SECURING HOME FIELD ADVANTAGE

Protecting New Jersey Franchisees under the New Jersey Franchise Practices Act

by Evan M. Goldman

Broadly speaking, franchising is on the rise in New Jersey as well as the entire United States. According to the International Franchise Association (IFA), there are 744,437 franchised establishments in the United States, contributing $426 billion toward the gross domestic product (GDP).[1] Given the prevalence of franchises in the culture, particularly in New Jersey, it is vital to know the laws that are applicable to New Jersey franchisees. In the hyper-technical area of franchise agreements where every term is pre-defined, this understanding is paramount.

This article will provide an overview of the New Jersey Franchise Practice Act (NJFPA). Beyond a high-level synopsis of the NJFPA, it is vital that franchisees work to receive the full benefits of the act. Thus, this article will also address the multiple prongs for obtaining protection under the NJFPA, the importance of securing venue where the NJFPA will be applied, and steps franchisees can take to secure venue.

The History and Purpose of the NJFPA

The NJFPA was enacted to remedy the disparity in bargaining power between franchisors and franchisees by protecting

franchisees against indiscriminate termination and non-renewals.[2] The NJFPA, therefore, "prevent[s] arbitrary or capricious actions by the franchisor who generally has vastly greater economic power than the franchisee."[3] In 2009, the NJFPA was amended to broaden the legislation's scope, evincing a clear legislative intent that the NJFPA should apply to additional types of franchise agreements as well.[4]

Definition of a Franchise

Under federal law, a franchise is defined as a continuing commercial relationship that requires the following three elements: 1) identification or association with the franchisor's trademark; 2) the exercise or right to exercise significant control over, or the provision of significant assistance to, the franchisee's method of business operation; and 3) a required payment of at least $570 made at any time before, or within six months after, the franchisee commences business.[5] While that definition is instructive and serves as a foundation, it is not directly applicable to New Jersey franchisees raising the NJFPA as a claim or defense.

Specifically, to qualify as a franchise under the NJFPA a franchisee "must show that (i) a written arrangement exists between the parties granting a license for use of a trade name, trademark, service mark, or related characteristics; and (ii) the arrangement demonstrates a 'community of interest' in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise."[6]

While the first prong seems relatively straightforward, it is a bit more complicated than often thought by franchisees and/or inexperienced practitioners. To establish a license under the NJFPA, "the franchisee must, at a minimum, use the name of the franchisor 'in such a manner as to create a reasonable belief on the part of the consuming public that there is a connection between the...licensor and licensee by which the licensor vouches, as it were, for the activity of the licensee."[7] A license may also be found to exist based on a long-standing business relationship, even absent an explicit contractual grant of authority.[8]

Beyond establishing a license, a franchisee must also show that a "community of interest" exists. Although an amorphous term, "the New Jersey Supreme Court has explained that 'a community of interest' exists when the terms of the agreement between the parties or the nature of the franchise business requires a licensee, in the interest of the licensed business's success, to make a substantial investment in goods or skill that would be of minimal utility outside of the franchise."[9] In order to find a community of interest, two requirements must be met: 1) the distributor's investments must have been substantially franchise-specific; and 2) the distributor must have been required to make these investments by the parties' agreement or the nature of the business.[10] The NJFPA protects franchise-specific tangible capital investments, such as a building, special equipment and franchise signs, all specific for use to promote a manufacturer's product and of no value outside the franchise.[11]

Notably, a fact finder is not required to find that a distributor's investments were *entirely* franchise-specific, but merely that they were *substantially* franchise-specific.[12] To this point, the NJFPA does not require the franchisee to be decimated completely by the franchisor's wrongful termination but, rather, that the franchisee invested a significant amount in light of the parties' putative franchise agreement.[13]

Unfortunately, many practitioners often stop their analysis at a review of these requirements. However, in order to qualify for protection and relief, it is critical to be aware that the NJFPA only applies to a franchise, when: "(1) the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey, (2) where gross sales or products or services between the franchisor and franchisee covered by such franchise shall have exceeded $35,000.00 for the 12 months next preceding the institution of suit pursuant to this act, and (3) where more than 20% of the franchisee's gross sales are intended to be or are derived from such franchise...."[14]

The applicability of these factors is often readily determinable, as described herein.

