase a franchise from a different franchisor offering a different form of agreement. As the FTC observed in its "Statement of Basis and Purpose," a "franchise purchase is entirely voluntary Prospective franchisees can avoid harm by comparison shopping for a franchise system that offers more favorable terms and conditions, or considering alternatives to franchising as a means of operating a business." 72 Fed. Reg. 15445.

Applied to the facts of this case, plaintiff Meyers had a broad array of choices in making her investment decision. Cold Stone presented her with all the information required by law — information that the state of California deemed "necessary to make an intelligent decision regarding" the franchise offered by Cold Stone. If she did not like the terms of the

⁷ See Entrepreneur.com Ice Cream Franchises, <http://www.entrepreneur.com/franchises/categories/ffqicecr.html>.

Cold Stone franchise agreement, Meyers could certainly walk away from that alternative and choose another franchisor or, as the FTC notes, “consider alternatives to franchising.”

B. Surprise

The type of “surprise” necessary to trigger procedural unconscionability under California law “involves the extent to which the supposedly agreed-upon terms are hidden in a prolix printed form drafted by the party seeking to enforce them.” *Id.*

Franchisees, particularly those located in the state of California, cannot reasonably claim “surprise” at the existence of a commitment to arbitrate in a franchise agreement. California, in fact, regulates the notice that franchisors must give to franchisees of the existence of a commitment to arbitrate, particularly an obligation to arbitrate outside the state of California. The California “Guidelines for Franchise Registration” established by the California Department of Corporations dictate the information that a franchisor must place on the outside front cover of its offering circular. Among other things, California law requires that a franchisor disclose on its cover page, in all capital letters, certain “risk factors” using certain specified language. As it relates to arbitration outside of California, the regulations require the following statements on the cover page of the disclosure document:

THE FRANCHISE AGREEMENT PERMITS THE FRANCHISEE (TO SUE) (TO ARBITRATE WITH) _____ ONLY IN _____. OUT OF STATE (ARBITRATION) (LITIGATION) MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST MORE (TO SUE) (TO ARBITRATE WITH) _____ IN _____ THAN IN YOUR HOME STATE.

The UFOC used by Cold Stone at the time of the sale of the franchise opportunity to Meyers contained the disclosure required by California law.⁸

According to the Cold Stone UFOC:

Risk Factors:

THE FRANCHISE AGREEMENT AND THE OTHER DOCUMENTS TO BE SIGNED BY THE FRANCHISEE PERMIT THE FRANCHISEE TO ARBITRATE OR LITIGATE WITH THE FRANCHISOR ONLY IN THE STATE OF ARIZONA. OUT OF STATE ARBITRATION OR LITIGATION MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST MORE TO ARBITRATE OR LITIGATE WITH THE FRANCHISOR IN THE STATE OF ARIZONA THAN IN YOUR HOME STATE.

⁸ California law requires that most franchisors register their franchise opportunity with the state. As a result, the disclosure document is a matter of public record. The Cold Stone disclosure document on file with the state of California is available at <http://134.186.208.228/caleasi/search.asp?TASKNAME=xshowDocs&PackageID=71328>. The UFOC on file with the state contains the same document control number (05104) as the receipt signed by Meyers. *See* Exhibit 3 to the Beem affidavit, Tab No. 3 of appellants' appendix, page 067 of the record. The Court may properly take judicial notice of the disclosure document pursuant to CAL. EVID. CODE § 452(h).

V.

SUBSTANTIVE UNCONSCIONABILITY

As it relates to substantive unconscionability, the IFA agrees with Cold Stone that the lesson from *Buckeye Check Cashing, Inc. v. Cardegna* (2006) 546 U.S. 440, is that the arbitrator, not the court, has authority to resolve the enforceability of provisions in an agreement that are outside the commitment to arbitrate. Here, most of the provisions challenged by the plaintiffs as unconscionable are not a part of the agreement to arbitrate itself as contained in Section 30 of the franchise agreement.

