Los Angeles Daily Journal
May 1, 2007

Frozen-Out Franchisee Battles Arbitration
Cold Stone Creamery's Contract Provision is 'Unconscionable,' Trial Judge Decides

By Rebecca Beyer, Daily Journal Staff Writer

LOS ANGELES - Attorney Lisa M. Meyers went to Cold Stone Creamery's Ice Cream University for 11 days to become a franchisee. She learned how to scoop ice cream, decorate cakes, mop a store's floors and keep track of its inventory.

Twelve months after she took possession of her own store, Meyers learned she had to vacate it.

Cold Stone executives told Meyers there was a problem with the company's lease and, eventually, that she had to give up the property. Meyers had sunk $375,000 in the store and was reimbursed only $45,000 for equipment. To recoup her loss, Meyers sued the company in Los Angeles County Superior Court. Cold Stone, citing its franchise agreement, filed a motion to compel arbitration.

But on April 18, Judge Paul Gutman denied that motion, calling the arbitration provision "unconscionable" because, among other restrictions, it requires franchisees to arbitrate disputes but allows the company access to the courts.

Arizona-based Cold Stone is appealing the judge's ruling, and the California appellate court's decision could be a case of first impression. In December, the 9th U.S. Circuit Court of Appeals ruled that a similar franchise arbitration provision was "unconscionable." Nagrampa v. MailCoups, 469 F.3d 1257 (9th Cir. 2006).

A representative from Cold Stone referred calls to the company's lawyer, William S. O'Hare, of Snell & Wilmer in Costa Mesa.

"From our standpoint, we have a sophisticated lawyer who was free to buy or not to buy an ice cream store, and she signed multiple contracts that had arbitration clauses in them," O'Hare said.

James M. Mulcahy, Meyers' attorney, usually represents franchisors in such disputes, but he said he found Meyers' case "irresistible."

"We're going to have California weigh in on these issues for the first time in a very important way," he said.

Meyers, an asbestos defense litigator, recently left her job as an associate at Selman & Breitman and plans to start at a downtown Los Angeles firm May 1. She said she decided to buy a Cold Stone Creamery in Long Beach in February 2005. The store was two blocks from her home, and a friend who owned several Cold Stones told Meyers it was a great investment.

"I had never done anything like this in my life," said Meyers, who spent five years as a safety technician in the U.S. Air Force and 10 years as an aerospace engineer.

She graduated from Whittier College law school in 1996.

According to her complaint, the previous owner of the store had been late paying his rent at least 20 times. Under Cold Stone's lease with the landlord, if three rent payments were late, the company lost its right to renew the lease.

Meyers' complaint states that Cold Stone knew of the previous owner's late payments yet failed to inform her and instead "verbally represented to [her] that there were 11 years left on the 15-year term of the master lease."

Mulcahy writes, "[D]efendants elected not to inform plaintiffs of these facts because they knew that [she] would not purchase [the store] if [she] knew that [she] would only have the right to operate at the premises until the master lease expired, which was no later than July 31, 2006."

In fact, Meyers closed escrow on the store on July 13, 2005. On Dec. 6, 2005, Cold Stone telephoned to tell her "there is a problem with the lease."

Meyers was forced to vacate the store on July 29, 2006.

"It was a long, drawn-out process," Meyers said. "And that was part of the torture, not knowing. You've got this huge investment, and at the same time you still have to run the business."

Meyers hired Mulcahy and filed suit, saying that Cold Stone violated the California Franchise Investment Law.

The company did not return Meyers franchise fee, which is estimated on the company's Web site to be $42,000, or the $375,000 she paid for the store. Instead, Meyers said, they paid her $45,000, not even enough to cover all the equipment she purchased.

Meyers is seeking at least $2 million in compensatory and punitive damages.

In denying the defendants' motion to compel arbitration, Gutman relied heavily on two 2006 decisions involving franchise arbitration provisions. In Buckeye

continued...

Check Cashing, the U.S. Supreme Court ruled that a challenge to the validity of an arbitration provision is to be decided by the court, and a challenge to a contract in its entirety should be decided by an arbitrator. Buckeye Check Cashing Inc. v. Cardegna, 126 S.Ct. 1204 (2006).

In Meyers' case, attorneys for Cold Stone argued that her objections to the arbitration provision "are scattered throughout" the franchise agreement "and are for the arbitrator to address," but the judge rejected that argument.

Another case Gutman relied on was the Nagrampa case, in which the 9th Circuit, sitting en banc, ruled it is unconscionable for an arbitration clause to set venue for disputes far from a franchisee's home and to force a franchisee to arbitrate disputes while allowing a franchisor to file in court.

According to Gutman, Cold Stone's arbitration provision was also unconscionable because it required arbitration to take place in Arizona and the franchise agreement was presented to Meyers on a "take-it-or-leave-it basis," meaning she could not negotiate any of its terms. The forum for arbitration, the American Arbitration Association, would require Meyers to pay an $8,000 initial filing fee, plus a case service fee of $3,250 - more than 30 times the cost of filing a complaint in the Los Angeles County Superior Court, Mulcahy's documents said.

The judge's ruling, Mulcahy said, "squarely presents the issues of Nagrampa to a California state court."

David C. Gurnick, an attorney at Lewitt Hackman in Encino, represents both franchisees and franchisors in disputes. He has written about the Nagrampa decision and its effects on franchise law.

Meyers' case, he said, is "an example of Nagrampa starting to have its anticipated effects."

"Prior to this line of decisions, the trend had been to enforce arbitration," he said.

O'Hare downplayed the significance of Nagrampa in Meyers' case, which he described as "garden-variety."

"If you went down the courthouse, and put all the arbitration cases together and pulled one out of a bin, you might get ours, you might get another one just like ours," he said.

The unconscionability argument, O'Hare said, "seems like more than a stretch for a lawyer" who most likely "took contracts in law school like the rest of us."

"You read a contract," he said. "This is pretty basic stuff."

But Gutman rejected this argument.

Mulcahy wrote that Meyers "had absolutely no business education, training or background before becoming a Cold Stone franchisee."

But O'Hare insisted Meyers should have known better.

"The last time I checked, asbestos litigators are no pushovers," he said.

Gurnick said the unconscionability of a clause "is not measured by the aptitude of the signor; it's measured by the conditions [of the clause]."

Meyers' case is on hold until an appellate court upholds or rejects Gutman's decision.

Mulcahy and Gurnick said the Nagrampa decision, and cases like Meyers', show that franchisors need to rethink their franchise agreements.

"Franchisors have to look at their contracts and make sure they're not unconscionable," Gurnick said. "How about a forum for arbitration that's close to the franchisee or has logic for some other reason than it's the franchisor's home county?"

Mulcahy said Meyers' case is significant for his typical clients, with whom he is "working to look at the alternative-dispute-resolution provisions that are in existing franchise agreements, in an effort to avoid the result that we had in Cold Stone."

California has long led the way in franchise law, according to Mulcahy. In 1971, the state became the first to regulate the offer and sale of franchises, and in August, it will be home to the country's first State Bar-certified specialists in franchise and distribution law, a new specialty offered by the California Bar.

Mulcahy was one of seven attorneys to serve on the bar's advisory committee and helped to write the examination that would-be specialists will take.

If the Nagrampa ruling had not come down in December, Mulcahy said, he might not have taken Meyers' case.

"This is a cutting-edge legal issue, and I wanted to be involved in the case because it squarely presents a case of first impression," he said. "That's what my underlying motivation was; otherwise, you would find me representing the franchisor, not the franchisee."

****

© 2007 Daily Journal Corporation.