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# Get The Best of Both Worlds: Illusory Arbitration Agreements

*Druco Rests., Inc. v. Steak N Shake Enters.*, 765 F.3d 776 (7th Cir. 2014).

DESIREE SHAY\*

## I. INTRODUCTION

In general, arbitration provisions have become increasingly popular in contracts between a larger party and a smaller, less-powerful party. However, these contracts have also given rise to a significant amount of litigation due to the contracts being unenforceable and unconscionable. At times, significant oddities in these agreements result in some curious results in the court system – whether this arises from oversight or something else is unclear.

This Note addresses the clauses in franchise-franchisee agreements that preserve the right for a franchisor to unilaterally alter the terms of arbitration after the franchise relationship has begun. A majority of courts, applying state contract law, have held that these clauses are unenforceable due to a lack of consideration, making the contract illusory.<sup>1</sup> However, courts still come to different conclusions because each court has to follow state contract law.<sup>2</sup> The United States Supreme Court's holding on this issue might not be able to have full effect because the Federal Arbitration Act requires that courts rely on state law.<sup>3</sup> The Seventh Circuit's decision in *Druco* further throws a twist into the circuit decisions because of the franchisor's decision to make arbitration non-binding, a factor that was not present in many other courts.<sup>4</sup>

Additionally, this Note will cover illusory arbitration agreements resulting from the unconscionability of unilateral contracts. Under this idea, this Note will discuss the concept of a minimum 30-day notification in an arbitration clause that would allow franchisors the ability to implement arbitration agreements at a later date, but also provide protection for the party with less power. Further, the comment section will explore binding and nonbinding arbitration and the idea that courts should treat them differently in franchise agreements. Interestingly, non-

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1. *Morrison v. Amway Corp.*, 517 F.3d 248, 257 (5th Cir. 2008). See generally, *Druco Rests., Inc. v. Steak N Shake Enters.*, 765 F.3d 776 (7th Cir. 2014).

2. See generally Michael L. DeMichele & Richard A. Bales, *Unilateral-Modification Provisions in Employment Arbitration Agreements*, 24 HOFSTRA LAB. & EMP. L.J. 63 (2006).

3. *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

4. See, *Druco*, 765 F.3d at 776.

binding and binding arbitration are treated the same for purposes of a presumption of arbitration – even though they are different in every other aspect.

## II. FACTS AND HOLDING

Often contracts are signed without thorough thought as to the ramification of certain clauses. In regard to the instant decision, the issue arose over whether a franchisor could implement an arbitration policy retroactively to prevent the matter from going to court.<sup>5</sup> Three franchisees, Druco Restaurants, Inc., People Sales & Profit Company, Inc., and Scott's S&S Inc., brought lawsuits to dispel an agreement about price fixing by the franchisor.<sup>6</sup> Steak n Shake then filed a motion to stay, claiming that an arbitration clause was controlling.<sup>7</sup>

### A. *The Franchise Agreements*

Prior to 2005, Steak n Shake granted franchise rights to other organizations for operation of its restaurants.<sup>8</sup> Druco Restaurants, Inc. (Druco) operated two of these franchises in Missouri, People Sales & Profit Company, Inc. (PSPC) operated five in Georgia, and Scott's S&S Inc. (Scott) operated one location in Pennsylvania.<sup>9</sup> All three of the franchise agreements included language about Steak n Shake reserving the right to implement a nonbinding arbitration clause.<sup>10</sup>

Druco owned and operated two franchises in Missouri since 1989.<sup>11</sup> PSPC originally signed four franchise agreements, and later obtained a fifth, known as the Brunswick Agreement,<sup>12</sup> from another franchisee.<sup>13</sup> Further, Scott had a franchise agreement in Pennsylvania.<sup>14</sup>

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5. *Id.* at 784.

6. *Id.* at 778-79.

7. *Id.* at 779.

8. *Id.* at 778.

9. *Id.* at 778.

10. *Druco*, 765 F.3d at 779-80. Though parts of the contract language differed, both contracts included the following statement:

The Company reserves the right to institute at any time a system of nonbinding arbitration or mediation. Any arbitration under this Agreement shall be held in a forum in the City of Indianapolis, State of Indiana. The Franchisee will be obligated to participate in such system, at the Company's request, in the event of a dispute. The Federal Arbitration Act applies to the arbitration forum clauses contained in this agreement.

*Id.*

11. *Druco Rests. v. Steak N Shake Enters.*, 2013 WL 5779646, \*1 (S.D. Ind. Oct. 9, 2013) [hereinafter *Druco Rests.*].

12. *Druco* 765 F.3d at 779. The court noted that there was "no language implicating arbitration" in the Brunswick Agreement, so there was no basis to compel or stay arbitration based on this franchisee agreement. *Id.* at 779.

13. *Druco*, 765 F.3d at 778.

14. *Druco Rests.*, 2013 WL 5779646, at \*1.

*B. The Corporate Change and Lawsuits*

Prior to 2010, franchisees of Steak n Shake had the freedom to set their own menu prices and the option to participate in corporate pricing promotions.<sup>15</sup> The only requirement of the franchisees was that they comply with the Steak n Shake “System,” though this term did not require conforming to recommended menu prices.<sup>16</sup> Following a corporate takeover, Steak n Shake began implementing the same pricing and corporate promotions for all of the franchisees, in effect controlling their revenues and promotions, known as the Menu Pricing and Promotion Policy (Policy).<sup>17</sup>

As the franchisees saw decreases in their revenue, they opted to bring suit in the United States District Court for the Southern District of Indiana, Indianapolis Division, seeking a declaratory judgment of their right to control pricing and promotions.<sup>18</sup> Due to language in the contracts that allowed Steak n Shake the unilateral right to amend the arbitration policy, an arbitration policy was adopted by Steak n Shake on May 1, 2013, after the suits had been filed.<sup>19</sup>

