NEW JERSEY LAW REVISION COMMISSION

Revised Draft Tentative Report
Relating to the
Franchise Practices Act

July 10, 2017

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 **August 25, 2017**.

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

Under N.J.S. 56:10-4 subsection a.(2) of the New Jersey Franchise Practices Act, the gross sales threshold currently applies only to a franchise where "gross sales of 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*."

In *Tynan v. General Motors Corp.,* the New Jersey Supreme Court considered this provision when reviewing the Appellate Division decision to dismiss a claim as untimely; where the plaintiff had not operated his franchise within the twelve months before filing suit and as a consequence, had no gross sales during that period.

The New Jersey Supreme Court holding reflected the conclusion of Appellate Division Judge Benjamin Cohen, who in his dissenting opinion found that the statutory period should be limited to existing franchises that are operating when the suit commences. "Businesses that have terminated before suit starts must have their gross sales calculated for the last 12 months they existed." This Revised Draft Tentative Report recommends clarifying N.J.S. 56:10-4 subsection a.(2), in accord with the New Jersey Supreme Court decision in *Tynan v. General Motors Corp.*

This Report also considers N.J.S. 56:10-7.3 of the New Jersey Franchise Practices Act which governs prohibitions of certain terms contained in forum-selection and arbitration clauses of motor-vehicle franchise agreements. Prior NJLRC Draft Reports concerning this section considered expanding the scope of this provision. Most recently, following the decision of the United States Supreme Court in *Kindred Nursing, L.P. v. Clark*, concerning state statutes which disfavor arbitration agreements, the work of the NJLRC regarding subsection 7.3 was revisited.

This Report recommends clarifying N.J.S. 56:10-7.3, to avoid confusion for franchisors or franchisees relying on the statute for guidance, by repealing portions of the subsection that are invalidated by the Federal Arbitration Act, as identified by the U.S. Supreme Court in the *Kindred Nursing* decision.

I. LEGISLATIVE FINDINGS AND INTENT

The New Jersey Franchise Practices Act (NJFPA or the Act) "was one of the earliest state franchise protection statutes in the United States" designed to "level the playing field for New Jersey franchisees," by addressing the disparity of bargaining power between franchisors and franchisees.[1] The NJFPA was enacted in 1971 to regulate franchise arrangements by providing

[1] NJ. STAT. ANN. §§ 56:10–1 to -15 (West 2017); *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 146 N.J. 176, 195 (1996); *see* W. Michael Garner, 1 Franchise & Distribution Law & Practice § 5:29 (last updated September 2016).

franchisees "the shelter of favorable law." [2]

The NJFPA intends 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."[3] Such "protections are necessary to protect not only retail businesses, but also wholesale distribution franchisees."[4]

A. Definition of "Franchise"

The statutory definition of "franchise" is found in N.J.S. 56:10-3 subsection a. and has remained unchanged since the NJFPA was first enacted in 1971.[5]

> "Franchise" means a written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trade mark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise.[6]

In 2010, however, the Legislature amended the definition of "place of business" to afford wholesale distribution businesses NJFPA protections.[7] 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.[8]

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 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

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[2] David J. Kaufman, Esq., 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).
[3] *See id*; N.J. STAT. ANN 56:10-2 (West 2017).
[4] Kaufman, *supra* note 2.
[5] *See* P.L. 1971, c. 356.
[6] NJ. STAT. ANN. § 56:10–1 (West 2017).
[7] P.L. 2009, c. 235.
[8] A.B. 2491, 213 Leg., 2d. Ann. Sess. *(*N.J. 2010) (Asm. Joseph Cryan, sponsor statement to the N.J. Assembly offering floor amendments).

> 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.[9]

B. Gross Sales Threshold

N.J.S. 56:10-4 describes which franchises are covered under the Act. The decision of the New Jersey Supreme Court, in *Tynan v. General Motors Corp.*, guides the interpretation of this provision.[10] In *Tynan*, the Supreme Court reversed in part the Appellate Division ruling and affirmed the reasoning of the partial dissent of Judge Cohen.

The plaintiff filed a claim in April 1987 against General Motors, following the sale of his General Motors franchised dealership in July 1985, for various violations of the NJFPA, including N.J.S. 56:10-4 subsection a.(2).[11] The plaintiff previously owned a General Motors franchised dealership which he sold in July 1985 prior to the suit.[12] Under subsection a.(2), the gross sales threshold "applies only to a franchise . . . where gross sales of 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*." Since the plaintiff did not operate his franchise within twelve months before filing suit, his gross sales during that period were zero, and his claim was therefore dismissed as untimely by the Appellate Division.