The plaintiffs identify a few provisions in the arbitration commitment that they claim are substantively unconscionable. The parties have thoroughly addressed these points in their briefs. The IFA will discuss here two of the claims of substantive unconscionability — the requirement of secrecy at the election of either party and the right to seek injunctive relief for certain disputes.

As to the element of secrecy, some courts express concern that a requirement of secrecy may support a “repeat player” effect — it may prevent a claimant from discovering whether a particular proposed arbitrator has resolved disputes involving the respondent in the past. Nothing in Section 30, however, precludes a franchisee from investigating whether a particular proposed arbitrator has heard other disputes involving Cold Stone. It is only the proceeding that may be secret at the election of a

party — not the participants in the proceeding or, for that matter, its ultimate result. As Cold Stone states in its brief, Item 3 of the UFOC Guidelines requires disclosure by a franchisor in its disclosure documents of any adverse results in a proceeding, including arbitration, for a ten-year period. Moreover, nothing precludes a franchisee from asking a proposed arbitrator to disclose his or her involvement in any past arbitration featuring the franchisor, and the AAA arbitrator disclosure guidelines likely require such disclosure in any event. *See* Rule 16(a) of the AAA Commercial Rules.

As to an alleged lack of mutuality, Section 30 of the subject franchise agreement does exclude “controversies or disputes where provisional or injunctive relief is sought (as provided in this Agreement).” The only part of the franchise agreement authorizing injunctive relief is Section 17, which allows the franchisor to seek injunctive relief solely to restrain violations of this particular section of the agreement. Section 17 is concerned in large part with what the franchise community commonly calls “deidentification,” namely, stopping a former franchisee from using the franchisor’s marks and otherwise holding itself as associated with the franchisor.

Under California law, a unilateral right to resort to the courts will not preclude enforcement of a commitment to arbitrate as long as there are legitimate business reasons for not making the right mutual. *See*

Armendariz v. Foundation Health Psychcare Servs., Inc. (2000) 24 Cal. 4th 83, 117, 120 (noting that a unilateral exemption from arbitration is not unconscionable where business realities provide “reasonable justification for the arrangement”).

A franchisor certainly has a legitimate interest in carving out of a commitment to arbitrate an exclusive right to resort to the courts to compel a franchisee to deidentify. At stake in disputes over deidentification is the most important asset a franchisor owns — its trade or service mark. “Typically, a franchisor’s principal asset is its trademark.” *Allen v. Choice Hotels Int’l* (Miss. Ct. App. 2006) 942 So. 2d 817, 826. *See also Murphy v. Holiday Inns, Inc.* (Va. 1975) 219 S.E.2d 874, 877. It is difficult to imagine a more egregious offense than a former franchisee continuing to hold itself out as associated with the franchisor, whether by continuing to use the franchisor’s trademark, trade dress, or other intellectual property, particularly in a state like California where the enforceability of a post-term noncompete in a franchise agreement is doubtful. It is not that an arbitrator cannot protect this right, it is a matter of timing. Quick resort to the courts to stop the offense is critical — not only to franchisors, but to their existing franchisees as well. Arbitration simply does not permit the type of speedy resolution of an issue that is so critical to any franchise system. The parties must select the arbitrator that will hear their dispute, and this can take time. In contrast, courts stand at the ready to resolve requests for injunctive relief.

The need at times for a franchisor to have a unilateral right to immediate injunctive relief to protect its principal asset — its trade or service mark — exemplifies another irony that arises when courts assume a paternalistic attitude toward franchisees. What may seem good for a single, former franchisee may not be good for existing franchisees that depend on the continued viability of the franchisor for their livelihood. A former franchisee has little interest in the protection of its former franchisor’s trademark, but existing franchisees have a keen interest in its protection. A former franchisee may just as soon force staff of its former franchisor to travel to its home state to resolve a dispute, but existing franchisees may well want their franchisor to remain at home as much as possible to focus on the needs of the system as a whole. The point is that fundamental fairness does not implicate the interests simply of the former franchisee and franchisor. It involves the interests of the entire franchise system, including all existing franchisees that have an ongoing stake in the continued existence and success of their franchisor.