The arbitration policy effectively required franchisees to participate in non-binding arbitration upon Steak n Shake’s request.<sup>20</sup> Following this policy, Steak n Shake then filed an order compelling nonbinding arbitration of the franchisees’ lawsuits and moved to stay the lawsuits on May 22, 2013.<sup>21</sup> Steak n Shake sought to stay the litigation on the Brunswick Agreement only until the other contracts were determined by arbitration.<sup>22</sup> Because the ruling for Steak n Shake was much the same in all three suits, the district court consolidated its ruling and opinion on the motion to stay filed by Steak n Shake.<sup>23</sup> The district court went through each agreement, stating why arbitration could not be compelled.<sup>24</sup> The Brunswick agreement was determined to never even have language referencing the arbitration clause, so the court determined that arbitration simply could not be enforced on that agreement.<sup>25</sup> For the remaining agreements, it was determined that the arbitration agreement was illusory because Steak n Shake retained a unilateral right to amend the arbitration agreement.<sup>26</sup> The court further stated that had the contracts not been illusory, they would not have been enforceable because the events in

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15. *Druco*, 765 F.3d at 778-79. The franchise agreements provided that “[f]ranchisees are free to set consumer prices different from prices on company-owned restaurant menus.” *Druco Rests.*, 2013 WL 5779646, at \*1 (citations omitted).

16. *Druco Rests.*, 2013 WL 5779646, at \*1.

17. *Druco*, 765 F.3d at 779. Franchisees were also required to acquire products from a distributor that Steak n Shake negotiated the prices for. *Id.* The “Policy” states, “All restaurants are required to follow set company menu and pricing as published with the exception of breakfast items. Additional[ly], all restaurants are required to offer all company promotions as published.” *Druco Rests.*, 2013 WL 5779646, at \*2 (citations omitted).

18. *Druco*, 765 F.3d at 779.

19. *Id.* The new clauses stated: “this policy does not represent a change, but is merely implementing a right previously reserved by the Company in certain of its franchise agreements.” *Druco Rests.*, 2013 WL 5779646, at \*3 (citations omitted).

20. *Druco*, 765 F.3d at 779.

21. *Id.* at 779; *Druco Rests.*, 2013 WL 5779646, at \*4.

22. *Druco*, 765 F.3d at 781. The contract in the Brunswick Agreement did not withhold the right for Steak n Shake to add an arbitration clause. *Id.* at 779.

23. *Druco Rests.*, 2013 WL 5779646, at \*1.

24. *Id.* at \*5.

25. *Id.*

26. *Druco*, 765 F.3d at 779.

question in the lawsuit occurred before Steak n Shake attempted to implement the arbitration policy.<sup>27</sup> It went on to state that because the arbitration was nonbinding, the clauses in no way implemented an agreement to settle by arbitration, so they could not be enforced under the FAA.<sup>28</sup> Steak n Shake appealed from the district court's decision.<sup>29</sup>

The central issue on appeal involved the rights of a franchisor to compel franchisees to arbitration after the franchisees have filed a claim in federal court.<sup>30</sup> The Seventh Circuit ultimately agreed with the district court,<sup>31</sup> holding that the arbitration agreement was illusory because no language in the contract prevented Steak n Shake from altering the arbitration system or completely deleting the provision.<sup>32</sup> This type of agreement was illusory under Indiana law because it left the agreement entirely optional to the promisor.<sup>33</sup> Further, the agreement was unenforceable because the clauses were vague and indefinite in that they gave Steak n Shake sole discretion over the details of arbitration.<sup>34</sup> The Seventh Circuit therefore held that the district court's denial of the motion to stay litigation was appropriate.<sup>35</sup>

### III. LEGAL BACKGROUND

#### *A. Arbitration and Contractual Background*

The Federal Arbitration Act (FAA) governs any arbitration agreement that is "a contract evidencing a transaction involving commerce."<sup>36</sup> The language of the FAA created a federal policy favoring arbitration.<sup>37</sup> This policy means that arbitration agreements are as enforceable as other contracts and no particular clause is weighted more than the rest.<sup>38</sup> Due to this policy favoring arbitration, when courts review the claims for arbitration, they must apply a "presumption of arbitrability" if the arbitration agreement at hand is not ambiguous as to whether arbitration governs the dispute.<sup>39</sup> When parties argue that the language is ambiguous, there is no presumption of arbitration.<sup>40</sup> If the language is clear, the plaintiff has to prove

27. *Druco Rests.*, 2013 WL 5779646, at \*6.

28. *Id.*

29. *Druco*, 765 F.3d at 779.

30. *Id.* at 778.

31. *Id.* at 784.

32. *Id.* at 783-84.

33. *Id.* at 783.

34. *Id.* at 784.

35. *Druco*, 765 F.3d at 784.

36. See 9 U.S.C. §§ 1-16 (2012); *Allied-Bruce Terminix Co., Inc. v. Dobson*, 513 U.S. 265, 268 (1995). ("[Section 2 of the FAA] makes enforceable a written arbitration provision in 'a contract evidencing a transaction involving commerce.'" (emphasis added).

37. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1745 (2011); see also 9 U.S.C. § 2 (2012) ("A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.").

38. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967).

