

15-719
No. 15-

Supreme Court, U.S.

FILED

NOV 30 2015

OFFICE OF THE CLERK

IN THE
Supreme Court of the United States

DICKEY'S BARBECUE RESTAURANTS, INC., *et al.*,

Petitioners,

v.

CHORLEY ENTERPRISES, INC., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

ROGER B. KAPLAN, Esq.

Counsel of Record

AARON VAN NOSTRAND, Esq.

GREENBERG TRAURIG, LLP

200 Park Avenue

P.O. Box 677

Florham Park, New Jersey 07932

(973) 360-7900

kaplanr@gtlaw.com

Of Counsel:

PAUL J. FERAKE, Esq.

Counsel for Petitioners



QUESTION PRESENTED

The question presented is:

Is an otherwise preempted state law, rule or regulation that is required by a state regulator to be included in a contract, as a condition and prerequisite for doing business in the state, not preempted on the ground that it was “*voluntarily*” included in the contract because the party (i) could have simply declined to do business in the state, or (ii) could have filed a declaratory action challenging the state regulator’s position before including the otherwise preempted contract clause in its agreements?

The Fourth Circuit’s opinion refusing to enforce federal preemption opens a new and dangerous chapter in attempts to unconstitutionally undermine federal statutes and regulations. Now, the question of constitutionality of state laws inconsistent with federal laws is rendered wholly irrelevant due to the behind-the-scenes involvement of state regulators. So long as state regulators mandate that a provision contradicting federal law appears in a company’s contract as a condition of doing business in the state, federal preemption is no longer an issue. The Supremacy clause no longer reigns supreme – at least when state regulators are involved.

Specifically, as interpreted by the Fourth Circuit, a Maryland regulation outright prohibits the arbitration of claims made under Maryland’s Franchise Law statute. From this Court’s recent decision in *Marmet Health Care* to the 1978 decision in *Southland* involving a similar franchise law, this Maryland regulation prohibiting arbitration of state law claims is preempted by the FAA.

Nonetheless, the Fourth Circuit held federal preemption disappears when the unconstitutional regulation is implemented by state regulators. According to the court, when a regulator requires a party to waive arbitration of state law claims in its contract with third parties as a condition of doing business in the state, it “freely assumes” the unconstitutional regulation. The court reasoned that, when the state regulator mandated that petitioner include the Prohibition of Arbitration Clause in its franchise agreements, petitioner “could have simply declined to do business in Maryland.” Thus, states seeking to undermine the FAA will look to the blueprint from the Fourth Circuit – a state can simply have its regulators impose unconstitutional anti-arbitration restrictions – or any other restriction that contradicts federal law – in a company’s contracts as a condition of doing business in the state.

The Fourth Circuit’s “state regulator exception” to FAA preemption presents an issue of exceptional importance with ramifications that extend well beyond franchising (which alone accounts for 3% of this country’s GDP). The decision contradicts this Court’s past precedents by burdening the federal right to arbitration that the FAA was designed to protect. Moreover, it ignores the Supremacy Clause, imposes an impermissible barrier to interstate commerce and violates the Equal Protection Clause.

PARTIES TO THE PROCEEDINGS

Petitioners, who were the defendants-appellants below, are Dickey's Barbecue Restaurants, Inc., Roland Dickey, Jr., and Jerrel Denton. Respondents, who were plaintiffs-appellees below, are Chorley Enterprises, Inc., Matthew Chorley, Carla Chorley, Jessica Trouard, and Justin Trouard.

RULE 29.6 STATEMENT

Petitioner Dickey's Barbecue Restaurants, Inc., which is a private family-owned corporation, hereby discloses and states that it has no parent corporation and that no publicly held corporations own any percentage of it.