VI.

“NEW JUDICIAL HOSTILITY TO ARBITRATION”

Judge Gutman’s decision reflects what some have dubbed the “new judicial hostility to arbitration.”⁹ This is the very same attitude that the

⁹ See Stephen J. Burton, *The New Judicial Hostility to Arbitration: Unconscionability and Agreements to Arbitrate* (May 16, 2006) bepress

United States Congress rejected in 1925 when it adopted the Federal Arbitration Act (FAA) mandating the enforcement of pre-dispute arbitration agreements “save upon such grounds as exist at law or in equity for the revocation of any contract.” (2006) 9 U.S.C. § 1-14. The United States Supreme Court said in *Southland Corp. v. Keating* (1984) 465 U.S. 1, 10, that Congress, in enacting the FAA, “declared a national policy favoring arbitration, and withdrew the power of states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.” California law, like federal law, establishes “a presumption in favor of arbitration.” *Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal. 4th 951, 971. The California legislature, like the United States Congress, established this presumption in favor of arbitration “to overcome earlier judicial hostility to arbitration agreements.” *Vandenberg v. Superior Court* (1999) 21 Cal. 4th 815, 830.

This “new judicial hostility” toward arbitration arises almost entirely in the context of consumer and employment law cases, although these notions have bled into the franchise context as represented by the *Nagrampa* majority decision. Even in the consumer and employment law setting, there is no empirical data supporting the notion that arbitration is not just as desirable as litigation for resolving disputes. In fact, the available

data contradict the assumption. Professor Stephen J. Burton of the University of Iowa offers the following summary:

There is . . . no evidence that arbitration is worse than litigation at achieving accuracy of results. What little empirical work we have suggests that arbitrators decide cases much as do judges, and with less cognitive distortion than juries suffer from. Juries in some parts of the country might be more pro-employee and pro-consumer than arbitrators, but this is speculative and irrelevant. Arbitration might in fact be more effective than litigation at achieving accuracy of results. There are normally no pre-trial substantive motions, discovery wars, antiquated rules of evidence or juries allowing clever advocates to skew the results. In addition, even when operating at its best, the civil litigation system must be assumed to achieve inaccurate results in some cases.

S. Burton, *New Judicial Hostility*, at 21.

Professor Christopher Drahozal concluded in an article entitled *A Behavioral Analysis of Private Judging*, published at (2004) 67 LAW & CONTEMPT PROBS. 105, 115-118, that there is no empirical data supporting the popular notion that arbitrators often make compromise awards rather than determining the parties' rights and duties according to the law. Similarly, Professors Sherwyn, Estreich, and Heise conclude from a review of all the available data that "plaintiffs do not fare significantly better in litigation, that arbitration provides a quicker resolution than litigation, and that available data does not indicate whether damages are fair under either system." David Sherwyn, Samuel Estreich & Michael Heise, *Assessing the*

Case for Employment Arbitration: A New Path for Empirical Research
(2005) 57 STAN. L. REV. 1557, 1564.¹⁰

VII.

CONCLUSION

Modern business format franchising has come a long way since its inception following World War II. It is today a major engine driving the United States economy. Moreover, the regulation of franchising at the state and federal level first begun in the 1970s has now, 30 years later, had its intended effect. Franchisees today have a wealth of information, as required by law, to allow them to make an informed decision before entering the franchise relationship. In particular, the franchisor must present the prospective franchisee with the form of franchise agreement in its disclosure document and must tender the final agreement well before its execution. California even requires that franchisors identify on the cover page of the disclosure whether the franchise agreement calls for arbitration outside the state. If a particular franchise opportunity is not to its liking, including the requirement of arbitration, the typical franchisee has a host of