The New Jersey Supreme Court, later reversed in part the Appellate Division ruling, the decision reflected the conclusion of Judge Cohen who found it "apparent from the structure of the Act and the words of N.J.S. 56:10-4 that the purpose was to restrict the application of the Act to franchises that were sufficiently local to merit regulation and sufficiently consequential to the franchisee to merit protection."[13] In his view, $35,000 in annual sales "is not a very stringent standard. But no franchise that went out of business a year or so before starting suit could satisfy it if applied literally," finding that a "plain meaning" interpretation would be inconsistent with the goals of the NJFPA. Judge Cohen provided the following illustration of the problem:

> A franchisee doing $35,001 in annual business has six years to sue its franchisor for a minor but illegal action which the franchisee can comfortably survive. N.J.S.A. 2A:14-1. But, if the majority is correct, a franchisee whose illegal

[9] A.B. 2491, 213 Leg., 2d. Ann. Sess. (N.J. 2010)(Asm. Joseph Cryan, sponsor statement to the N.J. Assembly); S.B. 1539, 213 Leg., 2d. Ann. Sess.(N.J. 2010)(Sen. Bob Smith, sponsor statement to the N.J. Senate).
[10] *Tynan v. General Motors Corp.*, 127 N.J. 269 (1992), *rev'g in part*, 248 N.J. Super. 654, 656 (App. Div. 1991).
[11] *Id.*, 248 N.J. Super. 654, 675 (App. Div. 1991) (noting plaintiff's initial claim was denied due to lack of standing).
[12] *Id*.
[13] *Id*.

> treatment by the franchisor is so horrendously effective that it destroys the business altogether has only 12 months to sue.[14]

Judge Cohen noted that the words of the statute were "plain enough" and that there was "no legislative history to help," but asserted that "the results of literal application are so unfair, and so capricious that the Legislature could not possibly have intended them."[15]

Considering the $35,000 threshold as indicative of a legislative intent "not to limit the time for suit but to measure the size of the businesses protected by the Act," Judge Cohen proposed that the current twelve-month period should be "limited to ongoing franchises that are in business when suit is started. Businesses that have terminated before suit starts must have their gross sales calculated for the last 12 months they existed."[16] This Report seeks to clarify N.J.S. 56:10-4 subsection a.(2) in accord with the Supreme Court decision in *Tynan*, which reflects the reasoning of Judge Cohen's dissent.[17]

II. FORUM-SELECTION AND ARBITRATION CLAUSES

The NJFPA promotes a level playing field for franchisees and discourages franchisors from exploiting their superior economic resources. In accord, the legislative intent of the Act extends to the resolution of conflict where the right to a jury trial is encouraged for the benefit of the franchisee, and arbitration is disfavored.

The Federal Arbitration Act (FAA), however, 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."[18] "Under the Supremacy Clause, federal law may be held to preempt state law where any of the three forms of preemption may be properly applied: express preemption, field preemption, and implied conflict preemption."[19]

The United States Supreme Court, in a series of decisions, prohibited efforts by states to regulate arbitration clauses,[20] finding "that a 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."[21]

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[14] *Id*.
[15] *Id*.
[16] *Id*.
[17] 127 N.J. 269 (1992) *see also Allen v. World Inspection Network Int'l, Inc.*, 389 N.J. Super 115, 128-9 (App. Div. 2006). (finding that forum-selection provisions of arbitration agreements are also considered a part of the arbitration clause, and thus "subject to the FAA.").
[18] *Kindred Nursing, L.P. v. Clark*, 137 S. Ct. 1421, 1426 (2017).
[19] 17 Am. Jur. 2d *Constitutional Law* § 234 (2017).
[20] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 268 (1995); *see* Allen, 389 N.J. Super at 126.
[21] *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)).

The U.S. Supreme Court, in *Kindred Nursing v.* Clark, held that the FAA establishes a "an equal-treatment principle" – allowing a court "to invalidate an arbitration agreement based on 'generally applicable contract defenses' like fraud or unconscionability, 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.' "[22]

> The FAA thus preempts any state rule discriminating on its face against arbitration—for example, a 'law prohibit[ing] outright the arbitration of a particular type of claim.' And not only that: The Act also displaces any rule that covertly accomplishes the same objective by disfavoring contracts that (oh so coincidentally) have the defining features of arbitration agreements.[23]

The U.S. Supreme Court, to further illustrate, recounted from a prior decision a hypothetical state statute "declaring unenforceable any contract that 'disallow[ed] an ultimate disposition [of a dispute] by a jury' " - "[s]uch a law might avoid referring to arbitration by name; but still . . . would "rely on the uniqueness of an agreement to arbitrate as [its] basis" - and thereby violate the FAA."[24]

