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Arbitration

Pennsylvania Federal Court Confirms Franchisor's Arbitration Award

A Pennsylvania federal court has confirmed an arbitrator's dismissal of a counterclaim brought by a California franchisee under the California Franchise Investment Law (CFIL) and enforced a covenant not to compete despite the fact that California law disfavors such provisions. *Paul Green School of Rock Music Franchising, LLC v. Smith*, 2009 WL 426175 (E.D. Pa. Feb. 17, 2009). The franchisee in this case had operated a music lesson franchise in California under an agreement that contained Pennsylvania choice of law and venue provisions. The franchisor began the case by filing an arbitration in Philadelphia, which sought an injunction, damages, and attorneys' fees. The franchisee filed an objection and a counterclaim under the CFIL. In addition, he sued in California federal court to compel arbitration there. In denying the franchisee's motion to compel, a California federal court had held that the Pennsylvania venue and choice of law provisions would apply, but only if the arbitrator in Philadelphia also heard the CFIL claim. After a full hearing, the Philadelphia arbitrator ultimately dismissed the CFIL claim, enjoined the franchisee from violating a two-year covenant not to compete, and awarded the franchisor over \$400,000 in damages and expenses.

In granting the franchisor's motion to confirm the arbitration award, the Pennsylvania federal court explained that under the Federal Arbitration Act it could vacate an award only in what it called "exceedingly narrow circumstances." Such an action could be taken only when an arbitrator displayed a "manifest disregard" of the law or when the award was "completely irrational" or had "no support at all in the record." With respect to the dismissal of the CFIL counterclaim, the court upheld the decision despite the California court's earlier ruling that the arbitration being in Pennsylvania was specifically contingent on the arbitrator hearing the California statutory claim. The Pennsylvania court noted that parties fully briefed the legal and factual issues with respect to the claim and thus the arbitrator was "aware" of the CFIL. Therefore, the arbitrator did not exceed his authority when he dismissed the counterclaim rather than ruling on the merits of the claim.

The Pennsylvania court also enforced the covenant not to compete. The franchisee pointed out that a specific California statute (Business & Professions Code § 16600) barred the enforcement of noncompete provisions and that the California court had required the arbitrator to apply California law at least with respect to the CFIL claim. However, the court held that the choice of law provision in the franchise agreement applying Pennsylvania law was valid and enforceable and, furthermore, that it would "not independently presume that the California Business & Professions Code should have been applied by the arbitrator." Finally, even if section 16600 applied, the court concluded that the arbitrator's decision would be upheld since the statute contains an exception for the protection of trade secrets, which the franchisee was accused of usurping.