39. *Granite Rock Co. v. Int'l Bhd. of Teamsters*, 561 U.S. 287, 301 (2010). However, courts should only apply this presumption when it is clear that the parties intended to arbitrate the dispute. *Id.*

40. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995) (At most, the choice-of-law clause introduces an ambiguity into an arbitration agreement that would otherwise allow punitive

that the arbitration agreement is illusory or unconscionable to rebut the presumption of arbitration.<sup>41</sup>

The appropriate forum for whether a valid arbitration clause exists is the district court – not arbitration.<sup>42</sup> When a party brings a petition regarding failure to arbitrate or to enjoin arbitration, the party can bring the petition in any United States court, federal or state, that would have jurisdiction in a civil action if no arbitration agreement was in place.<sup>43</sup> Courts should apply the same state law that governs the contract between the parties.<sup>44</sup> As a result, arbitration agreements can be invalidated by “generally applicable contract defenses, such as fraud, duress, or unconscionability.”<sup>45</sup>

For a party to compel arbitration, the Seventh Circuit held that a party needs only to show three elements: “(1) an agreement to arbitrate, (2) a dispute within the scope of the arbitration agreement, and (3) a refusal by the opposing party to proceed to arbitration.”<sup>46</sup> However, arbitration cannot be compelled if the matter to be arbitrated is a dispute that one party did not agree to arbitrate in the contract.<sup>47</sup> Further, Indiana law states that “[w]hether the parties agreed to arbitrate any disputes is a matter of contract interpretation, and most importantly, a matter of the parties’ intent.”<sup>48</sup> When determining the intent of the parties, courts should look to the language of the contract when the contract was signed.<sup>49</sup>

When performance is “entirely optional” for one party and not available for another party, the courts can find the agreement to be an illusory promise.<sup>50</sup> The Restatement (Second) of Contracts says that “[w]ords of promise which by their terms make performance entirely optional with the ‘promisor’ whatever may happen, or whatever course of conduct in other respects he may pursue, do not consti-

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damages awards. As we pointed out in *Volt*, when a court interprets such provisions in an agreement covered by the FAA, “due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.”)

41. *Applied Energetics, Inc. v. NewOak Capital Mkts., LLC*, 645 F.3d 522, 526 (2d Cir. 2011) (This is inferred from the language of this case, “presumption in favor of arbitrability should only be applied ‘where a validly formed and enforceable arbitration agreement is ambiguous about whether it covers the dispute at hand’ . . . while doubts concerning the scope of an arbitration clause should be resolved in favor of arbitration, the presumption does not apply to disputes concerning whether an agreement to arbitrate has been made.”) (citations omitted).

42. *AT&T Techs., Inc. v. Commc’ns Workers of Am.*, 475 U.S. 643, 652 (1986). (“Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.”).

43. 9 U.S.C. § 4 (2012).

44. *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 944 (1995). This concept is also stated in section 2 of the FAA, which expressly states that the basis for the enforcement or revocation of arbitration agreements shall come from state contract law. DeMichele & Bales, *supra* note 2, at 67.

45. *Rent-A-Ctr, W., Inc. v. Jackson*, 561 U.S. 63, 68 (2010) (quoting *Doctor’s Assocs., Inc. v. Casa-rotto*, 517 U.S. 681, 687 (1996)).

46. *Zurich Am. Ins. Co. v. Watts Indus., Inc.*, 466 F.3d 577, 580 (7th Cir. 2006).

47. *AT&T Techs.*, 475 U.S. at 648.

48. *MPACT Constr. Grp., LLC v. Superior Concrete Constructors, Inc.*, 802 N.E.2d 901, 906 (Ind. 2004).

49. *Wolvos v. Meyer*, 668 N.E.2d 671, 675 n.1 (Ind. 1996); *see also Brockmann v. Brockmann*, 938 N.E.2d 831, 834-35 (Ind. Ct. App. 2010) (determining that the terms of a contract will be given their “plain and ordinary meaning,” unless it is determined that the language in the contract is ambiguous).

50. *Drucro Rests., Inc. v. Steak N Shake Enters.*, 765 F.3d 776, 782 (7th Cir. 2014).

tute a promise.”<sup>51</sup> Illusory promises are unenforceable and cannot form a valid contract when one party is not obligated to do anything.<sup>52</sup>

### B. Other Circuit Backgrounds on Illusory Promises

Multiple circuits have held that arbitration clauses can be considered illusory promises in part for insufficient definiteness.<sup>53</sup> In the Seventh Circuit case, *Penn v. Ryan’s Family Steak Houses*, an employer, Ryan’s Family Steak Houses (Ryan’s), had an employee, Penn, sign an arbitration document with Employment Dispute Services (EDS),<sup>54</sup> a third party that contracted with Ryan’s “to provide an arbitration forum for all employment-related disputes.”<sup>55</sup> The Seventh Circuit affirmed the district court’s ruling that the arbitration agreement, if enforced, would create an atmosphere that was overly biased towards Ryan’s, which had selected and hired the arbitrators.<sup>56</sup>

The Seventh Circuit went on to say that the agreement between EDS and Penn included an illusory promise on the part of EDS because the agreement did not set out any details about the standards to be used for arbitration or the nature of the forum to be used.<sup>57</sup> In contrast, Penn’s obligations to EDS and Ryan’s under the agreement detailed what the agreement covered and how long Penn was required to adhere to those obligations.<sup>58</sup> Penn was given rules promulgated by EDS, but the agreement was still illusory because the rules stated that EDS could modify or amend them without Penn’s consent.<sup>59</sup> The court held that the contract was “hopelessly vague,” because of these factors.<sup>60</sup>

In a factually similar case to *Druco*, the Fifth Circuit held in *Morrison v. Amway Corp.* that when a party attempting to enforce an arbitration clause retains a unilateral right to amend the arbitration clause, the contract is illusory and unenforceable.<sup>61</sup> This includes eliminating arbitration entirely or simply restricting the claims and disputes for which arbitration could be used.<sup>62</sup> In *Morrison*, the seller, Amway, wanted to enforce an arbitration agreement when a dispute arose with the distributors.<sup>63</sup> However, the dispute at issue arose before the arbitration requirement was included in the agreements and only occurred when Amway amended

51. RESTATEMENT (SECOND) OF CONTRACTS § 2 cmt. e. (AM. LAW INST. 1981). The Restatement continues by saying: “Although such words are often referred to as forming an illusory promise, they do not fall within the present definition of promise. . . . Even if a present intention is manifested, the reservation of an option to change that intention means that there can be no promise who is justified in an expectation of performance.” *Id.*

52. *Penn v. Ryan’s Family Steak Houses*, 269 F.3d 753, 759 (7th Cir. 2001) (citations omitted).

