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GREEN TREE FINANCIAL CORP. V. BAZZLE: MORE FOR THE ARBITRATOR'S PLATE

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Roughly half of all leading franchisors' franchise agreements contain arbitration clauses requiring the franchisor and franchisee to arbitrate, rather than litigate, their franchise-related disputes.[i] Numerous franchisors have touted arbitration as a superior means of resolving disputes, and some lawyers representing franchisees have cautiously, if perhaps somewhat begrudgingly, acknowledged certain of its benefits to franchisees as well.[ii]

Because of the widespread reliance on arbitration in franchise relationships, franchisors and franchisees alike (and their lawyers) are highly attuned to court decisions concerning the enforceability of arbitration clauses, particularly those by the United States Supreme Court. The United States Supreme Court's recent decision in *Green Tree Financial Corp. v. Bazzle*[iii] concerning class arbitrations will, therefore, undoubtedly cause the franchise community's antennae to quiver. For franchisors with arbitration clauses expressly forbidding class arbitrations, this reaction is probably much ado about nothing. However, for franchisors whose agreements do not expressly forbid class arbitrations – probably the majority of franchisors with arbitration clauses in their agreements – the *Green Tree* decision should be of serious concern.

It has long been clear that courts will generally enforce parties' agreements to arbitrate disputes in accordance with the terms of their agreements under the Federal Arbitration Act (the "FAA"). What has not always been clear is the division of labor between the court and the arbitrator in deciding certain threshold matters. One of those threshold matters is whether a particular arbitration can involve multiple claimants against the franchisor in a single consolidated arbitration proceeding. While there are presumably potential efficiency benefits to arbitrating multiple claims at once rather than in separate "one-on-one" arbitrations, franchisors have long sought to avoid having to arbitrate in consolidated or class action proceedings for a number of compelling reasons. Legal commentators have noted that because many potential franchisee class members may never bring separate claims and arbitrators are unlikely to issue "runaway awards," franchisors often believe that avoiding class arbitrations can dramatically reduce their aggregate exposure.[iv] Another commentator has criticized the use of class actions in the franchise relationship as detrimental to both sides: "[C]lass actions are hardly a healthy way of resolving disputes within a franchise system. To the contrary, class actions tend to take a tremendous toll on the ability of franchisor and franchisee alike to get on with the business of selling products or services at a profit."[v] For these reasons, among others, franchisors generally seek to arbitrate disputes with each franchisee individually, rather than consenting to the franchisees' banding together against them.

As a procedural matter, if franchisees threaten to file, or do file, a lawsuit as a class action despite an arbitration agreement expressly prohibiting class arbitrations, a franchisor can simply file petitions in federal court to compel arbitration with each individual putative class member.[vi] *Green Tree* does not change any of this, but rather enables the party seeking to enforce the arbitration clause (generally the franchisor) to speed up the process of getting the matter before

an arbitrator by reducing the number of issues for the court to address before compelling arbitration. The decision does, however, call into question other court decisions that franchisors have relied upon that have forbidden class arbitrations when the franchise agreement in question did not explicitly provide for them.[vii]

The *Green Tree* Decision

In the *Green* Tree case, Green Tree Financial Corp. ("Green Tree") was accused of violating certain loan disclosure procedures required under South Carolina law.[viii] The arbitration provision in Green Tree's contracts did not explicitly forbid class arbitrations.[ix] A South Carolina court allowed two separate but similar arbitrations to go forward as class action proceedings, and the same arbitrator ultimately awarded the claimants a whopping total of over $20 million against Green Tree.[x] The South Carolina trial court eventually confirmed the awards at the claimants' request, essentially converting them into enforceable court judgments.[xi]

Not surprisingly, Green Tree appealed both awards claiming, among other things, that the administration of the proceedings as class arbitrations was improper.[xii] The case made its way through the South Carolina court system, the claimants prevailed, and then the United States Supreme Court agreed to review the case.

In its opinion, the Supreme Court did not discuss the numerous cases previously relied upon by franchisors for the proposition that class arbitrations are forbidden unless specifically authorized in the parties' arbitration clause, apparently accepting that class arbitrations may go forward (at least under South Carolina law) even if an arbitration clause does not explicitly authorize them. The Supreme Court found, however, that the question of whether the parties' arbitration agreement forbade class arbitrations should have been decided by the arbitrator rather than the South Carolina court. The Supreme Court, therefore, sent the cases back to the arbitrator for a decision on the issue.[xiii]

Green Tree should not affect the enforceability of franchise agreements that expressly forbid class actions. It simply clarifies that the arbitrator rather than the court should decide whether the contract does indeed forbid class arbitrations. The opinion could have serious ramifications, however, for the many franchisors whose agreements are silent on the issue. For these franchisors, *Green Tree* may encourage arbitrators to permit class arbitrations. If franchisors do not want to participate in class arbitrations, they should simply make sure that their franchise agreements (at least going forward) say so in no uncertain terms. While this will not prevent arbitrators from allowing class arbitrations in disputes involving pre-existing contracts, it should help avoid class arbitrations with new franchisees and with existing franchisees with new contracts. Franchisors may also want to consult with their counsel about including a provision in new franchise agreements with existing franchisees updating their pre-existing franchise agreements to clearly forbid class arbitrations. In any event, franchisors should take a fresh look at their existing contracts in light of *Green Tree* and consider whether additional changes are warranted.

[i] Christopher Drahozal, *Arbitration Clauses in Franchise Agreements: Common (and Uncommon) Terms*, 22 Franchise L.J. 81 (Fall 2002) (determining that 45% of seventy-five leading franchisors' franchise agreements on file with the State of Minnesota in the summer of 1999 contained arbitration clauses).
[ii] *See e.g.,* Jennifer Gehrig*, Arbitration: A Franchisee's Perspective*, 22 Franchise L.J. 121, 123 (Fall 2002)
[iii] 123 S. Ct. 2402 (2003).
[iv] Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 Franchise L.J. 141 (Spring 1997). Mr. Dunham practices at Wiggin & Dana LLP.
[v] William L. Killion, *An Informal Study of Arbitration Clauses Reveals Surprising Results*, 22 Franchise L.J. 79 (Fall 2002).
[vi] *See* generally, Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 Franchise L.J. 141, (Spring 1997). Mr. Dunham practices at Wiggin & Dana LLP.
[vii] See e.g., *Champ v. Siegel Trading Co.*, 55 F.3d 269, 274-77 (7th Cir. 1995); *Government of United Kingdom v. Boeing Co.*, 998 F.2d 68, 74 (2d Cir. 1993); *see also* Kevin M. Kennedy, *Drafting an Enforceable Franchise Agreement Arbitration Clause*, 22 Franchise L.J. 112, 113 (Fall 2002). Mr. Kennedy practices as Wiggin & Dana LLP. *Cf. Johnson v. West Suburban Bank*, 225 F.3d 366, 377 n.4 (3d Cir. 2000) (stating that while the "court has never addressed the question whether class actions can be pursued in arbitral forums, ... it appears impossible to do unless the arbitration agreement contemplates such a procedure").
[viii] 123 S. Ct. at 2405.
[ix] *Id*.
[x] *Id.* at 2405-06.
[xi] *Id*.
[xii] *Id.* at 2406.
[xiii] *Id.* at 2408.