

To: New Jersey Law Revision Commission
From: Jayne Johnson
Re: New Jersey Franchises Practices Act – Provisions governing arbitration
Date: June 5, 2017

EXECUTIVE SUMMARY

Based on the recent decision of the United States Supreme Court in *Kindred Nursing, L.P. v. Clark*, Staff revisited the Draft Tentative Report proposing revisions to the New Jersey Franchises Practices Act.

In *Kindred Nursing*, the Court considered a Kentucky rule permitting an agent to waive the principal's right to a jury trial only if expressly provided in the power of attorney. The U.S. Supreme Court held that the state rule violates the Federal Arbitration Act by singling out arbitration for disfavored treatment. This Memorandum, in accord with the *Kindred Nursing* decision, proposes removing statutory provisions disfavoring arbitration from the New Jersey Franchise Practices Act. Staff requests approval from the Commission to recommend the portions of N.J.S. 56:10-7.3 for repeal as indicated in the Appendix of this Memorandum.

BACKGROUND

The New Jersey Franchise Practices Act (NJFPA or the Act) was designed to “level the playing field for New Jersey franchisees and prevent their exploitation by franchisors with superior economic resources.”¹ In accord, case law interpreting the NJFPA recognizes the legislative intent to provide franchisees the “shelter of favorable state law.”² The work of the Commission in this area is focused on clarifying the Act based on case law governing the gross sales threshold under the definition of franchise in section 10-4, along with provisions governing forum-selection and arbitration in section 7.3.

The Federal Arbitration Act (FAA) pre-empts any state statute that “discriminates on its face against arbitration” or “covertly accomplishes the same objective by disfavoring contracts that have defining features of arbitration agreements.”³ The United States Supreme Court, in series of decisions, has prohibited efforts by states to regulate arbitration clauses,⁴ finding “that a

¹ N.J. STAT. ANN. §§ 56:10–1 to -15 (West 2017); *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 146 N.J. 176, 195 (1996).

² See Earsa Jackson & Jim Meaney, *Forum Selection After Atlantic Marine*, AMERICAN BAR ASSOC. 12 (Oct. 15, 2014), <http://www.americanbar.org/content/dam/aba/administrative/franchising/materials2014/w4.authcheckdam.pdf>.

³ *Kindred Nursing, L.P. v. Clark*, No. 16-32, 581 U. S. ____ (2017).

⁴ *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 268 (1995); see *Allen v. World Inspection Network Int'l, Inc.*, 389 N.J. Super 115, 126 (App. Div. 2006).

state statute that required judicial resolution of a franchise contract, despite an arbitration clause, was inconsistent with the FAA, and therefore violated the Supremacy Clause.”⁵

“State legislation cannot interfere with the terms found in arbitration clauses, as “the Federal Arbitration Act (FAA) protect[s] the parties rights’ to arbitrate under the terms they had agreed upon, including...the choice of law applicable to the arbitration.”⁶ A court may invalidate an arbitration agreement based on “generally applicable contract defenses,” but not on legal rules that “apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.”⁷

Location-selection provisions of arbitration provisions are also considered a part of the arbitration clause, and thus “subject to the FAA.”⁸ The District Court of New Jersey, in *Central Jersey Freightliner, Inc. v. Freightliner Corp.*, found a “clear conflict between FAA and N.J.S. 56:10-7.3 a(3).”⁹ The federal district court held that plaintiffs seeking to “invalidate a location-selection provision of an arbitration clause” may not invoke “the special burden-shifting presumption against forum-selection clauses as articulated in *Kubis*,..because that presumption in effect discriminates against arbitration clauses.”¹⁰ Therefore, the clause must be analyzed under general state law principles to determine whether it is unconscionable.¹¹

Summarizing its analysis of the nexus between the NJFPA and the FAA laws, the federal district court explained that “[b]ecause the FAA was intended to foreclose state legislative attempts to limit the enforceability of arbitration agreements, and section 56:10–7.3 a(3) is just such an attempt, the Court held that section 56:10–7.3 a(3) of the NJFPA violates the Supremacy Clause and is preempted by the FAA.”

RECENT CASE LAW

The New Jersey Supreme Court, decision in *Atalese v. U.S. Legal Services Group* established a rule similar in substance to the Kentucky rule considered by the United States Supreme Court in *Kindred Nursing*.¹² The two rulings differ, however, in scope with the New Jersey decision limited only to employment and consumer contracts, and the broader Kentucky rule applying to all contracts.

⁵ *Alpert v. Alphagraphics Franchising, Inc.*, 731 F. Supp. 685, 688 (D.N.J. 1990) (citing *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984)).

⁶ *Allen*, 389 N.J. Super at 127 (construing *Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468).

⁷ *AT&T Mobility LLC v. Concepcion*, 563 U. S. 333, 339 (2011).

⁸ *Id.* at 128-29.

⁹ *Central Jersey Freightliner, Inc. v. Freightliner Corp.*, 987 F. Supp. 289, 300 (D.N.J. 1997).

¹⁰ *Id.* at 129.

¹¹ *Id.*

¹² *Atalese v. U.S. Legal Services Group, L.P.*, 219 N.J. 430 (2015).