53. *See Id.* at 753; *Morrison v. Amway Corp.*, 517 F.3d 248, 255 (5th Cir. 2008); *Floss v. Ryan’s Family Steak Houses, Inc.*, 211 F.3d 206 (6th Cir. 2000); *Dumais v. American Golf Corp.*, 299 F.3d 1216 (10th Cir. 2002) (Cases all state, in one form or another, that when a party retains the unilateral and unresitriced rights to amend an arbitration agreement, that it is going to be considered illusory because it is considered indefinite).

54. EDS is a third party company that provides arbitration services. *Penn*, 269 F.3d at 755.

55. *Id.*

56. *Id.*

57. *Id.* at 759.

58. *Id.*

59. *Id.* at 759-60.

60. *Penn*, 269 F.3d at 760.

61. *Morrison v. Amway Corp.*, 517 F.3d 248, 257 (5th Cir. 2008).

62. *Id.*

63. *Id.* at 253.

its Rules of Conduct.<sup>64</sup> The contracts contained a provision that allowed Amway to make any amendment regarding arbitration.<sup>65</sup> After the distributors attempted on two occasions to sue Amway, Amway filed motions to stay the litigation pending arbitration, and both courts granted Amway's motions.<sup>66</sup>

The parties went to arbitration, but no party was successful on its claims and the arbitrator gave no explanation for this result.<sup>67</sup> Subsequently, the distributors moved for the district court to vacate the arbitration fees, alleging the arbitration clauses were not valid.<sup>68</sup> The district court denied this motion and the distributors appealed to the Fifth Circuit.<sup>69</sup>

When analyzing Amway's Rules of Conduct for 1998, the Fifth Circuit stated that nothing in the language suggested that the arbitration amendment would not apply to the events occurring before adoption of the 1998 Rules.<sup>70</sup> The court further stated that the Rules did not prevent Amway from unilaterally modifying arbitration provisions.<sup>71</sup> Because of this unilateral right, the arbitration agreement was an illusory agreement and could not be upheld.<sup>72</sup> The Fifth Circuit stated that Amway could have saved its arbitration clause by including what the court called a "Halliburton type savings clause," which was based off of Halliburton's contract which provided that the company could not unilaterally amend the contract to get out of a certain dispute and that an amendment would only apply prospectively.<sup>73</sup> The arbitration agreement, however, did not include such a clause and there was no obligation on behalf of Amway.<sup>74</sup> The arbitration agreement was illusory and unenforceable against the distributors concerning the disputes that arose before the implemented arbitration clause.<sup>75</sup>

*Druco* is very factually similar to *Morrison*, which was decided by the Fifth Circuit. *Druco* involved a franchisee, and *Morrison* involved a distributor. How-

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64. *Id.* at 250-51. When distributor agreed to sell Amway products, they agreed to abide by Amway's Code of Ethics and Rules of Conduct, including any amendments that occurred to the Code. *Id.* The Code had to be renewed on a yearly basis. *Id.* at 250.

65. *Id.* at 250-51.

66. *Id.* at 251-52.

67. *Morrison*, 517 F.3d at 252-53.

68. *Id.* at 253.

69. *Id.*

70. *Id.* at 254. The 1998 annual contract stated:

[T]o conduct [his or her] business according to the Amway Code of Ethics and Rules of Conduct, as they are amended and published from time to time in official Amway literature. ... I agree I will give notice in writing of any claim or dispute arising out of or relating to my Amway distributorship, or the Amway Sales and Marketing Plan or Rules of Conduct to the other party or parties ... I will then try in good faith to resolve the dispute using the Amway Conciliation and Enforcement Procedures contained in the Rules of Conduct for Amway Distributors. If the claim or dispute is not resolved to [his or her] satisfaction within 80 days, or after the Amway Conciliation process is complete, whichever is later, I agree to submit any remaining claim or dispute arising out of or relating to any Amway distributorship, the Amway Sales and Marketing Plan, or the Amway Rules of Conduct ... to binding arbitration in accordance with the Amway Arbitration rules, which are set forth in the Amway Business Compendium."

71. *Id.*

72. *Morrison*, 517 F.3d at 255, 257.

73. *Id.* at 255, 257; see also *In re Halliburton Co.*, 80 S.W.3d 566, 569-70 (Tex. 2002). The court determined that this meant that Halliburton had an obligation to act and the provision was not considered illusory. *Id.*

74. *Morrison*, 517 F.3d at 257-58.

75. *Id.*



ever, both cases involved parties that brought suit against the promisor.<sup>76</sup> Though the facts of why the disputes arose are different, both promisors attempted to enforce arbitration clauses that were not introduced into the agreements until after the disputes at issue arose.<sup>77</sup> Both courts ultimately held that an arbitration contract that is based on unilateral power by the promisor creates an illusory and unenforceable contract.<sup>78</sup>

In *Penn*, the Seventh Circuit held that when a performance by the promisor is completely optional, the contract becomes illusory and is therefore invalid.<sup>79</sup> Other circuits have also held that an arbitration clause is considered illusory and unenforceable when there is a unilateral right to amend by the party seeking enforcement.<sup>80</sup>

The Tenth Circuit<sup>81</sup> and the Sixth Circuit<sup>82</sup> have also made similar rulings and have joined the other circuits in holding that “an arbitration agreement allowing one party the unfettered right to alter the arbitration agreement’s existence or its scope is illusory.”<sup>83</sup> The Fourth Circuit has stated that secondary contracts should not be looked at and only the language in the arbitration clause should be considered in determining whether the arbitration clause is illusory.<sup>84</sup>

### C. Nonbinding Arbitration

In nonbinding arbitration, the arbitrator’s decision is ultimately not final.<sup>85</sup> Parties that participate in nonbinding arbitration treat the decision given by the arbitrator as an “independent assessment” of the potential lawsuit, identifying both weaknesses and strengths, with the hope those parties will be more likely to settle than take the financial burden of a lawsuit.<sup>86</sup> In binding arbitration, the arbitrator’s decision will rarely be overturned, and typically is only overturned when some sort of fraud is involved.<sup>87</sup>

Some states have gone as far as giving nonbinding arbitration the same authority and weight as binding arbitration under the FAA and similar provisions. The New York Court of Appeals, in *Board of Education v. Cracovia*, held that nonbinding arbitration is to be given the authority under the New York Arbitration

76. *Id.* at 251; *Druco Rests., Inc. v. Steak N Shake Enters.*, 765 F.3d 776, 779 (7th Cir. 2014).