TABLE OF CONTENTS

	<i>Page</i>
QUESTION PRESENTED	i
PARTIES TO THE PROCEEDINGS.....	iii
RULE 29.6 STATEMENT	iv
TABLE OF CONTENTS.....	v
TABLE OF APPENDICES	vii
TABLE OF CITED AUTHORITIES	viii
OPINIONS BELOW.....	1
JURISDICTION.....	1
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	1
STATEMENT OF THE CASE	3
I. Maryland Prohibits the Mandatory Arbitration of Claims Under the Maryland Franchise Law and Enforces This Prohibition as a Condition of Doing Business in the State	3
II. Petitioner Files Arbitrations Against Respondents, and Respondents File Lawsuits Against Petitioner Despite Arbitration Agreements.....	4

Table of Contents

	<i>Page</i>
III. The District Court Finds a Fact Issue With Respect to the Terms of the Arbitration Agreements.....	7
IV. The Fourth Circuit Holds That the Prohibition of Arbitration Mandated By the Regulator Creates an Exception to Federal Preemption Under the FAA	8
REASONS FOR GRANTING THE PETITION.....	10
I. This Court’s Review is Necessary to Stop State Regulators from Imposing Unconstitutional Mandates as a Condition of Doing Business in States	13
II. Undermining the FAA, The Fourth Circuit Blessed Maryland’s Unconstitutional “My Way Or The Highway” Approach.....	15
III. Further Undermining the FAA, the Fourth Circuit Mandates Challenges to State Regulators Prior to Doing Business in the State to Avoid an Unconstitutional Requirement	16
CONCLUSION	21

TABLE OF APPENDICES

	<i>Page</i>
APPENDIX A — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT, FILED SEPTEMBER 1, 2015	1a
APPENDIX B — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT, FILED AUGUST 5, 2015	5a
APPENDIX C — MEMORANDUM OPINION OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND, SOUTHERN DIVISION, FILED AUGUST 1, 2014	41a
APPENDIX D — DECLARATION OF THOMAS HIGIER, ESQ. IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND, SOUTHERN DIVISION, FILED JUNE 20, 2014	93a
APPENDIX E — EXCERPTS OF DICKEY'S BARBECUE RESTAURANTS, INC. FRANCHISE AGREEMENT, FILED MAY 28, 2014	96a

TABLE OF CITED AUTHORITIES

	<i>Page</i>
CASES	
<i>Allied-Bruce Terminix Cos. v. Dobson</i> , 513 U.S. 265 (1995).....	14
<i>American Airlines, Inc. v. Wolens</i> , 513 U.S. 219 (1995).....	17, 18, 20
<i>AT&T Mobility LLC v. Concepcion</i> , 563 U.S. 333 (2011).....	11, 13, 14
<i>Bankers Life & Cas. Co. v. Crenshaw</i> , 486 U.S. 71 (1988).....	19
<i>Cachia v. Islamorada</i> , 542 F.3d 839 (11th Cir. 2008)	16
<i>Cipollone v. Liggett Group, Inc.</i> , 505 U.S. 504 (1992).....	17, 18
<i>Engquist v. Or. Dep't of Agric.</i> , 553 U.S. 591 (2008).....	19
<i>Epps v. JP Morgan Chase Bank, N.A.</i> , 675 F.3d 315 (4th Cir. 2012).....	9
<i>Hines v. Davidowitz</i> , 312 U.S. 52 (1941)	14
<i>Maine v. Taylor</i> , 477 U.S. 131 (1986).....	15

Cited Authorities

	<i>Page</i>
<i>Marmet Health Care Ctr., Inc. v. Brown</i> , 132 S. Ct. 1201 (2012).....	11, 13
<i>New Energy Co. of Ind. v. Limbach</i> , 486 U.S. 269 (1988).....	15
<i>Northwest Inc. v. Ginsberg</i> , 134 S. Ct. 1422 (2014).....	17
<i>Saturn Distr. Corp. v. Williams</i> , 905 F.2d 719 (4th Cir. 1990).....	18
<i>Sec. Indus. Assoc. v. Connolly</i> , 883 F.2d 1114 (1st Cir. 1989)	18
<i>Southland Corp. v. Keating</i> , 465 U.S. 1 (1984).....	11, 12, 13
<i>Volt Info. Scis., Inc. v. Bd. of Trs.</i> , 489 U.S. 468 (1989).....	9, 14

Cited Authorities

Page

STATUTES AND OTHER AUTHORITIES

U.S. Const. amend. XIV, § 1.....	2, 19
U.S. Const. art. I, cl. 8	2
U.S. Const. art. VI, cl. 2	1
9 U.S.C. § 2.....	2
9 U.S.C. § 4.....	3
28 U.S.C. § 1254.....	1
COMAR § 14-206.....	12
COMAR § 14-210.....	12
COMAR 02.02.08.10(C)	19
COMAR 02.02.08.10(D)	19
COMAR 02.02.08.16(L)(3)	<i>passim</i>
MD. CODE REGS. 02.02.08.16	10
MD. CODE, BUS. REG. § 14-221(2)	10

OPINIONS BELOW

The published opinion of the Fourth Circuit vacating the district court's ruling and holding that respondents' Maryland Franchise Law claims are not subject to arbitration while compelling arbitration of petitioners' common law claims is reported at __ F.3d __, 2015 WL 4637967, and reproduced at App. 5-40a.

