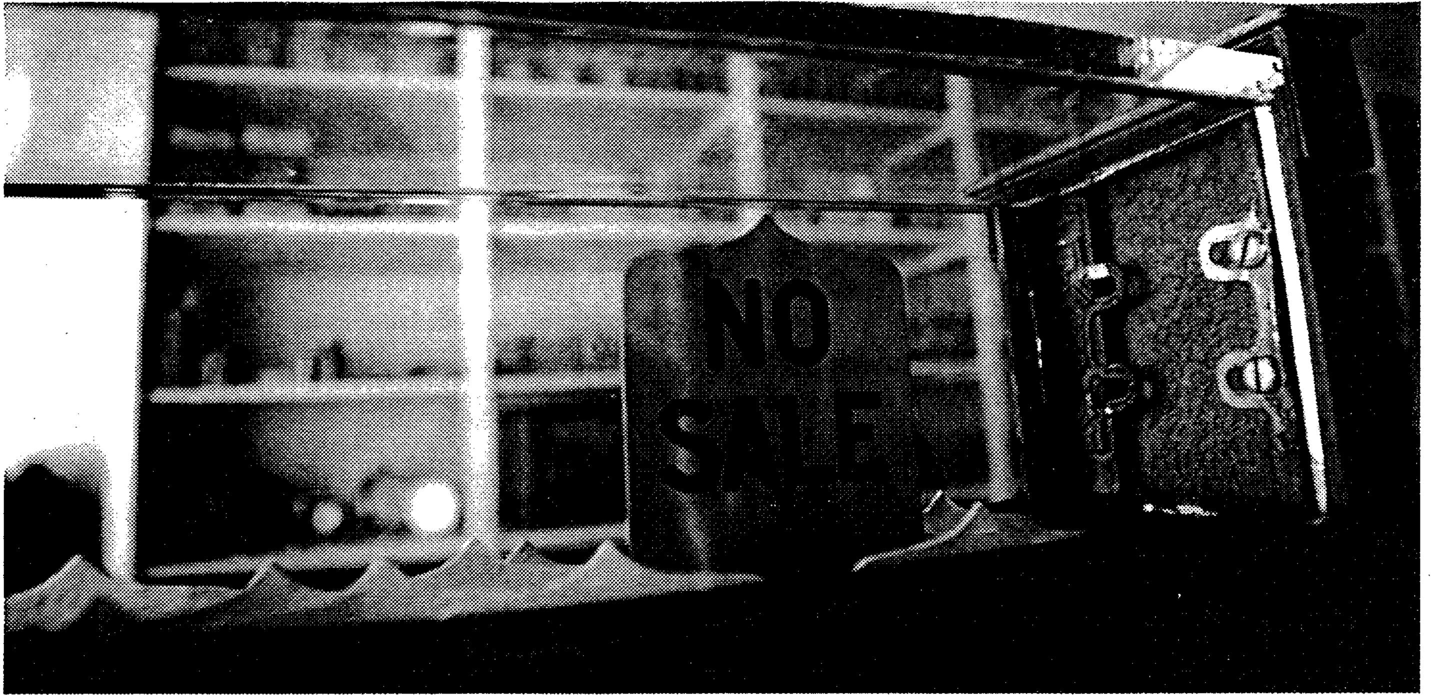

Defending Against the Termination of a Franchise in New Jersey

Some Practical Considerations

by Edward T. Kole and James E. Tonrey Jr.

When a client's franchise is purportedly terminated by the franchisor, there are a number of practical considerations to keep in mind when attempting to fend off the termination.

The New Jersey Franchise Protection Act

First and foremost is determining whether the client's franchise is governed by the New Jersey Franchise Protection Act (NJFPA).[1] The NJFPA is remedial legislation designed to level the unequal playing field between franchisors and franchisees caused by the fact that the franchisee, having invested money and time in promoting and selling the franchisor's product, may have no recourse in the event the franchisor unilaterally terminates the relationship.