77. *Morrison*, 517 F.3d at 251-252 (The dispute at the heart of this case arose in June 1997. In September 1997, Amway announced the amendment of the arbitration agreement. On January 8, 1998, Morrison brought suit for the incident in June 1997. Amway attempted to argue that the arbitration clause would retroactively apply to the incident.); *Druco*, 765 F.3d at 779.

78. *Morrison*, 517 F.3d at 257; *Druco*, 765 F.3d at 784-85.

79. *Penn v. Ryan’s Family Steak Houses*, 269 F.3d 753, 759-760 (7th Cir. 2001).

80. *Druco*, 765 F.3d at 784-85. *Morrison*, 517 F.3d at 257; *Dumais v. Am. Golf Corp.*, 299 F.3d 1216, 1220 (10th Cir. 2002); *Floss v. Ryan’s Family Steak Houses, Inc.*, 211 F.3d 306, 316 (6th Cir. 2000).

81. *See Dumais v. American Golf Corp.*, 299 F.3d 1216 (10th Cir. 2002).

82. *See Floss*, 211 F.3d 206; *Morrison*, 317 F.3d 646.

83. *Druco*, 765 F.3d at 783. *See Floss*, 211 F.3d at 316 (“EDSI has reserved the right to alter the applicable rules and procedures without any obligation to notify, much less receive consent from, Floss and Daniels. EDSI’s right to choose the nature of its performance renders its promise illusory.”).

84. *Hill v. Peoplesoft USA, Inc.*, 412 F.3d 540, 544 (4th Cir. 2005).

85. *See Barbara Kate Repa, Arbitration Basics*, NOLO LAW FOR ALL, <http://www.nolo.com/legal-encyclopedia/arbitration-basics-29947.html> (last visited April 29, 2015).

86. *Id.*

87. *Id.*

Act as binding arbitration.<sup>88</sup> The court reasoned that the desire for courts to favor arbitration is not altered by nonbinding arbitration agreements.<sup>89</sup> The New York Arbitration Act was the model for the FAA,<sup>90</sup> and because the New York Arbitration Act served as the model for the drafters of the FAA, the court decisions interpreting the New York Act are strongly persuasive for purposes of construing the FAA.<sup>91</sup>

#### *D. Enforceable Agreement*

To be enforceable, a contract must be adequately certain and define essential terms in order for courts to determine if and when a contract has been performed.<sup>92</sup> Consequently, a contract that is merely “an agreement to make an agreement” will be considered illusory and unenforceable under Indiana state law.<sup>93</sup> Regardless, such option contracts can be enforceable.<sup>94</sup> The difference between the two types of contracts has to do with the intent of the parties to be bound and the definiteness of terms.<sup>95</sup>

Courts require definiteness of terms in option contracts because treating an ambiguous writing as enforceable would create the danger of enforcing the words in a manner the parties did not intend.<sup>96</sup> The test Indiana courts have used looks to the important terms and analyzes whether they were vague and uncertain or definite in their meaning.<sup>97</sup> Then the court looks to see if the essential terms in the contract were precise to the point that neither party could misconstrue them.<sup>98</sup> Any agreement that allows a party to reserve the right to implement arbitration is going to be considered vague and unenforceable under Indiana law.<sup>99</sup>

The FAA is the governing law most often used for arbitration and it has created a federal policy favoring arbitration.<sup>100</sup> However, a problem appears when the clause reserves the right for unilateral amendment resulting in an illusory promise.<sup>101</sup> However, these clauses may be saved by the *Halliburton* type savings

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88. Bd. of Educ. of Cent. Sch. Dist. No. 1 v. Cracovia, 36 A.D. 2d 851. (N.Y. App. Div. 1971).

89. *Id.* (“A written agreement to submit any controversy ... is enforceable without regard to the justiciable character of the controversy.” We can see no compelling reason why article 75 of the CPLR should not be applicable to ‘advisory arbitration’ if that is what the parties intended. Arbitration is a creature of contract and its scope can be very broad or very narrow, depending on the provisions of the contract. At bar, the parties have agreed to submit their disputes to arbitration although additionally agreeing to limit the impact of the arbitrator’s award to that of merely an advisory nature in some instances.” (internal citations omitted)).

90. See S. Rep. No. 536, 68<sup>th</sup> Cong. 1<sup>st</sup> Sess. 3 (1924).

91. WILLIAM N. ESKRIDGE, JR. ET AL., CASES AND MATERIALS ON STATUTORY INTERPRETATION 575-79 (Thomas Reuters et al eds., 2012).

92. *Cty Dep’t of Public Welfare v. Ind. Council 62, Am. Fed’n of State, Cty & Mun. Emp.*, 416 N.E.2d 153, 156 (Ind. App. 1981).

93. *Id.*

94. *Wolvos v. Meyer*, 668 N.E.2d 671, 678 (Ind. 1996).

95. *Id.* at 675.

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.* at 674-75.

100. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1745 (2011); 9 U.S.C. § 2 (2012).