The district court's opinion denying petitioners' motion to compel arbitration and ordering a limited fact trial is unreported and reproduced at App. 41-92a.

JURISDICTION

The Fourth Circuit denied petitioner's petition for rehearing and rehearing en banc on September 1, 2015. App. 1-4a. This Court has jurisdiction under 28 U.S.C. § 1254.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the U.S. Constitution provides in relevant part:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; ... shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. art. VI, cl. 2.

The Commerce Clause of the U.S. Constitution provides in relevant part: “The Congress shall have power to . . . regulate commerce with foreign nations, and among the several states, and with the Indian tribes.” U.S. Const. art. I, cl. 8.

The Equal Protection Clause of the U.S. Constitution provides in relevant part:

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U.S. Const. amend. 14, sec. 1.

Section 2 of the FAA provides in relevant part:

A written provision in . . . a 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.

9 U.S.C. § 2.

Section 4 of the FAA provides in relevant part:

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any . . . court . . . for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration . . . is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

9 U.S.C. § 4.

STATEMENT OF THE CASE

I. Maryland Prohibits the Mandatory Arbitration of Claims Under the Maryland Franchise Law and Enforces This Prohibition as a Condition of Doing Business in the State

The State of Maryland prohibits franchisors from requiring a franchisee to “[w]aive the franchisee’s right to file a lawsuit alleging a cause of action arising under the Maryland Franchise Law in any court of competent jurisdiction in this State.” COMAR 02.02.08.16(L)(3) (“Prohibition of Arbitration Regulation”). The Maryland Commissioner of Securities is the state regulator empowered with the authority to regulate franchises in the State. The Commissioner of Securities implements the Prohibition of Arbitration Regulation by requiring franchisors such as petitioner to include the regulation

almost verbatim in its franchise agreements with Maryland franchisees. App. 93-95a. In this case, the Commissioner of Securities required petitioner to include the following clause in its Franchise Agreements:

Notwithstanding any provisions in this Agreement to the contrary, subject to Article 29 pursuant to Title 14, Sections 14-201 – 14-233 of the Annotated Code of Maryland (the “Maryland Franchise Registration and Disclosure Law”) and Title 02, Subtitle 02, Chapter 8, Sections 02.02.08.01 – 02.02.08.18 of the Code of Maryland Regulations (the “Maryland Franchise Regulations”):

* * *

4. The provisions of this Agreement shall not require you to waive your right to file a lawsuit alleging a cause of action arising under Maryland Franchise Law in any court of competent jurisdiction in the State of Maryland.

Id.; App. 104-105a. The Prohibition of Arbitration Clause was included as an addendum to petitioner’s Franchise Agreements with each of the respondents.

II. Petitioner Files Arbitrations Against Respondents, and Respondents File Lawsuits Against Petitioner Despite Arbitration Agreements

Petitioner Dickey’s is a barbecue franchisor with over 530 restaurants across the nation. Respondents Chorley and Trouard entered into two separate franchise

agreements with petitioner to open Dickey's Barbecue Pit® locations in Maryland (Germantown and Frederick, respectively). Significantly, both Franchise Agreements contained a virtually identical arbitration clauses applying to "all disputes."¹

After the Trouard respondents unilaterally closed their restaurant, petitioner filed an arbitration in Texas against the Trouard respondents asserting breaches of the Franchise Agreement on January 16, 2014. In the arbitration, petitioner contended that respondent Trouard had poor and non-conforming operations, poor and substandard food quality, and numerous health and cleanliness violations. Additionally, petitioner alleged fraud claims based on respondent Trouard's provision of false sales reports to petitioner.

Similarly, under the Arbitration Clause, petitioner filed an arbitration in Texas against the Chorley respondents on May 1, 2014. The arbitration petition asserts breaches of the Franchise Agreement based upon poor and non-conforming operations, poor and substandard food quality, numerous health and cleanliness violations, and other claims.