One former federal judge described the plight of the franchisee as follows:

> Thomas Hobson, an English liveryman who lived in the seventeenth century, required his customers to take the horse nearest to the stable door or none at all. Accordingly, a "Hobson's choice" refers to an apparently free choice that offers no real alternative. Here, the Defendant franchisor...offered the Plaintiff franchisee...a Hobson's choice—either to accede to [the franchisor's] new business plan, which would result in the loss of forty percent of [franchisee's] revenue, or, after a twenty-three-year-long relationship with [franchisor] to be cut out of doing any business with [the franchisor] at all. This case illustrates the very reason the New Jersey Franchise Practices Act ("NJFPA"), N.J.S.A. §§ 56:10-1, *et seq.*, was enacted—to protect franchisees, possessed of less bargaining power than their franchisors, from such daunting "choices."[2]

Determine the Applicability of the NJFPA

Generally speaking, the NJFPA applies to a business located in New Jersey, where certain minimum gross sales requirements are met, there is a written business relationship

between the parties and there is in existence a "community of interest"[3] between the parties.[4] In the event the NJFPA applies, a franchisee is provided broad protections against termination, including a prohibition on termination of the relationship in the absence of "good cause."[5]

In cases where the NJFPA applies, the franchisor is not free to terminate the franchise relationship with the franchisee. To the contrary, the franchisor must demonstrate the franchisee failed to substantially comply with the parties' franchise agreement.[6] This "substantial compliance" must be measured by the effect of the franchisee's actions or inactions on the trade name, trademark, good will and image of the franchisor.[7] Indeed, it is a violation of the NJFPA "...to cancel a franchise for any reason other than the franchisee's substantial breach, even if the franchisor acts in good faith and for a bona fide reason."[8] A franchisor may not fail to renew a franchise agreement even where the franchise is not economically feasible, or for other good faith economic reasons.[9]

Analysis of the Franchise Agreement/Choice of Law Provisions

Assuming, however, the NJFPA applies to the termination, making that determination is merely the beginning of the analysis. In addition to making the threshold determination of applicability of the NJFPA, counsel should also review the franchise agreement between the parties. Consider, for example, that the franchise agreement contains what is often contained in any garden-variety commercial agreement, a choice of law provision. Consider further that the franchise agreement contains a provision clearly, specifically and unequivocally stating the franchise agreement will be construed pursuant to the laws of a state other than New Jersey, and disclaims any applicability of the NJFPA. It is commonplace for parties to include a choice of law provision in their agreements; counsel unfamiliar with the NJFPA may conclude the NJFPA does not apply to the transaction in question.

But the NJFPA cannot be supplanted by any such choice of law provision. Consistent with the purpose of protecting franchisees from overreaching by the franchisor, the NJFPA, by its terms, prohibits a franchisor from waiving the protections of the statute.[10] The act expressly prohibits franchisors from directly or indirectly requiring a franchisee to assent to a release or waiver of the NJFPA at the time of entering into a franchise arrangement.[11]

Forum Selection Clauses

Similarly, it would not be surprising if the franchise agreement contains a forum selection clause. Just as a choice of law provision is commonplace in commercial agreements, it would not be uncommon for the franchise agreement to set forth with specificity that any claims under the franchise agreement be filed in a distant forum, often in a forum that would be more convenient for the party in the superior bargaining position (the franchisor) and just as inconvenient for the franchisee, such that the franchisee may be inhibited from asserting its rights under the NJFPA. Once again, counsel unfamiliar with the NJFPA or the decisions construing it may summarily conclude the forum selection clause would be an impediment to a lawsuit in New Jersey and advise the franchisee accordingly.

But the New Jersey Supreme Court has squarely addressed this issue, and has determined a forum selection clause contained in a franchise agreement is presumptively unenforceable.[12] In *Kubis & Perszyk Assoc., Inc. v. Sun Micro Systems, Inc.*, the New Jersey Supreme Court determined a forum selection clause in a franchise agreement is presumptively invalid. The Court in that case focused on the unequal bargaining position between the franchisee and franchisor, and found the franchisee should be protected from the added expense and inconvenience of litigating a claim in a distant forum.

