



NEW JERSEY LAW REVISION COMMISSION

Draft Tentative Report Relating to the Franchise Practices Act

January 5, 2015

The New Jersey Law Revision Commission is required to “[c]onduct a continuous examination of the general and permanent statutory law of this State and the judicial decisions construing it” and to propose to the Legislature revisions to the statutes to “remedy defects, reconcile conflicting provisions, clarify confusing language and eliminate redundant provisions.” N.J.S. 1:12A-8.

This Report is distributed to advise interested persons of the Commission's tentative recommendations and to notify them of the opportunity to submit comments. Comments should be received by the Commission no later than **March 15, 2015**.

The Commission will consider these comments before making its final recommendations to the Legislature. The Commission often substantially revises tentative recommendations as a result of the comments it receives. If you approve of the Report, please inform the Commission so that your approval can be considered along with other comments. Please send comments concerning this Report or direct any related inquiries, to:

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EXECUTIVE SUMMARY

In light of the inherent imbalance of power between franchisees and franchisors, the New Jersey Franchise Practices Act (FPA) was enacted to regulate franchise arrangements.¹ This project focuses on section 7.3 of the FPA, which makes presumptively invalid in a motor vehicle franchise agreement any provision that requires dispute resolution under the FPA in an out-of-state forum as well as any provision that requires arbitration. Subsequent developments have led to confusion over whether these provisions were meant to be restricted solely to franchises concerning motor vehicles, and also whether the FPA restriction on arbitration was unconstitutional. Staff's research answered these questions in the affirmative, and proposes revisions to clarify the FPA to that end. These proposed modifications are limited in scope and do not extend beyond the clear holdings of cases interpreting the FPA.

I. LEGISLATIVE FINDINGS AND INTENT

The FPA seeks to “define the relationship and responsibilities of franchisors and franchisees in connection with franchise arrangements and to protect franchisees from a disparity of bargaining power between national and regional franchisors and small franchisees.”² Such “protections are necessary to protect not only retail businesses, but also wholesale distribution franchisees”³ The sponsor statement to the original version of the FPA acknowledged an increased prevalence of franchising, noting that the practice is familiar not only “in relatively new enterprises such as fast food, lodging, specialized retailing, special auto repair and supply services and other undertakings, but . . . [also] in longer established businesses such as appliance and auto dealerships and gasoline stations.”⁴ The Legislature clearly had considered the general nature of the franchise industry, and had not originally sought to limit the FPA's application solely to those franchises concerning motor vehicles. Nevertheless, while some provisions of the FPA apply to all franchises, some appear to be limited to the franchises in the motor vehicle industry.⁵

Examination of the testimony before the New Jersey Assembly Judiciary Committee when the FPA was first enacted in 1971 confirms the broad scope contemplated for the FPA. Robert Burd, President of the New Jersey Automobile Dealers Association and President of Warren Volkswagen, Inc., urged enactment of the FPA and explained that “[n]ot only does this bill affect our industry, but if passed, it will be of immeasurable help to thousands of other New Jersey businessmen and their employees who operate other franchised enterprises.”⁶ Arguing against the bill, General Counsel for the General Motors Corporation Ross Malone explained that the FPA was “designed to regulate franchising as an industry without regard to the type of franchisee or franchisor,” and that “it d[id] not recognize the possibility of different needs

¹ See N.J.S. 56:10-1 to -15.

² N.J.S. 56:10-2.

³ *Id.*

⁴ Sponsor Statement to 1971 A.B. 2063.

⁵ See, e.g., N.J.S. 56:10-7.3, -7.4, -13, -13.3, -13.4, and -15.

⁶ *Public Hearing before New Jersey Legislature, Assembly, Judiciary Committee, on Assembly Bill No. 2063 (Franchise Practices Act), (N.J. 1971)* (statement of Robert Burd, President of the New Jersey Automobile Dealers Association and President of Warren Volkswagen, Inc.).

between franchisees in different types of industries.”⁷ Although both of these powerful voices were on opposite sides of the debate, both seemed to understand that the objectives sought by the FPA were not to be restricted to the context of motor vehicle franchises, but would affect the franchising industry in general.