Dickey's seeks declaratory relief and damages under its "common law" claims against respondents. None of

1. The Franchise Agreements between petitioner and respondents are identical, and, in pertinent part, provide: "[A]ll Disputes which shall not be resolved through mediation in accordance with Article 27.1 shall be submitted for binding arbitration to the office of the AAA located nearest to Dickey's corporate headquarters in Plano, Collin County, Texas, on demand of either party. . . ." App. 99-100a.

the claims made by petitioner in the arbitrations arises under the Maryland Franchise Law. Therefore, none of petitioner's claims falls within any of the limitations in the Prohibition of Arbitration Regulation (as implemented by the mandated Clause in the respective Franchise Agreements).

Despite the fact that petitioner filed an arbitration, on May 21, 2014, the Trouard respondents filed a complaint in the United States District Court for the District of Maryland. The Trouard respondents make claims under the Maryland Franchise Law. Similarly overlooking the existence of the Arbitration Clause in their Franchise Agreement, on May 28, 2014, the Chorley respondents filed a separate action in the same District. Like the Trouard respondents, the Chorley respondents assert similar violations of the Maryland Franchise Law. Respondents seek damages and rescission of their Franchise Agreements.

Simultaneous with the filing of their Complaints, respondents filed separate motions to preliminarily enjoin the pending arbitrations. Significantly, respondents sought to avoid arbitration of their Maryland Franchise Law claims and petitioner's common law claims. Conversely, petitioner filed a cross-motion to compel arbitration of all causes of action arising out of the Franchise Agreements, including respondents' Maryland Franchise Law claims, and to stay all proceedings in court. The two cases were consolidated in the District of Maryland.

III. The District Court Finds a Fact Issue With Respect to the Terms of the Arbitration Agreements

On August 1, 2014, the District Court entered its Opinion and Order denying “without prejudice” respondents’ motion for a preliminary injunction and petitioner’s cross-motion to compel arbitration and to stay all court proceedings. App. 41-92a. The District Court held that the Prohibition of Arbitration Regulation did not prohibit arbitration of causes of action under the Maryland Franchise Law. Rather, the District Court held that the Prohibition of Arbitration Regulation “prohibit[s] the franchisor from requiring the franchisee to waive its right to bring claims against the franchisor” either in court or in an arbitration. App. 83a. Accordingly, the District Court held that Plaintiffs failed to establish “that the ... Regulation . . . renders the Arbitration Clause void” as to Plaintiffs’ claims under the Maryland Franchise Law. App. 83-84a.

The District Court reasoned that, although the Prohibition of Arbitration Clause did not invalidate or preclude the Arbitration Clause, that “does not mean that the Arbitration Clause necessarily is valid because the language of the [Prohibition of Arbitration] Clause could trump the language of the Arbitration Clause.” App. 84a. Thus, although the parties agreed that the Prohibition of Arbitration Clause was “not ambiguous,” the District Court nevertheless held that the Prohibition of Arbitration Clause was “ambiguous” and could still invalidate the Arbitration Clause even though the corresponding, virtually identical Prohibition of Arbitration Regulation did not. Therefore, the District Court ordered:

The ambiguity in the Franchise Agreements that the parties entered into and the Development Agreement that Plaintiffs Chorley Enterprises, Inc., Matthew Chorley and Carla Chorley and Defendants entered into as to whether the parties intended to arbitrate as opposed to litigate franchise claims arising under the Maryland Franchise Registration and Disclosure Law, Md. Code Ann., Bus. Reg. § 14-201 et seq., and whether the Franchise Agreements require such claims to be brought in Texas or Maryland, must be resolved through a jury trial.

App. 91a.

IV. The Fourth Circuit Holds That the Prohibition of Arbitration Mandated By the Regulator Creates an Exception to Federal Preemption Under the FAA

The parties filed cross-appeals of the District Court's Order, and the Circuit Court reversed the District Court. The Circuit Court held that no jury trial was necessary because there was no material fact in dispute. App. 23a. Also, the court rejected respondents' arguments that the Prohibition of Arbitration Clause prohibited the arbitration of petitioner's common-law claims (*i.e.*, breach of contract, fraud, etc.). App. 25a. Nevertheless, the Circuit Court held that the Clause gave respondents' the right to file claims under the Maryland Franchise Law either in court or in arbitration. Thus, the court refused to compel the arbitration of respondents' Maryland Franchise Law claims. App. 35a.

