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Please contact the following attorneys if you would like further information about the progress of the legislation or want additional information regarding distribution and franchise matters:

Practice Chair:

Roberta F. Howell
Madison, Wisconsin
608.258.4273
rhowell@foley.com

Author:

Mark A. Salzberg
Washington, D.C.
202.295.4613
msalzberg@foley.com

Eleventh Circuit Decision Reminds Franchisors and Suppliers to Closely Examine Their Contractual Arbitration Obligations

On February 22, 2008, the Eleventh Circuit Court of Appeals issued an opinion that highlights the need for franchisors and suppliers to carefully examine their contracts to avoid being unwittingly ensnared in arbitration agreements they never signed. The opinion, issued in the case *World Rentals and Sales, LLC v. Volvo Construction Equipment Rents, Inc.*, et al., Case No. 06-16352, 2008 WL 466127 (11th Cir. Feb. 22, 2008), also demonstrates the need for franchisors and suppliers to think strategically in litigation if they wish to avoid arbitration.

Background

The facts of the case are relatively straightforward. Volvo Construction Equipment Rents, Inc. (Volvo Rents) franchises rental equipment facilities. World Rentals and Sales, LLC (World Rentals) operated as a Volvo Rents franchisee under the terms of a development agreement and two franchise agreements, collectively referred to by the court as the "Franchise Agreements." The Franchise Agreements all contained an arbitration clause which provided that "all disputes . . . arising between Franchisee and Franchisor" are subject to arbitration. The Franchise Agreements also provided that the term "Franchisor" referred only to Volvo Rents and did not include Volvo Rents' parents or affiliates.

World Rentals obtained financing for its franchise from Volvo Commercial Finance, LLC (Volvo Finance), an affiliate of Volvo Rents. The terms of financing were set forth in fifteen separate agreements, collectively referred to by the court as the "Loan Documents." Certain of the Loan Documents contained a cross-default provision which provided that a default or breach of the Franchise Agreements constituted a default under those Loan Documents. The Loan Documents did not include an arbitration provision; however, two of the Loan Documents included the following incorporation provision:

> All schedules, exhibits, and other documents attached to or referred [sic] in this Agreement now or at any time hereafter are hereby incorporated in this Agreement by this reference in their entirety as if fully restated in this Agreement.

World Rentals' principal, and two related companies, executed guaranty and subordination agreements that guaranteed all of World Rentals' obligations under the Loan Documents.

World Rentals subsequently defaulted under the Loan Documents. Facing imminent legal action, World Rentals and its guarantors (collectively referred to by the court as the "World Parties") sued both Volvo Rents and Volvo Finance in district court, alleging various contract and tort claims. Volvo Rents responded to the complaint by moving to stay the World Parties' claims pending arbitration. For its part, Volvo Finance filed counterclaims for, among other things, breach of the Loan Documents by virtue of World Rentals' failure to make required payments. Importantly, Volvo Finance *did not* rely in its counterclaim on any breach of the Franchise Agreements notwithstanding the cross-default provisions in certain of the Loan Documents. Volvo Finance also moved for dismissal, or in the alternative, for summary judgment on the World Parties' claims.

Faced with Volvo Rents' motion to stay and Volvo Finance's motion to dismiss, the World Parties took the interesting and highly unusual step of repudiating their complaint and filing a cross-motion to stay all claims and compel arbitration of the *entire* dispute, including Volvo Finance's counterclaims. The district court initially granted the World Parties' cross-motion and ordered arbitration of the entire dispute; however, on reconsideration the district court held that Volvo Finance could not be compelled to arbitrate. The World Parties appealed the district court's decision.

The Eleventh Circuit's Decision

The question facing the Eleventh Circuit was whether Volvo Finance could be compelled to arbitrate when it had not executed an agreement (i.e., the Franchise Agreements) which included an arbitration clause. The court began its decision by noting that, under federal law, "arbitration is a matter of consent, not coercion." Nonetheless, the court noted that there are five theories on which a signatory to an arbitration agreement could bind a non-signatory: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter-ego; and (5) estoppel.

The primary argument advanced by the World Parties was that the incorporation language in two of the fifteen Loan Documents incorporated the arbitration clauses in the Franchise Agreements, and therefore that Volvo Finance was required to arbitrate its claims. In response, Volvo Finance argued that the incorporation language was "simply vague boilerplate" and was never intended to incorporate the arbitration clauses in the Franchise Agreements. Volvo Finance also argued that the incorporation language could not render it subject to the arbitration clauses because the incorporation language did not specifically reference the arbitration clauses.

The Eleventh Circuit rejected Volvo Finance's arguments. Notwithstanding Volvo Finance's contention that the incorporation language was "boilerplate," the court held that "an arbitration clause can be incorporated even if the relevant incorporation language does not specifically refer to [the arbitration clause]." Because the subject Loan Documents specifically referred to the Franchise Agreements and because the incorporation provision incorporated "[a]ll schedules, exhibits, and other documents attached to or referred [sic] in this Agreement," the court held that "the unambiguous language of the Loan Documents incorporates the arbitration clauses in the Franchise Agreements."