The motor vehicle industry was highlighted during the original FPA debate as one to be particularly affected, and the Legislature later acknowledged that motor vehicle franchisors were leveraging their strong bargaining position to coerce franchisees into “relinquish[ing] their rights which ha[d] been established by the [FPA]”⁸ Specifically, they were circumventing the FPA by offering “franchise renewal agreements which require them to settle disputes through compulsory arbitration instead of exercising their rights as spelled out under New Jersey law.”⁹ Some agreements had also featured measures to move disputes to jurisdictions beyond New Jersey in order to evade the FPA.¹⁰ In 1989, the Legislature responded to this phenomenon by enacting provisions which significantly and specifically hampered a motor vehicle franchisor’s ability to require arbitration clauses and forum-selection clauses.¹¹

In 1993, the Legislature expanded the scope of the FPA again. Whereas franchises previously had to meet a threshold sales requirement to be subject to the FPA, an amendment waived that minimum sales requirement for “a franchise for the sale of new motor vehicles”¹² In a statement regarding the addition, the Assembly Judiciary Committee acknowledged that in the years since the original enactment of the FPA,

changes have occurred in the ways in which motor vehicle franchisors do business with their dealers, requiring changes in the existing body of franchise legislation. To keep up with changing market conditions, over the past twenty years, an increasing number of motor vehicle dealers have come to hold more than a single franchise. While no business more classically represents a franchise than a motor vehicle dealership, because the current “Franchise Practices Act” protects only those franchises representing twenty percent or more of a dealer's gross sales, those “dualled” dealerships with multiple franchises may not be covered under this act.¹³

This statement seems to indicate that the Legislature sought to increase applicability of the FPA to motor vehicle franchises not because that industry is materially different from other franchises in substance, but rather that the practical organizational structure of motor vehicle franchises

⁷ Memorandum from Ross L. Malone, General Counsel, General Motors Corporation, to the New Jersey Assembly Judiciary Committee (Mar. 12, 1971) (on file with the New Jersey State Library).

⁸ Act of Feb. 6, 1989, ch. 24, 1988 N.J. Senate No. 2737.

⁹ *Id.*

¹⁰ *Id.*

¹¹ See N.J.S. 56:10-7.3.

¹² N.J.S. 56:10-4 (The FPA applies only to a franchise, “the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey.”); see also Act of July 19, 1993, ch. 356, Assembly Bill 2550 (featuring the amendment expanding FPA application to motor vehicle franchises).

¹³ *Assembly Commerce and Regulated Professions Committee Statement to Assembly, No. 2550*, 1993 N.J. Assemb. (May 17, 1993).

allows the industry to escape regulation. The threshold used to exempt smaller operations functioned as a loophole which was exploited by larger operations of the sort intended by the Legislature to be subject to the FPA's restrictions, and this amendment sought merely to close that loophole.

II. FORUM-SELECTION CLAUSES

In *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, the New Jersey Supreme Court found that a franchisee-franchisor relationship had been created through an agreement to distribute computing products.¹⁴ This agreement featured a provision directing that all disputes must be governed by California law and heard in California courts, but the enforceability of this forum-selection clause was successfully challenged as invalid under the FPA, specifically with regard to N.J.S. 56:10-7.3.¹⁵ The Court had expressly rejected an argument that the 1989 amendment indicated that the Legislature had intended for the prohibition to apply strictly to motor-vehicle franchise agreements.¹⁶ While noting that automobile dealerships were clearly affected, the Court further explained that:

the Legislature considered [forum-selection] clauses in general to be inimical to the rights afforded all franchisees under the Act. The Legislature apparently elected to limit their express prohibition only to motor-vehicle franchises based on its determination that the use of unequal bargaining power to compel the inclusion of such clauses was largely confined to motor-vehicle franchise agreements.¹⁷

Court based its reasoning heavily on the presumption that

the Legislature's avowed purpose . . . [is] to level the playing field for New Jersey franchisees and prevent their exploitation by franchisors with superior economic resources. The general enforcement of forum-selection clauses in franchise agreements would frustrate that legislative purpose, and substantially circumvent the public policy underlying the Franchise Act.¹⁸

The concern was not whether foreign courts would "faithfully and fairly apply the Franchise Act,"¹⁹ but rather that franchisee rights guaranteed by the FPA could be materially diminished because the "economically weaker franchisees . . . often lack the sophistication and resources to litigate effectively a long distance from home."²⁰

¹⁴ 146 N.J. 176, 178-79 (1996). See generally James I. McClammy, *Forum Selection Clauses in Contracts Governed by the New Jersey Franchise Practices Act Are Presumptively Invalid*, 28 Seton Hall L. Rev. 213 (1997) (featuring a breakdown of *Kubis* and its relation to other New Jersey case law regarding the enforceability of forum-selection clauses).

¹⁵ *Kubis*, 146 N.J. at 178-79.