The Circuit Court rejected respondents' argument that the Prohibition of Arbitration Clause was preempted under the FAA. Paying lip service, the Circuit Court recognized that "[i]t is well established that the FAA 'pre-empts application of state laws which render arbitration agreements unenforceable.'" App. 36a (quoting *Volt Info. Scis., Inc. v. Bd. of Trs.*, 489 U.S. 468, 472 (1989)). The court reasoned, however, that it could sidestep federal preemption under the FAA based on the following logic:

[T]he [Prohibition of Arbitration] Clause is not a state law prohibiting arbitration. Rather, it is a contractual provision prohibiting arbitration. And it is generally well-settled that when a 'party to a contract voluntarily assumes an obligation to proceed under certain state laws, traditional preemption doctrine does not apply to shield a party from liability for breach of that agreement.

App. 37a (quoting *Epps v. JP Morgan Chase Bank, N.A.*, 675 F.3d 315, 326 (4th Cir.2012) (citing *Am. Airlines v. Wolens*, 513 U.S. 219, 228 (1995))). The Circuit Court then held that preemption did not apply because "Dickey's was not forced to do anything. If Dickey's did not want to include the [Prohibition of Arbitration] Clause, it had several options. It could have simply declined to do business in Maryland. Or, ... it could have filed a declaratory action challenging the Maryland Commissioner of Securities' position *before* including the [Prohibition of Arbitration] Clause in its agreements." App. 39a (emphasis in original).

Petitioner filed a petition for rehearing or rehearing en banc. The court denied the petition. Petitioner now seeks relief from this Court. App. 1-4a.

REASONS FOR GRANTING THE PETITION

Like many other industries outside of franchising (banking, insurance, telecommunications, car loans and leases, etc.), state regulators routinely implement state law by mandating that certain regulations appear in the regulated parties' contracts with third parties. Until the Fourth Circuit's decision, a state regulator that required a state law be included in a regulated parties' contracts had no impact on federal preemption - if the state law was federally preempted, then the contractual provision reciting that state law similarly was preempted.

Now, however, those state regulators seeking to undermine federal law can bypass preemption and implement an otherwise preempted state law by requiring regulated parties to include the unconstitutional state law in a private contract. Regulated parties are left with the Hobson's Choice of either not doing business in the state or suing the state regulator - thus, preventing the regulated entity from doing business during the pendency of the action.

The Fourth Circuit's exception to federal preemption is the newest, and perhaps most potent, vehicle to undermine arbitration agreements across the nation. Here, petitioner sought to sell its barbecue-based franchises in Maryland. Maryland's franchise laws prohibit a franchisor from requiring a franchisee to "[w]aive the franchisee's right to file a lawsuit alleging a cause of action arising under the Maryland Franchise Law in any court of competent jurisdiction in this State." MD. CODE REGS. 02.02.08.16; MD. CODE, BUS. REG. § 14-221 (2). As a condition of doing business in the state only applicable to mid-size

franchisors like petitioner, Maryland's Commissioner of Securities required petitioner to place this regulation prohibiting arbitration in the franchise agreements it sold to third parties in Maryland. App. 93-95a. The required clause inserted into petitioner's franchise agreement by the Maryland regulator is virtually identical to the regulation prohibiting arbitration: "[the] provisions of this Agreement shall not require [franchisee] to waive your right to file a lawsuit alleging a cause of action arising under Maryland Franchise Law in any court of competent jurisdiction in the State of Maryland." App. 105a.

Significantly, the Fourth Circuit found that the "plain language" of this regulation (and its implementation in petitioner's franchise agreement) prohibits petitioner from requiring arbitration of respondents' Maryland Franchise Law claims. App. 26a. As this Court is forced to continuously reaffirm, "[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1203-04 (2012) (citing *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011)). Prohibiting franchisors like petitioner from arbitrating state franchise law claims is preempted under the FAA. Indeed, this Court struck down California's franchise law that prohibited arbitration in the same manner that Maryland's regulation does here. *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (applying federal preemption to the provision of the California Franchise Investment Law voiding "[a]ny condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law [requiring judicial consideration of claims brought under the act]."). Therefore, like the

similar arbitration waiver in in *Southland*, little doubt exists that Maryland's law prohibiting arbitration with respect to state law franchise claims runs afoul of the Supremacy Clause.