¹⁰ The following websites collect data indicating that arbitration is as effective as litigation in resolving disputes and is generally more efficient and less expensive:
<http://www.adrforum.com/users/naf/resources/2005GeneralCommercial.pdf>;
http://www.mediate.com/cdri/cdri_print_Aug_6.pdf;
http://www.ncsconline.org/D_Research/csp/1999-2000_Files/1999-2000_Tort-Contract_Section.pdf.

alternatives. Franchisors ultimately compete with each other for franchisees, and the treat segment of the franchise market is no exception. Gone are the days of when franchisees were only mom-and-pop business folks. Although they certainly continue to exist, the small entrepreneurs have been joined by large, sophisticated, multi-unit franchisees — franchisees that drive favorable terms in franchise agreements, terms that benefit large and small franchisees alike given the uniform nature of franchise agreements. The upshot is that franchise agreements are not one-sided and are not the by-product of a disparity in the bargaining power between franchisor and franchisee.

Although franchising today is not just about mom-and-pop franchisees, the small entrepreneur is certainly still important to franchising. Indeed, it is franchising that ultimately equips individual businessmen and women to compete with the likes of the “big box” retailers. Ultimately, Judge Gutman’s decision reflects what the dissent in *Nagrampa* calls a “paternalistic endeavor” that “carries the seeds of great irony.”

By invoking the unconscionability doctrine to protect “the little guy” in this case, the majority has construed California franchise law in a way that will result in fewer opportunities for other “little guys” in the future. The ever-growing cost of litigation is one of the most serious and uncontrollable risks faced by modern businesses. As the California courts have recognized, arbitration helps businesses manage this risk by “providing for resolution of disputes in a presumptively less costly, more expeditious, and more private manner by an

impartial person or persons typically selected by the parties themselves.” *Keating*, 183 Cal. Rptr. 360, 645 P.2d at 1198. But, according to the majority, only those who already control the means of production or possess vast economic resources on par with those of a major corporation are sophisticated enough to enter into enforceable arbitration agreements. This undermines the important policies of the Arbitration Act, denying potential first-time business owners the very benefits Congress meant to secure for them. The result is that fewer aspiring business owners—many of whom are minorities and first generation Americans—will find franchisors willing to offer them opportunities like the one MailCoups offered to Nagrampa.

Nagrampa, 469 F.3d at 1313.

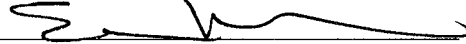
Certificate of Compliance

The undersigned certifies that pursuant to the word count feature of the word processing program used to prepare this brief, that it contains 5,881 words, exclusive of the matters that may be omitted under Rule 8.204(c)(3).

Dated: February 6, 2008

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MEYERS, et al. v. CONEHEAD INVESTMENTS, INC., et al.
Court of Appeal, Case No. B198018

PROOF OF SERVICE

I am employed in the County of Hennepin, State of Minnesota. I am over the age of 18 and not a party to the within action; my business address is 2200 Wells Fargo Center, 90 South Seventh Street, Minneapolis, Minnesota, 55402.

On February 6, 2008, I served, in the manner indicated below, the foregoing document described as:

APPLICATION AND BRIEF OF THE INTERNATIONAL FRANCHISE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF COLD STONE CREAMERY, INC., ET AL., DEFENDANTS AND APPELLANTS

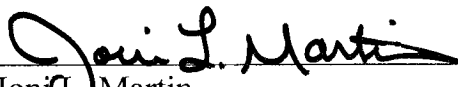
on the interested parties in this action by placing true copies thereof, enclosed in sealed envelopes, at Minneapolis, Minnesota, addressed as follows:

Please See Attached Service List

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- BY FACSIMILE: (C.C.P. § 1013(e)(f)).

I declare under penalty of perjury under the laws of the State of Minnesota that the above is true and correct.

Executed on February 6, 2008, at Minneapolis, Minnesota.


Joni L. Martin

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