The Threat or Prospect of Franchise Termination

Knowing Your Rights In New Jersey

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From a franchisee's perspective, the prospects of termination of the franchise relationship can be devastating, from the loss of significant start up, fit up, improvement and marketing expenses, to the blood, sweat and tears that any business owner invests in nurturing and growing his or her "baby." From the franchisor's point of view, the prospects of terminating a franchisee are often not nearly so human and personal, since many times a franchisee is merely a line item on the franchisor's accounting report. However, regardless of the perspective from which it is viewed, the termination of a franchise relationship is a legally significant event in that the propriety of the termination, and the parties' respective rights and responsibilities upon termination, are often not as clear cut as one side or the other would like to believe. If you are facing the prospect of termination of the franchise relationship, you must know your rights.

If your franchise relationship is one governed by New Jersey law, you may have rights that are in addition to, or even contrary to what is stated in your franchise agreement. Also, even the question of whether New Jersey law governs your franchise relationship may not be as clear as you might think.

In 1971, New Jersey enacted the Franchise Practices Act (the "NJFPA")[1] in order to level the playing field between franchisors and franchisees. The NJFPA shields franchisees from abuses of their franchisors with superior bargaining power.[2] Any New Jersey franchise which fits the definition under the NJFPA, that is, a written business relationship in which a person is granted a license to use the trade name or mark of another and in which there is a "community of interest" in the marketing of goods or services, is entitled to the NJFPA's protections.[3] A franchise is a "New Jersey franchise" entitled to protection if the franchisee establishes or maintains a place of business in New Jersey, and where certain minimum gross sales requirements are met.[4] Significantly, the protections of the NJFPA will likely apply to a franchise fitting the definition of a New Jersey-based franchise even in the face of a choice of law provision in the franchise agreement that designates the law of some other state as the governing law.[5]

Under the NJFPA a franchisor can only lawfully terminate a franchise under very limited circumstances. The NJFPA prohibits a franchisor from directly or indirectly terminating or failing to renew a franchise without "good cause." Good cause is defined as "the failure by the franchisee to substantially comply with the requirements imposed upon him by the franchise."[6] Thus, a franchisor cannot terminate a franchisee even when acting in good faith for a bona fide business reason where the franchisee is not in substantial breach of its obligations under the franchise agreement.[7] Nor can a franchisor terminate the franchise for the bona fide business reason to dispose of property,[8] or upon deciding that its original decision to grant the franchise was mistaken.[9] A franchisor also cannot duck the "good cause" requirement of the NJFPA by including a provision that permits termination of the franchise at will.[10]

Further, a franchisee is not required under the NJFPA to comply with obligations that "impose unreasonable standards of performance upon a franchisee."[11] For example, a franchisor imposes unreasonable standards of performance upon a franchisee when it requires a franchisee to operate at a substantial financial loss while the franchisor attempts to implement a new and unproven marketing strategy.[12] The issue of whether a standard of performance is "unreasonable" calls for

a subjective determination by a court, but in light of the pro-franchisee construction of the NJFPA, is one that likely will be made in favor of the franchisee.

Finally, the NJFPA has recently been interpreted to additionally bar "constructive" termination of a franchise agreement without good cause, i.e., conduct geared towards the termination of a franchise.[13] Thus, a franchisee can seek relief under the NJFPA even where it has not yet been actually terminated, but where the franchisor has threatened termination or otherwise has exerted efforts to essentially push the franchisee out of the franchise.

Franchisees are entitled to a variety of remedies when their franchisors violate the NJFPA. A franchisee may seek an injunction preventing a franchisor from terminating the franchise agreement until a court determines whether good cause has been shown by the franchisor. If a court finds that a franchisor has wrongfully terminated a franchisee under the NJFPA, the franchisee is entitled to "the reasonable value of the business less the amount realizable on liquidation."[14] Furthermore, if successful, a franchisee is also entitled to the costs of the action, including reasonable attorney's fees.[15]

Cloaked with the protections afforded by the NJFPA, franchisees should not be shy about defending themselves against the unscrupulous franchisor when it believes it has been or will soon be improperly, unreasonably or arbitrarily terminated. The enactment of the NJFPA and substantial body of case law interpreting it provide a great protection to franchisees who no longer remain vulnerable to the abuses of their franchisors. We encourage any franchisee facing or dealing with improper termination to consult with experienced franchise counsel and take advantage of the many benefits provided under the NJFPA.

1 N.J.S.A. 56:10-1 to -15.
2 Allen v. World Inspection Network Int'l, Inc., 389 N.J. Super. 115, 123 (App. Div. 2006).
3 N.J.S.A. 56:10-3(a).
4 N.J.S.A. 56:10-4(a).
5 Kubis & Perszyk Assoc., Inc. v. Sun Microsystems, Inc., 146 N.J. 176 (1996).
6 Monmouth Chrysler-Plymouth, Inc. v. Chrysler Corp., 102 N.J. 485, 492 (1986) (quoting N.J.S.A. 56:10-5).
7 Maintainco, Inc. v. Mitsubishi Caterpillar Forklift America, Inc., 408 N.J. Super. 461, 477 (App. Div. 2009); Westfield Centre Serv. v. Cities Serv. Oil Co., 86 N.J. 453, 465-66 (1981).
8 Ibid.
9 Westfield Centre Serv. v. Cities Serv. Oil Co., 158 N.J. Super. 455, 475 (Ch. Div. 1978), aff'd and remanded, 172 N.J. Super. 196 (App. Div. 1980), aff'd, 86 N.J. 453 (1981).
10 General Motors Corp. v. New A.C. Chevrolet, Inc., 263 F.3d 296 (3d Cir. 2001).
11 N.J.S.A. 56:10-7(e).
12 Beilowitz v. Gen. Motors Corp., 233 F. Supp. 2d 631, 643-44 (D.N.J. 2002).
13 Maintainco, Inc. v. Mitsubishi Caterpillar Forklift America, Inc., 408 N.J. Super. 461 (App. Div. 2009).
14 Westfield Centre Serv. v. Cities Serv. Oil Co., 86 N.J. 453, 469 (1981).
15 N.J.S.A. 56:10-10.

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