101. *Drucos Rests., Inc. v. Steak N Shake Enters.*, 765 F.3d 776, 782 (7th Cir. 2014).

clause.<sup>102</sup> The final oddity in these agreements is when the parties implement nonbinding arbitration, meaning that the arbitrator's decision will not be deemed final.<sup>103</sup>

#### IV. INSTANT DECISION

In *Druco*, the Seventh Circuit Court of Appeals relied on case law from Indiana state courts and other federal circuit courts to determine whether an arbitration agreement existed.<sup>104</sup> The Seventh Circuit began by determining the weight to be given to the FAA.<sup>105</sup> Then, the court examined the contract and agreement under Indiana state law.<sup>106</sup> Both parties stipulated that Indiana law applied to all of the franchise agreements.<sup>107</sup> The court concluded by examining whether the agreement was an illusory promise.<sup>108</sup>

Steak n Shake argued that the court must give weight in favor of arbitration because of the federal policy favoring arbitration.<sup>109</sup> However, in order for a contract to be enforceable, both parties must have agreed to the terms.<sup>110</sup> Federal and state courts accept the idea that the policy in favor of arbitration only applies when the scope of an arbitration agreement is questioned.<sup>111</sup> To determine the breadth of requirements for the contract to be enforceable, the court had to consider Indiana state law.<sup>112</sup>

Indiana law required the court to consider the intent of the parties at the time they entered into the contract.<sup>113</sup> During oral arguments, Steak n Shake admitted that none of the franchise agreements included the language used in the later-implemented arbitration policy, but rather used language to create an option.<sup>114</sup> However, the franchise agreements did state that it was necessary for disputes to be brought in competent jurisdictions.<sup>115</sup>

The district court found that the arbitration clauses in the franchise agreement were illusory because performance by Steak n Shake was "entirely optional."<sup>116</sup> The court reasoned that because Steak n Shake retained the right to implement the arbitration clause, it also retained the power to control the "circumstances and

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102. *Morrison v. Amway Corp.*, 517 F.3d 248, 257 (5th Cir. 2008); *in re Halliburton Co.*, 80 S.W.3d 566, 569-70 (Tex. 2002)

103. *See Repa*, *supra* note 86.

104. *Druco*, 765 F.3d at 782-83.

105. *Id.* at 781.

106. *Id.* at 782.

107. *Id.* at 781.

108. *Id.* at 782-83.

109. *Id.* at 781.

110. *AT&T Techs., Inc. v. Commc'ns Workers of Am.*, 475 U. S. 643, 648 (1986).

111. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995) (However, when it is due to ambiguous provisions in the arbitration agreement, courts should give more weight towards arbitration.).

112. *Druco*, 765 F.3d at 781. Indiana state law must be considered in reading the arbitration agreement "without giving any special consideration to the federal policy favoring arbitration." *Id.* at 781-82.

113. *Id.* at 782.

114. *Id.* The specific language used stated "reserve[ing] the right to institute at any time a system of nonbinding arbitration[.]" *Id.*

115. *Id.*

116. *Id.*

procedures” for when arbitration would occur.<sup>117</sup> As the power to perform remained with the promisor, the arbitration clause was illusory under Indiana law.<sup>118</sup> Further, as Steak n Shake retained the power to control the details of any arbitration that occurred, including applying the arbitration clause retroactively to a dispute that was already being litigated in court, the arbitration clause was “vague and indefinite” and could not be enforced under Indiana state law.<sup>119</sup>

## V. COMMENT

Contracts containing arbitration clauses have been highly litigated and every court system has created slightly different caselaw on this issue. This comment will focus on conscionability, unilateral agreements, and nonbinding arbitration. This comment discusses whether a franchise<sup>120</sup> can enforce a contract that reserves the right to implement an arbitration policy after an initial contract, without the clause being unconscionable or the contract being a unilateral agreement. Next, this comment will explore the concept of courts not differentiating between binding and nonbinding arbitration and how this seems counterintuitive to the concept of nonbinding arbitration. Ultimately, it would be in the best interest of parties with less bargaining power to have a notification requirement before an arbitration clause is implemented. A little more unsteady is the idea of nonbinding arbitration enforcement, although enforcing nonbinding arbitration makes little sense.

### *A. Conscionability and Unilateral Agreements*

When something is unconscionable, it refers to some portion of a contract being so incredibly harsh that it would be exceedingly unfair for the courts to enforce the contract as is.<sup>121</sup> Often, a clause will be considered unconscionable when there is a unilateral agreement to amend, meaning that one party reserves the sole right to change the language.<sup>122</sup>

The courts appear to be split on what unilateral-modification clauses mean for the enforceability of the contract between the franchisor and franchisee. Many courts refuse to enforce the clauses based on the contract having no consideration, an illusory promise, indefiniteness, or unconscionability, while other courts refuse to enforce the clauses because such agreements would allow employers to alter rules or clauses after a dispute has arisen.<sup>123</sup> Unfortunately, some courts, even if they are a minority, will enforce these types of arbitration clauses, resulting in a further disadvantage for franchisees in the bargaining process.<sup>124</sup>

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117. *Id.* at 783.

118. *Druco*, 765 F.3d at 783.

119. *Id.* at 784.

120. Franchise refers to the over arching corporate entity for the restaurant. Franchisee refers to the individual parties running store locations.

121. See *Unconscionable*, BLACK’S LAW DICTIONARY (10th ed. 2014).

122. See *Unilateral*, BLACK’S LAW DICTIONARY (10th ed. 2014) (meaning “[o]ne-sided; relating to only one of two or more persons or things”).

123. DeMichele & Bales, *supra* note 2, at 64-65.

124. *Id.* at 64. See *Hill v. Peoplesoft USA, Inc.*, 412 F.3d 540 (4th Cir. 2005) (Shows a court that enforced an arbitration clause that had a unilateral-modification clause).

As is clear from the outcome in *Druco*, franchisors need to use clear language that does not give them unilateral power to amend an arbitration clause.<sup>125</sup> The Fifth Circuit and Texas state courts within that circuit have suggested that providing a “savings clause”<sup>126</sup> and a time frame before the implementation or dissolution of an arbitration clause is final would save the arbitration clause from being illusory.<sup>127</sup>

However, in *Druco*, the Seventh Circuit also pointed to the fact that the arbitration clause, reserving the right to amend the clause, did not contain the terms of what would be included in the arbitration clause to be adopted.<sup>128</sup> The Court also relied heavily on the idea that Steak n Shake was never obliged to adopt the arbitration policy and could ignore the provision in the contract.<sup>129</sup> This seems to suggest that, under Indiana law, courts will be required to look for more than a savings clause and a time frame for implementation and dissolution.