¹⁶ *Id.* at 185.

¹⁷ *Id.* at 185-86.

¹⁸ *Id.* at 195.

¹⁹ *Kubis*, 146 N.J. at 196.

²⁰ *Id.* at 194.

The Court held that

[F]orum-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. Evidence that the forum-selection clause was included as part of the standard franchise agreement, without more, is insufficient to overcome the presumption of invalidity.

The Court then explained that this holding was not restricted to the context of motor vehicle franchises, but to all New Jersey franchises:

Although the Legislature expressly has prohibited the use of forum-selection clauses only in motor-vehicle franchise agreements, N.J.S.A. 56:10-7.3, . . . we entertain little doubt that the Legislature would prefer to extend that prohibition to other franchisees rather than to permit forum-selection clauses to thwart the vindication of franchisees' rights under the Act. . . . We are confident that a rule of law *generally* barring enforcement of forum-selection clauses in contracts subject to the Franchise Act best serves the public policies vindicated by the Act and faithfully adheres to the Legislature's objectives in adopting the Act.²¹

Subsequent Appellate Division decisions have interpreted *Kubis* as expanding the restriction on forum-selection clauses to all franchises.²²

Even without further legislative action, this declaration is legally sufficient to invalidate forum-selection clauses in this context. The United States Supreme Court acknowledged that “[a] contractual choice-of-forum clause should be held unenforceable if enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision.”²³ Indeed, the Court acknowledged that its “decision establishe[d] a new rule of law,” noting that “settled principles dictate that it should apply retroactively to franchise agreements entered into prior to the filing of this opinion.”²⁴ This broad interpretation harmonized with a 2009 amendment which provided that “the Legislature declares that the courts have in some cases more narrowly construed the Franchise Practices Act than was intended by the Legislature.”²⁵

²¹ *Id.* at 197, 197 (emphasis added).

²² See *Allen v. World Inspection Network Int'l, Inc.*, 389 N.J. Super. 115, 120 (App. Div. 2006) (“this prohibition extends to all franchise agreements”).

²³ *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972), *quoted in Kubis*, 146 N.J. at 188.

²⁴ *Kubis*, 146 N.J. at 197.

²⁵ N.J.S. 56:10-2. The amendment which added this language also sought to expand the definition of “place of business” for entities that “do not make a majority of their sales directly to consumers” as a condition for applicability of the FPA. *Id.* The debate on the amendment focused seemingly exclusively on this aspect of the proposed change, and Staff’s research into the history of this legislative effort did not reveal which cases, in particular, led to the claim they the FPA was construed more narrowly than the Legislature had intended. A news agency targeting franchise owners published an article at the time regarding the bill effecting this change, and Justin Klein, a New Jersey franchisee attorney, explained: “The courts have narrowly interpreted the franchise practice act to exclude certain franchise owners and consumers from protection. The legislation is instructing courts that when evaluating a particular situation, err on the side of inclusion rather than exclusion.” Don Sniegowski, *IFA Stifles*

III. ARBITRATION CLAUSES

The presumptive invalidity of both forum-selection clauses and arbitration clause in franchise agreements stem from the same legislative intent to level the naturally unequal bargaining power between franchisees and franchisors. The invalidity of arbitration clauses, however, results from federal preemption. The United States Supreme Court prohibited efforts by states to regulate arbitration clauses,²⁶ finding “that a state statute that required judicial resolution of a franchise contract, despite an arbitration clause, was inconsistent with the Federal Arbitration Act, and therefore violated the Supremacy Clause.”²⁷

In *Central Jersey Freightliner, Inc. v. Freightliner Corp.*, the District Court of New Jersey found a “clear conflict between the [Federal Arbitration Act (FAA)] and the NJFPA § 56:10-7.3 a(3).”²⁸ Summarizing its analysis of the nexus between the two laws, the court explained that “[b]ecause the FAA was intended to foreclose state legislative attempts to limit the enforceability of arbitration agreements, and because NJFPA § 56:10-7.3 a(3) is just such an attempt, the Court holds that NJFPA § 56:10-7.3 a(3) violates the Supremacy Clause and is preempted by the FAA.”²⁹ 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.³⁰

State legislation cannot interfere with the terms featured in arbitration clauses, as “the FAA protect[s] the parties rights’ to arbitrate under the terms they had agreed upon, including . . . the choice of law applicable to the arbitration.”³¹ Location-selection provisions of arbitration provisions have also been held “subject to the FAA[] because it is part of the arbitration clause. Therefore, the clause must be analyzed under general state law principles to determine whether it is unconscionable.”³² Plaintiffs seeking to invalidate a location-selection provision of an arbitration clause may not invoke “the special burden-shifting presumption against forum

Broadening of New Jersey Franchisee Protection Law, BLUE MAU MAU, June 22, 2008, http://bluemaumau.org/5725/ifa_stifles_broadening_new_jersey_franchisee_protection_law. Given the context, the Legislature may not have been talking expressly about application of certain FPA provisions solely to the motor vehicle franchise industry as having been interpreted “narrowly,” but might, at the very least, demonstrate a general comment by the Legislature on the Judiciary’s general approach.