The Court concluded as follows:

> [W]e are convinced that forum selection clauses in the vast majority of franchise agreements are not the subject of arms-length negotiation between parties of comparable bargaining power.
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> . . .
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> Accordingly, we hold that forum selection clauses in franchise agreements are presumptively invalid, and should not be enforced unless the franchisor can satisfy the burden of proving that such a clause was not imposed on the franchisee unfairly on the basis of its superior bargaining position.[13]

Thus, while the franchise agreement, on its face, may require the franchisee to litigate any dispute under the agreement in a distant, inconvenient forum, such clauses are presumptively invalid.

Additional Substantive Considerations Under the NJFPA

Beyond review of the terms of the franchise agreement, another important consideration is the conduct by the franchisor. In many different factual scenarios, a franchisor may impose conditions on a franchisee and then claim 'good cause' for terminating the franchise agreement based on the franchisee's failure to substantially comply with the terms of the conditions. In such situations, it may conclude that the franchisee has not complied with the terms of the franchise agreement and advise the franchisee that the chances of prevailing in a lawsuit under the NJFPA are minimal.

However, the NJFPA, by its terms, prohibits a franchisor from imposing "unreasonable standards of performance upon a franchisee."[14] In other words, in

cases where the franchisor establishes a standard or condition of performance on the franchisee, benign on its face, and then attempts to terminate the franchisee based on its failure to 'substantially comply' with the condition or standard, counsel should scrutinize the standard to determine if it is reasonably attainable or impossible to reach. If the condition falls into the latter category and is objectively unattainable, the franchisor's purported termination of the franchise agreement based on non-compliance with the franchise agreement may be ineffectual.

By way of example, the United States District Court for the District of New Jersey, applying the NJFPA, confronted a scenario in which a franchisee with a relationship in excess of 20 years with a franchisor faced termination of its franchise. In *Beilowitz v. GMC*, the franchisor, GMC, had imposed a new sales program on the franchisee, Beilowitz, which would result in the franchisor losing $11 million in sales, representing approximately 40 percent of the franchisor's total revenue.[15] The new program, which did not specifically target the franchisee or terminate the franchisee's relationship with the franchisor, would, among other things, restrict the franchisee from selling outside the Philadelphia area, and restrict the franchisee's market area to a region already served by two competitors.[16] Moreover, the court found the franchisee could incur over $1 million in pre-tax operating losses during the pendency of the case.[17] Yet, the new sales program was even-handed on its face, purportedly represented a good faith program by the franchisor to run its business as it deemed fit, and almost all of the franchisor's franchisees entered into the new program.[18]

The franchisee filed an application for a preliminary injunction to enjoin the franchisor's failure to renew the franchise agreement in light of the franchisee's refusal to take part in the new program. In reviewing the application, the court found the franchisor's new program was untried, and that its implementation would have the aforesaid negative economic consequences on the franchisee. The court found the program was not reasonably attainable by the franchisee and enjoined GMC from refusing to renew the franchise agreement with the franchisee.

Thus, while the franchisor's new program was facially neutral, and was accepted by most of the other franchisees, the court found the application of the new program to the franchisee at issue would have an economically crippling effect on the franchisee, and that the terms of the program, related to the franchisee, were not attainable. In such circumstances, the court applied the NJFPA and enjoined the franchisor from terminating the franchise. Thus, even where there is no termination, *per se*, of a franchise agreement, careful scrutiny of the facts and familiarity with the NJFPA are important in addressing matters regarding the potential termination of a franchise in New Jersey.

Remedies Under the NJFPA

Having determined the applicability of the NJFPA, having scrutinized the franchise agreement as well as the franchisor's conduct, and having concluded a viable cause of action exists under the NJFPA, the remaining arrows in counsel's quiver consist of the remedies available under the NJFPA for the aggrieved franchisee.

The NJFPA authorizes an award of damages as well as injunctive relief.[19] Typically a combination of both will come into play; first, to enjoin the termination of the franchise agreement and, secondly, to compensate the franchisee for any lost sales or other losses compensable with monetary damages. Additionally, consistent with the remedial purposes of the NJFPA, and to act as a disincentive for arbitrary conduct by franchisors, the NJFPA also permits a franchisee who prevails in an action under the NJFPA to recover its costs and reasonable attorneys' fees for the action.[20] Thus, an aggrieved franchisee required to bring an action under the NJFPA who prevails, may be made whole through recovery of fees and costs.