> In the absence of express preemptive language, Congress's intent to preempt all state law in a particular area may be inferred when the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress left no room for supplementary state regulation. In determining whether Congress, through legislation, has so occupied a particular field as to preclude state legislation, the Supreme Court, in order to discover the boundaries of the particular field involved, will look to the federal statute itself and read in the light of its constitutional setting and its legislative history. Further, a court will find preemption where it is impossible for a private party to comply with both state and federal law and where state law is obstacle to accomplishment and execution of Congress's full purposes and objectives; what is a sufficient obstacle is determined by examining the federal statute and identifying its purpose and intended effects.[25]

In *Central Jersey Freightliner, Inc. v. Freightliner Corp.,* the District Court of New Jersey found a "clear conflict between the FAA and the N.J.S. 56:10-7.3 subsection a(3)."[26] 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 N.J.S. 56:10–7.3 subsection a.(3) is just such an attempt, the

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[22] *Kindred Nursing,* 137 S.Ct. at 1426.
[23] *Id., quoting AT & T Mobility LLC v. Concepcion,* 563 U.S. at 342.
[24] *Id.*
[25] 17 Am. Jur. 2d *Constitutional Law* § 234 (2017).
[26] *Central Jersey Freightliner, Inc. v. Freightliner Corp.,* 987 F. Supp. 289, 300 (D.N.J. 1997).

Court holds that N.J.S. 56:10–7.3 subsection a.(3) violates the Supremacy Clause and is preempted by the FAA."[27]

The NJFPA disfavors arbitration and reflects New Jersey's high regard for an individual's right to a jury trial, in violation of the FAA. Federal law, however, does not require repeal of state provisions pre-empted by federal statute.[28] New Jersey, in fact, has a right to retain the statutory provisions preempted by the FAA.[29]

The Commission, however, finds that retaining an invalid statutory provision may lead to confusion, particularly for franchisors or franchisees relying on the New Jersey statute for guidance, as well as in situations where New Jersey statutes are considered in the formation of interstate franchise agreements. The recommendations of the NJLRC to repeal portions of section 7.3 which violate the FAA, as identified by the U.S. Supreme Court in the *Kindred Nursing* decision, are consistent with the Commission's statutory mandate to clarify confusing provisions in the law.

PROPOSED REVISION

The proposed revisions to N.J.S. 56:10-4 subsection a.(2) reflect the Supreme Court holding in *Tynan v. General Motors Corp*., which reversed in part the Appellate Division decision and affirmed the reasoning of Judge Cohen's partial dissent, proposing that the current twelve month period should be "limited to ongoing franchises that are in business when suit is started."[30] Businesses that have terminated before suit starts must have their gross sales calculated for the last 12 months they existed."[31]

The recommendations which follow also propose revisions to N.J.S. 56:10-7.3 and identify for repeal portions of that section, consistent with the Commission's statutory mandate to clarify confusing provisions in the statutory body of law.

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[27] *Freightliner*, 987 F. Supp. at 300; *see also Doctor's Assoc. 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"); *see also 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.").

[28] *See* Ernest A. Young, *The Ordinary Diet of the Law*, 2011 Sup. Ct. Rev. 253, 311

[29] *See id.*

[30] 248 N.J. Super. at 675.

[31] *Id.*

APPENDIX

N.J.S. 56:10–4. Franchises to Which Act Applicable

This act applies only:

a. to a franchise:

(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 of products or services between the franchisor and franchisee covered by such franchise shall have exceeded $35,000.00 for:

(A) the 12 months ~~next~~ immediately preceding the institution of suit pursuant to this act for ongoing franchises that remain in business when suit is instituted or,

(B) the last 12 months of business operation for businesses that have terminated before 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; or

b. to a franchise for the sale of new motor vehicles as defined in R.S.39:10-2, the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey.[32]

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)~~ ~~S~~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~~

[32] The revisions are based on the determinations of the Supreme Court decision in *Tynan v. General Motors Corp.*, 127 N.J. 269 (1992), *rev'g in part*, 248 N.J. Super. 654, 656 (App. Div. 1991)(adopting the reasoning of the partial dissent of Judge Cohen)(considering the $35,000 threshold as indicative of a legislative intent "not to limit the time for suit but to measure the size of the businesses protected by the Act," Judge Cohen proposed that the current twelve month period should be "limited to ongoing franchises that are in business when suit is started. Businesses that have terminated before suit starts must have their gross sales calculated for the last 12 months they existed").

~~(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.