However, the Fourth Circuit sidestepped any constitutional analysis of Maryland's Prohibition of Arbitration Regulation and created a vast exception to federal preemption. The Fourth Circuit ruled that a state regulator's mandated inclusion of the unconstitutional Prohibition of Arbitration Clause was not preempted because petitioner's insertion of the clause into its Franchise Agreements in order to do business in Maryland was "voluntary." Specifically, in ignoring that regulators enforce state law, the Fourth Circuit held that the Prohibition of Arbitration Clause mandated by the Maryland regulator to be included in petitioner's franchise agreement "is not a *state law* prohibiting arbitration. Rather it is a *contractual provision* prohibiting arbitration" -- and *freely-assumed* contractual agreements are not preempted." App. 37a (emphasis in original). Missing from the Fourth Circuit's analysis, however, is the fact that state regulators do not exist in a vacuum. Instead, they are charged with implementing state law, including Maryland's unconstitutional prohibition on the mandatory arbitration of franchise law claims. COMAR § 14-206 ("The Commissioner may adopt and enforce regulations to administer and enforce this subtitle."); COMAR § 14-210 ("Whenever the Commissioner finds that a person has violated or is about to violate this subtitle or a regulation adopted or order passed under it, the Commissioner may order the person to cease and desist from the further offer to sell or sale of the franchise until the offer or sale complies with this subtitle.").

Moreover, the Fourth Circuit reasoned that petitioner “freely assumed” the waiver of arbitration because: (i) petitioner “could have simply declined to do business in Maryland”; or (ii) Dickey’s “could have filed a declaratory action challenging the Maryland Commissioner of Securities’ position *before* including the [Maryland] Clause in its agreements.” App. 39a. (emphasis in original). The choice between not doing business in a state or engaging in expensive litigation with regulators prior to doing business in the state does violence to the phrase “freely assumed.” More importantly, these choices mandated by state regulators undermine the FAA and impede interstate commerce.

I. This Court’s Review is Necessary to Stop State Regulators from Imposing Unconstitutional Mandates as a Condition of Doing Business in States

The Fourth Circuit’s decision illuminates the path that states hostile to arbitration can take to undermine the FAA and this Court’s precedents holding that anti-arbitration laws are preempted. By simply using state regulators to mandate entities to include such state laws in their contracts, arbitration can be outright prohibited notwithstanding the strong policy of preemption under the FAA. Accordingly, if this decision stands, the Fourth Circuit will render meaningless *Southland*, *Concepcion*, and *Marmet Health Care* when regulators are involved.

Moreover, the decision below has widespread commercial ramifications in a number of industries, much greater than the franchise context at issue here. Where third party relationships are governed by state

regulators, a backdoor now exists allowing states to impose unconstitutional requirements as a conditions of doing business. Thus, the impact of the Fourth Circuit's holding will not be limited to franchising (3% of the country's GDP). Instead, this new way to undermine arbitration will also impact industries such as banking, insurance, automobile sales and telecommunications.

As this Court is aware, the hostility toward arbitration and the FAA is real and enduring. Term after term, this Court is called upon to strike down attempts to undermine the FAA and federal preemption. Allowing state regulators to mandate unconstitutional laws be included in third party contracts without constitutional scrutiny significantly undermines the FAA and burdens interstate commerce.

The Fourth Circuit's decision creates an exception to federal preemption under the FAA swallowing the rule, and "stand[s] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). It also contradicts this Court's directive that the FAA was enacted to overcome *hostility* to arbitration, *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270 (1995); and that the "'principal purpose' of the FAA is to 'ensur[e] that private arbitration agreements are enforced according to their terms.'" *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748 (2011) (quoting *Volt Info. Scis., Inc. v. Bd. of Trs.*, 489 U.S. 468, 478 (1989)). By permitting state regulators to *require* petitioners to include an arbitration prohibition in its franchise agreements, the Fourth Circuit sanctioned Maryland's hostility to arbitration by preventing petitioners from contracting that Maryland Franchise Law claims must be arbitrated.

II. Undermining The FAA, the Fourth Circuit Blessed Maryland's Unconstitutional "My Way Or The Highway" Approach

The first "option" offered by the Fourth Circuit in support of their logic that petitioner "freely assumed" the unconstitutional Prohibition of Arbitration Regulation - not doing business in Maryland - encourages states to erect barriers to interstate commerce by requiring unlawful contractual provisions that would otherwise be preempted by federal law. The decision will, on a wholesale basis, encourage states to restrict out-of-state businesses from doing business in the state unless they include otherwise preempted provisions in their contracts with in-state entities or customers.