²⁶ *Allen v. World Inspection Network Int’l, Inc.*, 389 N.J. Super 115, 126 (App. Div. 2006) (citing *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 268 (1995)).

²⁷ *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)).

²⁸ 987 F. Supp. 289, 300 (D.N.J. 1997).

²⁹ *Freightliner*, 987 F. Supp. 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.”).

³⁰ 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.”).

³¹ *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).

³² *Id.* at 128-29.

selection clauses as articulated in *Kubis*, . . . because that presumption in effect discriminates against arbitration clauses.”³³

IV. DEFINITION OF “FRANCHISE”

As of June 2013, twenty-one states and three territories had franchise relationship laws,³⁴ though no Uniform Law currently exists in this area. The New Jersey Franchise Practices Act “was one of the earliest state franchise protection statutes in the United States.”³⁵

Definitions applicable to the New Jersey Franchise Practices Act are provided in N.J.S. 56:10-3, and the current definition of a “franchise” under this act has remained unchanged since the Act was first enacted in 1971.³⁶ In 2010, however, the Legislature amended the definition of “place of business” to afford wholesale distribution businesses FPA protections.³⁷ An Assembly Statement succinctly explained that prior to the amendment, any wholesaler or distributor:

that requires its customers to come to its place of business to buy goods may be treated as a franchisee, while one that provides the service of going to its customers to deliver products and make sales may not be considered a franchisee under the act. Under the bill, both businesses may be treated as franchisees.³⁸

While this change did not directly impact the language of the definition of “franchise” per se, it affected the applicability of that definition. The Sponsor Statement of the bill actually featured a review of the definition of “franchise” as necessary to understanding the amendment explained:

A contract between two parties constitutes a franchise agreement if five conditions are met: 1) the franchisor must grant the franchisee license to use a trade name, trade mark, service mark, or related characteristic; 2) there must be a community of interest in the marketing of goods and services; 3) the franchisee must establish or maintain a place of business in the State; 4) the gross sales of products or services between the franchisor and franchisee must be more than \$35,000 in the prior year; and 5) more than 20 percent of the franchisees sales are intended to be or derived from the franchise.³⁹

³³ *Id.* at 129.

³⁴ David J. Kaufman, Senior Partner, Kaufmann Gildin Robbins & Oppenheim LLP, *An Overview of the Business and Law of Franchising*, ASPATORE, June 2013, available at 2013 WL 3773409, at *7 (citing laws in Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, South Dakota, Utah, Virginia, Washington, Wisconsin, District of Columbia, Puerto Rico, and the US Virgin Islands).

³⁵ W. Michael Garner, 1 Franchise & Distribution Law & Practice § 5:29 (database last updated September 2014).

³⁶ See P.L. 1971, c. 356.

³⁷ P.L. 2009, c. 235.

³⁸ A.B. 2491, 213 Leg., 2d. Ann. Sess., Statement to the Assembly with Floor Amendments Proposed by Assemblyman Cryan (N.J. 2010).

³⁹ A.B. 2491, 213 Leg., 2d. Ann. Sess., Sponsor Statement (N.J. 2010); S.B. 1539, 213 Leg., 2d. Ann. Sess., Sponsor Statement (N.J. 2010).

IV. PROPOSED REVISION

Although the New Jersey courts understand that N.J.S. 56:10-7.3 is not restricted to motor vehicle franchises, the plain language of the statute appears to indicate otherwise in a way likely to mislead members of the public. The proposed revision contained in the Appendix would make clear that the prohibition against forum-selection clauses in franchise agreements is not limited exclusively to the context of motor vehicle franchises but to all franchises. Additionally, the proposed revision acknowledges that the current restriction on arbitration has been expressly declared preempted by the Federal Arbitration Act.

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.) for any franchisor, including, but not limited to, any motor vehicle franchisor, 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; or

(2) Specifies the jurisdictions, 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;~~;~~

~~(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.