Conclusion

The NJFPA is broad legislation designed to eliminate the disparity of bargaining power between a franchisor and franchisee. While the franchise agreement defines and governs the relationship between the franchisor and franchisee, the NJFPA adds another layer of terms to the parties' relationship that not only adds protections for the franchisee but also invalidates certain provisions the parties included in their agreement. For this reason, counsel is well advised to tread carefully in any franchise termination matter. The foregoing factors should be part of any analysis. ⚖

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ENDNOTES

1. N.J. Stat. Ann. 56:10-1 to -15.
2. *Beilowitz v. GMC*, 233 F. Supp. 2d 631 (D.N.J. 2002) (footnotes omitted).
3. In *Beilowitz*, 233 F. Supp. 2d at 640, Judge Orlofsky explained: "[w]hat characterizes community of interest is the potential for abuse that is triggered 'when the reputation and good will of the network, created primarily by the efforts of each of the individual franchisees, passes back to the franchisor without compensation to the franchisee.'" (*citing Instructional Sys., Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 358 (1992) (ISI) (*quoting Neptune T.V. & Appliance Serv., Inc. v. Litton Sys., Inc.*, 190 N.J. Super. 153, 164 (App. Div. 1983)). Further, the court explained that "A 'community of interest' exists when the terms of the agreement between the parties or the nature of the franchise business requires the licensee, in the interest of the licensed business's success, to make a substantial investment in goods or skill that will be of minimal utility outside the franchise." *Id.* at 359.
4. *Id.* 56:10-3 and -4.
5. The NJFPA reflects the New Jersey Legislature's concerns regarding abuse of franchisees that may arise from the disproportionate bargaining positions between the parties. *Shell Oil CO. v. Marinello*, 63 N.J. 402, 409 (1973).
6. N.J. Stat. Ann. 56:10-5.
7. *Amerada Hess Corp. v. Quinn*, 143 N.J. Super. 237, 251 (Law Div. 1976).
8. *General Motors Corp. v. Gallo GMC Truck Sales*, 711 F. Supp. 810, 816 (D.N.J. 1989) (*citing Westfield Centre Serv. v. Cities Serv. Oil Co.*, 86 N.J. 453, 469 (1981)).
9. *General Motors Corp.*, 711 F. Supp. at 816; *Westfield Centre Serv.*, 86 N.J. at 453.
10. N.J. Stat. Ann. 56:10-7(a). In *Instructional Systems, Inc. v. Computer Curriculum Corp., supra*, 130 N.J. at 345, the Supreme Court of New Jersey addressed New Jersey's interest under the NJFPA in the face of a contractual choice of law provision in a franchise agreement:

   "Few franchises are intrastate," and were parties free to dispense with the protection afforded by franchise acts, any "large franchisor by insertion of a choice of law provision requiring the application of the franchisor's home state's law, could with a stroke of a pen remove the beneficial effect of the franchisee's state's remedial legislation." "We will reject even the parties' choice of New Jersey local law in order to preserve the fundamental public policy of the franchisee's home state where its statutes afford greater protection." (citations omitted).

11. The NJFPA provides in this regard as follows:

    It shall be a violation of this act for any franchisor, directly or indirectly, through any officer, agent or employee, to engage in any of the following practices:

    a. *To require a franchisee at time of entering into a franchise arrangement to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this act....N.J. Stat. Ann. 56:10-7(a).*

12. *Kubis & Perszyk Assoc., Inc. v. Sun Micro Sys., Inc.*, 146 N.J. 176 (1996).
13. *Id.* at 194-95.
14. N.J. Stat. Ann. 56:10-7(e).
15. *Beilowitz*, 233 F. Supp. 2d at 638.
16. *Id.* at 636.
17. *Id.* at 639.
18. *Id.* at 638.
19. *Id.* 56:10-10.
20. *Id.*