However, courts in prior cases have specified that such agreements are enforceable and allow one party to modify unilaterally without providing notification to the other party.<sup>130</sup> A unilateral contract, is defined as a one-sided contract in regards to amendments and rejections, “often with neither notice to, nor consent from, the other party.”<sup>131</sup> The Seventh Circuit in *Druco*, applying Indiana law, never addressed whether providing notification would have made the arbitration agreement enforceable – the term “notification” is never mentioned in the Seventh Circuit’s opinion.<sup>132</sup>

Arbitration agreements have been held enforceable when notification was given of any changes to the process.<sup>133</sup> The Sixth Circuit upheld an arbitration clause retaining the right for an employer, on December 31 of every year, to alter or terminate the arbitration agreement with a 30-day notice to all employees of the change.<sup>134</sup> The decision was also further distinguished from other cases because the amendment was only allowed on one day during the year.<sup>135</sup> However, this

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125. The language in the *Druco* arbitration clause stated that:

“[t]he Company reserves the right to institute at any time a system of nonbinding arbitration or mediation. Any arbitration under this Agreement shall be held in a forum in the City of Indianapolis, State of Indiana. The Franchisee will be obligated to participate in such system, at the Company’s request, in the event of a dispute. The Federal Arbitration Act applies to the arbitration forum clauses contained in this agreement.”

*Druco Rests., Inc. v. Steak N Shake Enters.*, 765 F.3d 776, 780 (7th Cir. 2014).

126. A savings clause is a clause in a legal instrument that states that if some portion of the agreement is deemed invalid by a court, “the remaining valid portion will still be enforceable.” See *Savings Clause*, THE FREE DICTIONARY, <http://www.thefreedictionary.com/saving+clause> (last visited May 17, 2015). See generally *Carey v. 24 Hour Fitness, USA, Inc.*, 669 F.3d 202 (2012); *Gonzales v. Brand Energy & Infrastructure Servs.*, No. H-12-1718, 2013 U.S. Dist. LEXIS 39635 (2013).

127. *In re Halliburton Co.*, 80 S.W.3d 566, at 569-70 (Tex. 2002); See also *Illusory Agreement*, 67-Oct DISP. RESOL. J. 91 (2012). It is important to note that these rules apply arbitration clauses in employer handbooks; however, it is reasonable to believe that this would be the same policy adopted for franchise-franchisee agreements.

128. *Druco*, 765 F.3d at 782.

129. *Id.*

130. *Floss v. Ryan’s Family Steak Houses, Inc.*, 211 F.3d 306, 310 (6th Cir. 2000).

131. *DeMichele & Bales*, *supra* note 2, at 64.

132. See generally *Druco*, 765 F.3d 776.

133. *Morrison v. Circuit City Stores, Inc.* 317 F.3d 667, 668 (6th Cir. 2003). It is important to note that while the issues governing at-will employment are different than franchise agreements, the notice requirement for arbitration is still going to be the same requirement.

134. *Id.* at 646, 656.

135. *Id.*

was just one factor out of many that the Sixth Circuit considered during the case.<sup>136</sup>

In states that require a “mutuality of obligation,” courts will be hard pressed to ever uphold a clause reserving the right to later implement an arbitration policy because there is no consideration for a unilateral right to implement, making it an illusory promise.<sup>137</sup> This would seem to be the case, even when notification is provided. However, in Ohio, a state that requires mutuality of obligation, a modification to the contract for an arbitration clause can be deemed a binding obligation to both sides only when there is notification and time passes before the change takes place.<sup>138</sup> The court used the Restatement (Second) of Contracts as its guide for its decision, as the Restatement allows a 30-day notice provision in a contract to suffice for consideration.<sup>139</sup>

It would be beneficial for employers and employees alike if the Supreme Court would require a notification of a change to an arbitration agreement, to prevent the agreements from being illusory. Although the Supreme Court could promulgate this requirement, states are still going to be required to apply state law when determining the enforceability of arbitration clauses. This state law provides for much of the federal circuit split on this issue.

Based on the opinion in *Druco* and cases from other districts mentioned above, the safest way for corporations, in both franchise and employer situations, to include arbitration clauses would be to state that the clause is only implemented with a 30-day notification. In addition, the clause should provide the exact language of the arbitration agreement that would be implemented. The language would also need to include some guarantee that the implementation of the clause would not have retroactive effects.

From an employee standpoint, having a 30-day notification would ensure arbitration did not catch employees by surprise. Disallowing retroactive effects would prevent situations where a corporation wants to use arbitration for an already binding contract. Striking this balance between concepts that favor the corporation and the employee helps to get “the best of both world”<sup>140</sup> for both parties.

However, in a world where corporations have a large amount of power over their employees, the ideal method would be to have a method that favors employees over employers. In this, it would be ideal for courts to say that there is no consideration even when a 30-day, or longer, notification is given. Doing this would require corporations to include the specific language in the employee agreement contracts for the arbitration requirement and only allow them to amend the contract if there is adequate consideration.

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136. *Id.* at 668. The court also considered five factors for whether the plaintiff/employee had “knowingly and voluntarily” agreed to the contract:

“(1) plaintiff’s experience, background, and education; (2) the amount of time the plaintiff had to consider whether to sign the waiver, including whether the employee had an opportunity to consult with a lawyer; (3) the clarity of the waiver; (4) consideration for the waiver; as well as (5) the totality of the circumstances.”

*Id.* (citations omitted).

137. DeMichele & Bales, *supra* note 2, at 69.

138. *See Morrison*, 317 F.3d at 668.