This aspect of the Fourth Circuit's holding violates the Dormant Commerce Clause. The Commerce Clause prohibits "regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273 (1988). If a statute discriminates against out-of-state entities on its face, in its purpose, or in its practical effect, it is unconstitutional unless it "serves a legitimate local purpose, and this purpose could not be served as well by available nondiscriminatory means." *Maine v. Taylor*, 477 U.S. 131, 138 (1986).

Especially given its importance in the modern economy, franchising is an instrumentality of interstate commerce. Even though Maryland's Prohibition of Arbitration Regulation does not facially discriminate against out-of-state entities, its practical effect of impairing franchise development within a state has a

discriminatory effect on interstate commerce. *See Cachia v. Islamorada*, 542 F.3d 839, 843 (11th Cir. 2008) (although not facially discriminatory, ordinance “serves to exclude national chain restaurants from competition in the local market” and “has the practical effect of discriminating against interstate commerce”). Maryland’s prohibition on mandatory arbitration distinguishes franchises from other types of similar businesses, and imposes a burden only on those franchisors desiring to arbitrate under the FAA. By placing franchisors on the horns of a dilemma by requiring them to either surrender their right of arbitration or decline to do business in Maryland, the Maryland regulation deters franchises valuing arbitration from doing business in the state. Therefore, Maryland’s regulation prohibiting mandatory arbitration violates the Dormant Commerce Clause.

III. Further Undermining the FAA, the Fourth Circuit Mandates Challenges to State Regulators Prior to Doing Business in the State to Avoid an Unconstitutional Requirement

Further straining the phrase “freely assumed,” the Fourth Circuit refused to consider federal preemption because petitioner did not challenge the unconstitutional regulation “*before* including the [Maryland] Clause in its agreements.” App. 39a (emphasis in original). That option, however, also places an undue burden on interstate commerce and the right to arbitration under the FAA.

First, under this secondary option, a franchisor would be required to delay its registration indefinitely while spending hundreds of thousands of dollars to undo a *concededly unlawful* requirement. Potential business will be lost to competitors until the litigation concludes.

Second, this secondary option contradicts Supreme Court precedent. The Fourth Circuit did not cite a single case holding that federal preemption disappears when a business does not challenge an improper state-imposed contractual provision *before* including that improper provision in its contracts. Indeed, the panel ignored this Court's numerous decisions in which a regulated entity was permitted to challenge such a contractual provision *after* inclusion in a contract and *after* it was raised only in a subsequent litigation. Specifically, the Court's controlling decision in *American Airlines, Inc. v. Wolens*, 513 U.S. 219 (1995), held that federal preemption "bars *state-imposed*" contractual provisions that contravene federal law, as opposed to "enforcement of contract terms *set by the parties themselves*." *Id.* at 222 (emphasis added). The Court in *Wolens* explained that preemption extends to claims based on "state-imposed obligations," as opposed to "self-imposed undertakings," because "privately ordered obligations . . . do not amount to a State's 'enact[ment] or enforce[ment] [of] any law, rule, regulation, standard or other provision having the force and effect of law.'" *Id.* at 228-229 (quoting *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 526 (1992) (preemption applies to contract provisions "imposed" by state law)).

Crucially, nothing in *Wolens* or *Cipollone* requires a party to challenge the state-imposed clause before including it in its contracts. In fact, the *Wolens*' holding would be rendered nonsensical if a party was prohibited from challenging a state-mandated clause after inclusion in its contracts as the Fourth Circuit instructs. *See also Northwest Inc. v. Ginsberg*, 134 S. Ct. 1422, 1432 (2014) ("[w]hen the law of a State does not authorize parties to free themselves from [a contract] covenant, a breach

of covenant claim is pre-empted under the reasoning of *Wolens*”). Therefore, the Fourth Circuit’s decision represents a stark departure from this Court’s holdings in *Wolens* and *Cipollone* – a departure that will significantly undermine the FAA.