Prohibited Conduct under the NJFPA

The NJFPA "reflects the legislative concern over long-standing abuses in the franchise relationship," caused by the power disparity between franchisors and franchisees.[15] The NJFPA prohibits a franchisor from terminating, canceling or failing to renew a franchise without written notice explaining good cause for the threatened action 60 days in advance.[16] Good cause is "limited to [the] failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise."[17] It is a violation of the NJFPA, therefore, to terminate 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.[18] As stated, the notice required must set forth all the reasons for termination of a franchise, and must be sent to the franchisee at least 60 days in advance of termination.[19]

Obtaining Protection under the NJFPA

Assuming the NJFPA applies to a particular franchise and the franchisee can claim the NJFPA as a basis for relief, either affirmatively or in defense, franchisees must take steps to ensure they are litigating in a court that will apply the NJFPA. This includes when a fran-

chise agreement contains a choice-of-law and/or forum selection clause. In this regard, many courts outside of New Jersey will misapply, or refuse to apply, the NJFPA in light of out-of-state forum selection and/or choice-of-law provisions. For example, in *Michelin North America, Inc. v. Inter City Tire and Auto Center, Inc.*, a dispute arose between the franchisor and franchisee and, during negotiations, litigation was first-filed in South Carolina by the franchisor, who was located in the state, in spite of the fact that the franchisee was a New Jersey franchise.[20] Despite refusing to apply the NJFPA to the franchisee's claims, the district court judge in the District of South Carolina stated, "I think you have a strong argument under the New Jersey Franchise law."[21] Thus, while the court acknowledged that the franchisee had a 'strong' claim under the NJFPA, in light of the franchise agreement's choice-of-law provisions, the court refused to apply it.[22]

This case is one example of many. Therefore, it is vital that New Jersey franchisees seeking to gain protection under the NJFPA seek to initiate litigation in New Jersey. Unlike many other states, New Jersey has a strong policy in favor of protecting its franchisees, and where New Jersey had significant contact with the franchise transaction New Jersey courts hold that New Jersey is the state of applicable law.[23] Additionally, with respect to common law claims, the substantive law per the parties' franchise agreement will apply.[24]

In fact, under the NJFPA, forum selection clauses in franchise agreements are presumptively invalid because they fundamentally conflict with the basic legislative objectives of protecting franchisees from the superior bargaining power of franchisors, as well as providing swift and effective judicial relief against franchisors that violate the NJFPA.[25]

While *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.* did not establish an irrefutable presumption that forum selection clauses are always invalid in NJFPA cases, it did hold that the burden shifts to their proponent to provide their validity.[26] Given the importance of the forum and venue to the viability of a franchisee's NJFPA claim, as stated in *Michelin North America, Inc.*, it is important to venue the case in New Jersey, notwithstanding whether choice-of-law and venue provisions apply.

Importance of First-to-File Rule

One way franchisees can, at the very least, increase their chances of maintaining litigation in New Jersey is to be the first to file. The first-filed rule requires that "in all cases of federal concurrent jurisdiction, the court which first has possession of the subject must decide it."[27] The first-filed rule "counsel[s] trial judges to....enjoin the subsequent prosecution of similar cases in different federal district courts."[28] For the first-filed rule to apply, there must be "substantial overlap" between the subject matter and the parties in both cases.[29] "Courts must be presented with exceptional circumstances before exercising their discretion to depart from the first-filed rule."[30] In light of the presumption toward invalidating forum selection clauses, and because litigating in New Jersey is so important, franchisees are implicitly encouraged to be the first to file, and it is critical they attempt to do so.[31]

Conclusion

The NJFPA is a wide-ranging protective statute meant to address many of the inequities between franchisors and franchisees. Despite its existence, many franchisees miss opportunities to take advantage of the NJFPA's protections, such as franchisee-friendly fee-shifting provisions.[32] Some do so because they do not understand the true definition of a franchise under New Jersey law. Some do so because they do not recognize violations of the NJFPA. And some do so because they miss an opportunity to raise the NJFPA in their litigation. Thus, it is important for franchisees to know about the NJFPA and what it protects, how it can protect them, and how they can ensure that they, too, are protected by it. ⚖

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Endnotes

1. https://www.franchise.org/sites/default/files/Franchise_Business_Outlook_Jan_2017.pdf.
2. *See Red Roof Franchising, LLC v. Patel*, 877 F. Supp. 2d 124, 137 (D.N.J.) (Hillman, J.).
3. *Instructional Sys., Inc. v. Computer Curriculum Corporation*, 130 N.J. 324, 340-341 (1992).
4. *See, e.g., Carroll v. Bimbo Foods Bakeries Distribution, Inc.*, 2013 WL 1007289 (D.N.J. March 13, 2013) (Kugler, J.).
5. 16 C.F.R. 436.1.
6. N.J.S.A. 56:10-3.
7. *Beilowitz v. General Motors Corp.*, 233 F. Supp. 2d 631, 642 (D.N.J. 2002) (*citing Instructional Sys., Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 352 (1992)).
8. *Id.* (*citing Cooper Distrib. Co. Inc. v. Amana Refrigeration Inc.*, 63 F.3d 262, 272-73 (3d Cir. 1995); *Lithuanian Commerce Corp. v. Sara Lee Hosiery*, 179 F.R.D. 450, 471 (D.N.J. 1998)).
9. *See Boyle v. Vanguard Car Rental USA, Inc.*, 2009 WL 3208310, at *19 (D.N.J. Sept. 30, 2009); *Instructional Sys., Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 359 (1992); *Atlantic City Coin & Slot Serv. Co., Inc. v. IGT*, 14 F. Supp.