The Kentucky ruling arose from a claim filed by two plaintiffs, each relatives of patients in a long-term care facility, who signed separate arbitration agreements providing that any claims arising from their relative’s care at the facility would be resolved through binding arbitration.¹³ Following the death of the patients, the estates filed suit alleging that the deaths resulted from the substandard care they received at the facility.¹⁴ The Kentucky Supreme Court consolidated the claims and allowed the estates to proceed in a court of law.¹⁵ The Kentucky Court ruled that an agent may “waive the ‘divine God-given right’ to a jury trial,” only if “ ‘an explicit statement before an attorney-in-fact’ ” is provided.

On the other hand, the New Jersey Supreme Court ruled that arbitration provisions, in employment and consumer contracts, are not enforceable unless the contract clause expressly provides in clear and unambiguous terms that disputes will be resolved through arbitration instead of a court of law.¹⁶

While the New Jersey decision has not come under review, the United States Supreme Court decision concerning the Kentucky rule implicates the New Jersey ruling, holding that the Kentucky rule fails to place arbitration agreements on an equal plane with other contracts.¹⁷ Moreover, the state court “adopt[ed] a legal rule hinging on the primary characteristic of an arbitration agreement—namely, a waiver of the right to go to court and receive a jury trial.”¹⁸

Applying the *Kindred Nursing* ruling to subsection 7.3 of the NJFPA, it appears that the statute fails to place arbitration agreements on an equal plane with other contracts, in violation of the FAA. In accord, this Memorandum recommends repealing portions of subsection 7.3 of the NJFPA.¹⁹

CONCLUSION

The Commission noted, when previously considering proposed revisions to the NJFPA, that the FAA pre-empts state statutes disfavoring arbitration agreements. The recommendations

¹³ *Kindred Nursing*, 581 U.S. ____ (2017) (slip op. at 2-3).

¹⁴ *Id.* at 3.

¹⁵ *Id.* at 4.

¹⁶ *Id.* at 5 (citing *Extencicare Homes, Inc. v. Whisman*, 478 S.W.3d 306, 328-29 (2015)(quoting Ky. Const. §7).

¹⁷ *Id.* at 6.

¹⁸ *Id.* at 5.

¹⁹ *Id.* at 300; see also *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998) (“to the extent that *Kubis* can be read to invalidate arbitral forum-selection clauses in franchise agreements, it is preempted by the FAA.”); New Jersey courts have acknowledged and affirmed this holding of federal preemption, though they have noted that common law contract defenses may still apply to invalidate arbitration provisions under certain circumstances, see *B & S Ltd., Inc. v. Elephant & Castle Int'l, Inc.*, 388 N.J. Super. 160, 175 (Ch. Div. 2006) (“While the arbitral forum-selection clause is not presumptively invalid under the *Kubis* decision, . . . New Jersey state contract law will be applied to analyze whether the arbitration clause and the arbitral forum-selection clause are enforceable.”).

in this memorandum are consistent with the recommendations of the Commission and the recent decision of the Court in *Kindred Nursing*.

Staff will continue drafting revisions to the NJFPA based on case law governing the gross sales threshold and forum-selection, and present a Revised Draft Tentative Report incorporating these revisions at a later date.

Staff requests approval from the Commission to recommend the portions of section N.J.S. 56:10-7.3 for repeal as indicated in the Appendix of this Memorandum.

APPENDIX

N.J.S. 56:10-7.3. Motor vehicle franchises; prohibition of certain terms or conditions; presumption; remedies

a. It shall be a violation of the “Franchise Practices Act,” P.L.1971, c. 356 (C.56:10-1 et seq.) to require a motor vehicle franchisee to agree to a term or condition in a franchise, or in any lease or agreement ancillary or collateral to a franchise, which:

~~(1) Requires the motor vehicle franchisee to waive trial by jury in actions involving the motor vehicle franchisor;~~

~~(2) Specifies the jurisdictions, or venues or tribunals in which disputes arising with respect to the franchise, lease or agreement shall or shall not be submitted for resolution, or otherwise prohibits a motor vehicle franchisee from bringing an action in a particular forum otherwise available under the law of this State; or~~

~~(3) Requires that disputes between the motor vehicle franchisor and motor vehicle franchisee be submitted to arbitration or to any other binding alternate dispute resolution procedure; provided, however, that any franchise, lease or agreement may authorize the submission of a dispute to arbitration or to binding alternate dispute resolution if the motor vehicle franchisor and motor vehicle franchisee voluntarily agree to submit the dispute to arbitration or binding alternate dispute resolution at the time the dispute arises.~~

b. For the purposes of this section, it shall be presumed that a motor vehicle franchisee has been required to agree to a term or condition in violation of this section as a condition of the offer, grant or renewal of a franchise or of any lease or agreement ancillary or collateral to a franchise, if the motor vehicle franchisee, at the time of the offer, grant or renewal of the franchise, lease or agreement is not offered the option of an identical franchise, lease or agreement without the term or condition proscribed by this section.

c. In addition to any remedy provided in the “Franchise Practices Act,” any term or condition included in a franchise, or in any lease or agreement ancillary or collateral to a franchise, in violation of this section may be revoked by the motor vehicle franchisee by written notice to the motor vehicle franchisor within 60 days of the motor vehicle franchisee's receipt of the fully executed franchise, lease or agreement. This revocation shall not otherwise affect the validity, effectiveness or enforceability of the franchise, lease or agreement.