Rejecting this Court’s decisions, the Fourth Circuit cited two cases in which a regulated entity successfully challenged a state-required anti-arbitration contract clause *before* including it in its contracts. App. 36-39a (citing *Saturn Distr. Corp. v. Williams*, 905 F.2d 719 (4th Cir. 1990); *Sec. Indus. Assoc. v. Connolly*, 883 F.2d 1114 (1st Cir. 1989)). Both of those Circuit cases held that a state-mandated contract clause requiring an “opt-out” from an arbitration clause was preempted. While these cases demonstrate that a declaratory judgment action *may* be brought by parties such as General Motors and the Securities Industry Association -- who have the resources to mount such a challenge -- neither case holds that a prior declaratory judgment action is *required* to challenge a state’s imposition of an unlawful contractual provision.

Third, litigating against the very regulators who are responsible for overseeing their businesses at the onset of the relationship is not an “option” for many franchisors, or other businesses, that want (or need) to do business in-state without such delay. This is not a hypothetical concern – Dickey’s was forced to seek approval of its franchise agreement this year in Maryland, and the state regulator again required the Prohibition of Arbitration Clause be included in the franchise agreement, which petitioner is unwilling to accept given the Fourth Circuit’s ruling. As of the filing of this Petition, Dickey’s has not been approved to do business in the state of Maryland.

Furthermore, many business may not have the resources (or want) to engage in such protracted litigation *against the very regulators* with whom they must interact regularly and on an ongoing basis. In fact, large and small franchisors are exempt from registering their franchise documents. COMAR 02.02.08.10(D) (excluding franchises from the registration requirement that have at least \$10,000,000 net equity and at least 25 franchises conducting the same franchised business at all times during the 5-year period immediately preceding the offer or sale of the franchise; and COMAR 02.02.08.10(C) (“The registration provisions of the Maryland Franchise Law do not apply to an offer or sale of a franchise when the franchise fee does not exceed \$100 on an annual basis.”). Thus, mid-sized franchisors would be forced to shoulder the burden of challenging Maryland’s unconstitutional Prohibition of Arbitration Regulation.

Maryland’s disparate and arbitrary treatment of medium-sized franchisors with respect to registration requirements violates the Constitution’s Equal Protection Clause. The Equal Protection Clause provides that no State shall “deny to any person within its jurisdiction the equal protection of the laws.” U.S. Const. amend. XIV, § 1. “[A]rbitrary and irrational discrimination violates the Equal Protection Clause under even [the] most deferential standard of review.” *Bankers Life & Cas. Co. v. Crenshaw*, 486 U.S. 71, 83 (1988) (laws that “intentionally” treat “similarly situated” entities “differently” are invalid if “there is no rational basis for the difference in treatment”). Indeed, providing “a shield against arbitrary classifications” is the “core concern” of the Equal Protection Clause. *Engquist v. Or. Dep’t of Agric.*, 553 U.S. 591, 598 (2008).

The Fourth Circuit's adoption of a rule requiring mandatory challenges to state regulators encourages states to erect barriers to interstate commerce. Specifically, the ruling requires regulated entities to include otherwise unlawful preempted provisions in their contracts, knowing that the only way the regulated entities can prohibit the states from doing so is to file a lengthy and expensive declaratory judgment action against the very regulators that control their businesses. This decision not only permits states to require anti-arbitration clauses in franchise agreements, but also in any other type of contract for which the state seeks to require an anti-arbitration clause as a condition to doing business in the state.

The only way to preserve the flow of interstate commerce, while permitting regulated entities to challenge unlawful, state-mandated anti-arbitration contractual provisions, is to reject the Fourth Circuit's new rule and to permit challenges to these provisions in subsequent lawsuits, as in *Wolens*.

CONCLUSION

The Fourth Circuit has created a vast exception to federal preemption under the FAA and otherwise that allows state regulators to simply mandate that a regulated entity include the otherwise preempted provision in their private contracts. This decision not only will undermine the strong federal policy in favor of arbitration, which has been the scourge of states across the country, but also will undermine other federal policies and regulatory schemes on which state regulators have influence. The Court should grant the petition in order to close this loophole to federal preemption.

Respectfully submitted,

ROGER B. KAPLAN

Counsel of Record

AARON VAN NOSTRAND

GREENBERG TRAURIG, LLP

200 Park Avenue

P.O. Box 677

Florham Park, New Jersey 07932

(973) 360-7900

kaplanr@gtlaw.com

Of Counsel:

PAUL J. FERAU

Counsel for Petitioners

November 30, 2015