2d 644 (D.N.J. 1988); *Emergency Accessories & Installation, Inc. v. Whelen Engineering, Co., Inc.*, 2009 WL 1587888 (D.N.J. June 3, 2009)).

10. *Cooper Distributing Co., Inc. v. Amana Refrigeration, Inc.*, 63 F.3d 262, 269 (3d Cir. 1995).
11. *See id.* at 271.
12. *See id.*
13. *See, e.g., Oracle America, Inc. v. Innovative Technology Distributors*, 2012 WL 4122813 at *14 (N.D.CA. Sept. 18, 2012) (in applying the NJFPA, the court held that a question of fact existed as to the existence of a community of interest due to numerous non-transferrable franchise-specific investments by the distributor, including requirements to hire specialized staff and spend substantial sums on manufacturer-related trainings and manufacturer-specific equipment).
14. N.J.S.A. § 56:10-4.
15. *Gen. Motors Corp. v. Gallo GMC Truck Sales Inc.*, 711 F. Supp. 810, 814 (D.N.J. 1989); *see also Westfield Ctr. Serv. Inc. v. Cities Serv. Oil Co.*, 86 N.J. 453 462-63 (1981); *see also* N.J.S.A. 56:10-2.
16. *See* N.J.S.A. 56:10-5.
17. *Ibid.*; *see also Consumers Oil Corp. of Trenton v. Phillips Petro. Co.*, 488 F.2d 816, 819 (3d Cir. 1973) ("[O]nly delinquency or dereliction of the franchisee is stated as 'good cause' ....").
18. *See Atlantic City Coin and Slot Service Company, Inc., et al v. IGT*, 14 F. Supp. 2d 644, 658 (D.N.J. 1998) (*quoting Westfield Centre Serv., Inc.*, 86 N.J. at 469).
19. *See Soft Pretzel Franchise Systems, Inc. v. Taralli, Inc.*, 2013 WL 5525015, *6 (E.D. Pa. Oct. 4, 2013). The District of New Jersey, in addressing the 60-day statutory notice period, has expressed differing views, albeit in *dicta*, as to whether the 60-day period is simply a notice period or a notice and cure period. *Compare Dunkin' Donuts Franchised Restaurants LLC v. Strategic Venture Group, Inc.*, 2010 WL 4687838, *20, 2010 U.S. Dist. LEXIS 119417 (D.N.J. Nov. 10, 2010) (notice period) and *Jiffy Lube Int'l v. Weiss Bros.*, Inc., 834 F. Supp. 683, 689 (D.N.J. 1993) (notice period) with *Dunkin' Donuts, Inc. v. All Madina Corp.*, 2006 WL 842403, *5 (D.N.J. March 28, 2006) (notice and cure period).
20. *Michelin North America, Inc. v. Inter-City Tire and Auto Center, Inc.*, Civil Action No. 6:13-cv-01067-HMH, Docket No. 38 (D.S.C. May 22, 2013).
21. *Id.*
22. *Id.*
23. *Instructional Sys., Inc.*, 130 N.J. at 345-346 (holding that significant contact included where the franchisee was located within New Jersey's borders, the franchisee's employees resided within the state, the franchise-specific investments related to assets were made in New Jersey, and where goodwill was developed with New Jersey residents).
24. *See, e.g., Innovative Technology Distributors, LLC v. Oracle America, Inc.*, 2011 WL 1584297 (D.N.J. April 25, 2011) (holding that contractual choice of law agreements that prevent application of the NJFPA by selecting the substantive law of another state that are contrary to New Jersey public policy will not be enforced, but that the choice of law with respect to common law claims will be respected).
25. *See, e.g., Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 146 N.J. 176 (1996).
26. *Id.* at 495; *see also Innovative Technology Distributors, LLC v. Oracle America, Inc.*, 2011 WL 1584297 (D.N.J. April 25, 2011).
27. *EEOC v. University of Pennsylvania*, 850 F.2d 969, 971 (3d Cir. 1988).
28. *Id.* (internal citations omitted).
29. *Ivy Dry, Inc. v. Zanfel Labs., Inc.*, 2009 WL 1851028, at *3 (D.N.J. June 24, 2009).
30. *EEOC*, 850 F.2d at 979.
31. Of course, if the relationship is still ongoing but the franchisee is concerned with controlling venue, the franchisee can file, but not serve, a complaint. This could secure venue but not, unnecessarily, disturb an ongoing franchise relationship.
32. *Alboyacian v. BP Products North America, Inc.*, 2012 WL 3862549, *4 (D.N.J. Sept. 5, 2012) (holding that franchisees are entitled to reasonable fees and costs if they are successful in a claim under the NJFPA).