139. *Id.*

140. HANNAH MONTANA, THE BEST OF BOTH WORLDS (Walt Disney 2005).

Ultimately, it would be the best compromise to require a minimum 30-day notification for any person to have the right to amend an arbitration clause. Therefore, it is likely that the Supreme Court would uphold this requirement in order to protect the party with less power.

### *B. Nonbinding Arbitration*

In *Druco*, the Seventh Circuit did not address whether nonbinding arbitration fits under the rules for arbitration under the FAA because it held that the arbitration clauses in the contract were illusory and unenforceable.<sup>141</sup> Although, other courts have held that nonbinding arbitration falls within the FAA and can be compelled.<sup>142</sup> The Supreme Court has never addressed such an issue, though there are cases that are persuasive on this matter. Cases decided under the New York Arbitration Act would be particularly persuasive to the Supreme Court because the FAA was modeled after the New York Act.<sup>143</sup> Courts out of New York have pointed to the purpose of the arbitration acts – a desire for courts to favor arbitration agreements in their decisions – and suggest that nonbinding arbitration in no way damages this purpose.<sup>144</sup>

At initial glance, it seems interesting that courts do not interpret nonbinding arbitration clauses in a different manner than binding arbitration, even though the two types of arbitration have different end results. In binding arbitration, the complaining party has no remedy if the court upholds the arbitration clause. In nonbinding arbitration, parties are free to appeal the arbitrator's decision in the district court as permitted by the contract. Yet, despite the fact that nonbinding arbitration does not require the parties to be stuck with that decision, courts still show a pattern of holding nonbinding arbitration to be compelled under the FAA.<sup>145</sup>

Due to the essence of nonbinding arbitration, it would seem logical to give a different standard to nonbinding arbitration, despite FAA standards. The essence of this type of arbitration is to give the parties an idea of what litigation would entail and hopefully reach an agreement the two parties would be happy with. If the parties are unhappy, they are free to take the issue to court. By requiring par-

141. *Druco Rests., Inc. v. Steak N Shake Enters.*, 765 F.3d 776, 784-85 (7th Cir. 2014).

142. See *Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205 (9th Cir. 1998); *AMF, Inc. v. Brunswick Corp.*, 621 F. Supp. 456 (E.D.N.Y. 1985); *American Italian Pasta Co. v. Austin Co.*, 914 F.2d 1103 (8th Cir. 1990).

143. It should be noted that the persuasiveness of legislative history is going to be more accepted by Justices who identify as Purposivists, believing that legislative history is indicative of the legislatures purpose. If the Justices identify as Textualists, they will be inclined to use the legislative history *only* if the words are ambiguous or it supports their interpretation of the plain meaning of the Act. ESKRIDGE, *supra* note 92, at 135-252.

144. See *Bd. of Educ. of Cent. Sch. Dist. No. 1 v. Cracovia*, 36 A.D.2d 851 (N.Y. 1971). (“A written agreement to submit any controversy ... is enforceable without regard to the justiciable character of the controversy.’ We can see no compelling reason why article 75 of the CPLR should not be applicable to ‘advisory arbitration’ if that is what the parties intended. Arbitration is a creature of contract and its scope can be very broad or very narrow, depending on the provisions of the contract. At bar, the parties have agreed to submit their disputes to arbitration although additionally agreeing to limit the impact of the arbitrator’s award to that of merely an advisory nature in some instances.”) (citations omitted).

145. *AMF Inc.*, 621 F.Supp. at 461 (holding that the court could compel parties to non-binding arbitration under the FAA); *Kelley v. Benchmark Homes, Inc.*, 250 Neb. 367 (1996) (Holding that the FAA applies to nonbinding arbitration); *Cracovia*, 36 A.D. 2d at 851. (holding that a court can compel non-binding arbitration).

ties to participate in non-binding arbitration, it almost seems that the courts are attempting to prevent the matter from going to trial. Arbitration takes time and money, especially when one party has what seems like infinite resources and funds. The court is making these parties spend twice as much money by requiring the less powerful party to go through arbitration and then litigation if they are ultimately unhappy with the arbitration results.

Because courts do not differentiate between nonbinding and binding arbitration in determining whether an arbitration agreement exists, sophisticated parties must plainly write what they desire in a contract. Requiring consideration on both sides of the contract, however, can help protect unsophisticated parties from sophisticated parties, particularly in employee-employer relationships, where the employee has significantly less power in negotiating. This ultimately represents the best compromise for both the franchise and franchisee, or employer and employee, because it ensures that the parties are specific in their contracting.

## VI. CONCLUSION

*Druco* represents another example of federal circuit courts not enforcing an arbitration agreement due to it being unconscionable and illusory. This is due in part to the FAA's requirement to analyze contract language regarding arbitration under applicable state law, which results in every district coming to different results while using the same analysis.<sup>146</sup> Because of the intricacies of contract law in each individual state, the Supreme Court will likely never be able to set a blanket rule, but the Court could still provide a road map for the district and state courts that would allow some consistency for parties to have a better understanding.

The logical solution for this would be to require a 30-day notification in regards to retaining the right to insert an arbitration clause, as this deals directly with the conscionability and unilateral right to amendment. This gives franchisors the right to still maintain control over the party, while protecting those that do not necessarily have the power to protect themselves. When looking at non-binding arbitration, it is unnecessary to treat it the same as binding arbitration. Doing so just costs the parties more money and time, which will often be a detriment to the party with less power.

As arbitration provisions grow in popularity, issues such as notification, illusory agreements, and the binding authority of arbitration are going to continue to become more relevant. At some point, it is going to be necessary for the Supreme Court to take a case on a similar issue in order to provide a clear guide to other courts as well as the parties involved in contracting.

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146. *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 944 (1995). This concept is also stated in section 2 of the FAA, which expressly states that the basis for the enforcement or revocation of arbitration agreements shall come from state contract law. DeMichele & Bales, *supra* note 2, at 67.