This did not end the court's analysis, however. The court next turned its attention to the arbitration clauses to determine whether the dispute between Volvo Finance and the World Parties fell within the scope of the clauses. Notwithstanding the long-standing principle that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration," the court held that Volvo Finance's claims did not fall within the scope of the arbitration clauses because of the definition of the term "Franchisor" in the Franchise Agreements. Specifically, the Franchise Agreements defined "Franchisor" to refer *only* to Volvo Rents and not its parents or affiliates. Moreover, World Rentals specifically acknowledged in the Franchise Agreements that Volvo Rents was "not authorized to contract for or on behalf of its parents or any of its affiliates" and that the Franchise Agreements "shall not be deemed to bind or otherwise

restrict [Volvo Rents'] parent or any of its affiliates." Thus, the court held that the dispute between Volvo Finance and the World Parties did not fall within the scope of the arbitration clauses, stating:

> Thus, the applicable arbitration clause unambiguously limits its reach only to disputes between the World Parties and Volvo Rents; plainly and expressly it excludes any disputes between the World Parties and Volvo Finance.

The court summarily rejected the World Parties' remaining arguments. The court noted that a non-signatory may be compelled to arbitrate under an agency theory if the signatory signed the arbitration agreement as the non-signatory's agent or if the non-signatory so dominated the signatory that it is appropriate to pierce the corporate veil. However, the court held that the World Parties had presented no evidence that Volvo Rents had acted as the agent or alter ego of Volvo Finance.

The court also cited case law holding that a non-signatory may be estopped from avoiding arbitration if the non-signatory relies on a contract containing an arbitration clause. However, the court noted that Volvo Finance's counterclaim was based on World Rentals' failure to make timely payments under the Loan Documents and was not based on a breach of the Franchise Agreements, notwithstanding the cross-default provision. Accordingly, the court held that Volvo Finance was not estopped from avoiding the arbitration clause.

Practical Considerations

As was the case in *World Rentals*, many franchise and distribution relationships include financing from entities affiliated with the franchisor or supplier. The contracts underlying these relationships are oftentimes complex, overlapping, and interconnected. World Rentals teaches franchisors and suppliers to keep the following considerations in mind:

Incorporation by Reference

A non-signatory may be bound by an arbitration clause contained in a contract when that contract is incorporated by reference. As evidenced in World Rentals, the incorporation language may be enforced notwithstanding that it may be characterized as "merely boilerplate." Accordingly, it is crucial that franchisors and suppliers closely scrutinize any incorporation provisions in their contracts to determine if they could be considered bound by arbitration clauses contained in the incorporated contracts.

Scope of Arbitration Provisions

World Rentals further illustrates that the scope of an arbitration clause will ultimately determine whether a dispute is in fact subject to arbitration. There, although Volvo Finance was held bound by the arbitration clauses in the Franchise Agreements (by virtue of the incorporation provision in two of the Loan Documents), the dispute between Volvo Finance and World Rentals was nonetheless held to be non-arbitrable due to the limited scope of the arbitration clauses. Thus, it is imperative that franchisors and suppliers carefully review arbitration provisions in their contracts, or in incorporated contracts, to ensure that only those disputes which they wish to be subject to arbitration fall within the scope of the arbitration provision.

Reliance on Contract Containing an Arbitration Provision

World Rentals also teaches that the allegations asserted in an action may have real implications on whether arbitration will be required. In many franchise and distribution relationships, the financing and franchise agreements contain cross-default provisions. This was the case in World Rentals, where certain of the Loan Documents provided that a default or breach of the Franchise Agreements constituted a default under the Loan Documents. Notwithstanding this cross-default provision, Volvo Finance's counterclaim did not rely on a breach of the Franchise Agreements, but instead relied solely on World Rentals' failure to make timely payments under the Loan Documents. Based on the limited nature of the allegations, the court held that Volvo Finance was not estopped from avoiding the arbitration clauses in the Franchise

Agreements as it was not relying on the Franchise Agreements to make its claim. Thus, World Rentals teaches that franchisors and suppliers wishing to avoid arbitration must be extremely careful when asserting their claims, avoiding where possible any reliance on contracts that contain arbitration clauses.

Conclusion

World Rentals should be seen as a cautionary tale. The case exposes the potential pitfalls of boilerplate incorporation language. The case also counsels franchisors and suppliers to scrutinize the language of their arbitration clauses carefully, since the scope of the arbitration clause will ultimately determine whether a dispute is subject to arbitration. Moreover, *World Rentals* demonstrates that franchisors and suppliers, if possible, should refrain from relying on contracts containing arbitration clauses if they wish to avoid arbitration.

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