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Arbitration Where the Franchisor is Intentionally Excluded

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Franchisees seeking to recover on claims of fraud often seek to circumvent the arbitration clause contained in the franchise agreement. The arbitration clause is drafted to prevent trial by jury, runaway juries and limited discovery that might delay or expand the scope of the dispute. One method of avoiding the arbitration clause is bringing suit against the individuals rather than against their employer or principal. Courts will often look beyond the four corners of the pleading in order to consider a petition to enforce the arbitration clause, but the court needs the full view of the dispute to decide whether the matter should be arbitrated.

In *Doctor's Associates v. Burr* (D. Conn., Dec. 28, 2016), the Subway franchisor petitioned to compel arbitration of claims asserted in California state court by Brian Burr and Bryn Burr, unsuccessful franchisee applicants for a casino location. The Burrs claimed that the development agents eventually awarded the franchise interfered with their appointment as a franchisee. The underlying story is not an uncommon fact pattern.

The Burrs alleged that, in 2013, the Morongo Tribal Council approved them to be the new Subway franchisee located inside the Morongo Casino and Hotel Spa. The Burrs then applied to the Subway franchisor in early 2014.

The scope of the arbitration clause provided: "I agree that I will settle any and all previously unasserted claims, disputes or controversies arising out of or relating to my application or candidacy for the grant of a Subway franchise from franchisor, pursuant to the laws of Connecticut, USA and by binding arbitration only."

The Burrs alleged that, after considering their application, the franchisor eventually awarded the franchise to the development agents, Raghu Marwaha and Rohit Marwaha. The Burrs filed suit in California state court claiming that the Marwahas allegedly caused the franchisor to withdraw its acceptance of the Burrs so the Marwahas "could steal the franchise for themselves." The Burrs asserted claims against the Marwahas for intentional misrepresentation, interference with contractual relations and prospective - economic relations and unfair business practices. The Subway franchisor then filed an arbitration against the Burrs for declaratory relief relating to the facts of the underlying California state court lawsuit in addition to filing its petition to compel arbitration.

In summary, the federal district court in Connecticut held that: The development agent defendants in the state court case were not required parties on the franchisor's petition to compel arbitration; comity and respect for the state court would not preclude federal court from compelling - arbitration; the arbitration agreement in the Burrs' franchise application required arbitration of state court claims against the development agents, even though the agents were not parties to the arbitration agreement.

- The Marwahas were not required to be parties to the petition to compel arbitration.

The Burrs' first defense to the motion to compel arbitration was lack of jurisdiction. The Burrs claimed that the Marwahas were required to be parties to the motion to compel filed in federal court and could not be joined as it would destroy diversity because both the Burrs and the Marwahas were citizens of California. The court had previously decided similar issues in two other Subway cases under Federal Rule of Civil Procedure 19(a). The question was whether the Marwahas were indispensable parties, such that the case should be dismissed without them or should continue in their -

absence. The court applied the threshold tests whether complete relief could be granted among the existing parties, whether going forward would impede the interests of the absent parties or expose the absent parties to more exposure or inconsistent obligations. The court concluded that the Marwahas were not parties to the underlying arbitration agreement and therefore were not indispensable parties. The court thus confirmed its diversity jurisdiction and continued with its analysis.

- Comity did not require deference.

The Burrs' next defense to the motion to compel was the request to defer to the California state court to decide arbitrability. The Burrs argued that the Marwahas should assert the arbitrability argument in the California state law case. The court rejected that argument because the Marwahas were not parties to the arbitration clause and could not assert such a right.

As a supplemental argument, the Burrs asserted the "first-filed rule" to argue that the first filed state court case had priority. The court rejected that argument because the rule only applies between competing federal courts and not between parallel state and federal proceedings, holding citing "federal courts have a virtually unflagging obligation to exercise the jurisdiction given to them."

- Absent party does not prevent arbitration among the parties.

The Burrs argued that the California lawsuit was outside of the scope of the arbitration clause because the Marwahas were not parties to the arbitration agreement, were not acting in their capacity of develop agents when they committed the business torts and the Burrs never agreed to arbitrate with the Marwahas.

The court determined that the scope of the clause included the intentional torts alleged because all arose out of the Burrs' candidacy for a franchise. Similarly, the court found that the absence of the Marwahas from the arbitration contract to be unavailing. The arbitration provision contained a broad reference to claims, which could encompass claims against nonparties to the agreement. The clause did not limit the Burrs to arbitration only against parties to the agreement. Furthermore, the Burrs tried to distance the Marwahas from Subway claiming that they were sued in their individual capacities rather than their conduct as Subway® development agents. The court cited precedent which "repeatedly held that a 'court will not permit plaintiffs to avoid arbitration simply by naming individual agents of the party to the arbitration clause and suing them in their individual capacities ... to do so would be to subvert the federal policy favoring arbitration and the specific arbitration clause in the instant case.'"

In summary, the court concluded that even though the Burrs did not agree to arbitrate against persons who were not parties to the arbitration, they did agree to arbitrate all claims, which could include related parties within the scope of the arbitrable claims. The court noted that the Subway franchisor "did not seek to compel the Burrs to arbitrate with the Marwahas ... rather, DAI Subway seeks to compel the 'Burrs to arbitrate with DAI their claims against' the Marwahas."

The lesson learned is that arbitration clauses can capture all parties and claims if drafted properly. By including all claims and parties, the clause can require joinder of all claims and parties, and avoid all of the evils of unbridled litigation.

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