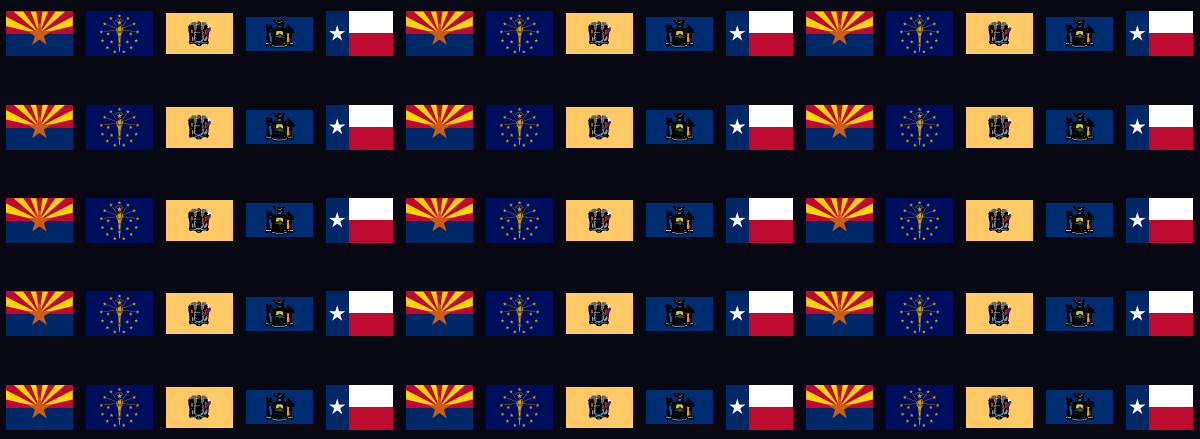
FRANCHISE USA

USA - New Jersey



LEXOLOGY
Getting The Deal Through

Franchise USA

Quick reference guide enabling side-by-side comparison of local insights, including into market climate and general legal framework; the franchisor/franchisee relationship; IP, data protection and cybersecurity; competition law; employment and labour; real estate; taxation; dispute resolution (including alternative dispute resolution); and recent trends.

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Contributors

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Richard L Rosen
rlr@rosenlawpllc.com
Rosen Karol Salis, PLLC

Leonard Salis
ls@rosenlawpllc.com
Rosen Karol Salis, PLLC

John Karol
jak@rosenlawpllc.com
Rosen Karol Salis, PLLC

MARKET CLIMATE AND GENERAL LEGAL FRAMEWORK

Market climate

What is the extent of franchise business in your state, including any franchise-heavy sectors?

Prior to the outbreak of the coronavirus (COVID-19) pandemic, the outlook for franchise business in the United States in 2020 was positive. The International Franchise Association (IFA), a leading franchise organization, indicated on its website in February 2020, that the franchising industry is expected to "continue riding the economic boom in 2020, despite growing uncertainty around the economy." In February 2020, the IFA released its Franchise Business Economic Outlook Report detailing the franchise industry's projected economic forecast for 2020. Among the many facts highlighted in the Report is that overall, franchise business development will continue to increase in the south and west due to growing populations, state-level economic policies and favorable business tax climates. The Report also indicated that the number of franchised businesses in the U.S. forecasted growth of 1.5% in 2020, to a total of 785,316 establishments.

According to the Report, New Jersey was not projected to be among the top 10 states in franchise growth in 2020 in terms of new franchise outlets and new jobs created. New Jersey was projected to have a small increase in growth (0.8%) in terms of franchise establishments, up to 19,720 from 19,571 in 2019. In terms of franchise employment, New Jersey was projected to have an increase of 2.0% up to 208,347 from 204,280 in 2019. Regarding franchise output, New Jersey projected growth of 3.1% up to $23,413 (in millions) from $22,705 (in millions) in 2019. However, with the country still in the grip of the COVID-19 pandemic as of the date of this chapter, the above positive outlook and the forecasts for 2020 did not materialize either in the Unites States as a whole, or in New Jersey.

The IFA's Economic Outlook Report for Franchising 2021 indicated that, assuming that the coronavirus was "under control" by year-end 2021 (which did not occur), FRANdata predicted that franchising will have recovered to nearly 2019 levels in most metrics, such as business growth, employment, economic outlook and contribution to GDP. The Report also indicated that FRANdata forecast a net gain of 26,000 franchised small businesses in 2021 bringing the total number of franchises in the U.S. to over 780,000, which is approximately 6,500 more units than pre-COVID levels in 2019. Further, the Report predicted that by year-end 2021, franchises will employ approximately 8.3 million people, adding nearly 800,000 jobs. It was anticipated that most of these new jobs will be in the retail, food or service industries and will mainly consist of lower-skilled workers, a group that has been hit disproportionately hard by the COVID-19 pandemic.

Looking back on 2020, New Jersey was an early coronavirus hotspot. In terms of small businesses, New Jersey was the fourth most heavily impacted state or territory in the U.S., behind only New York, Hawaii and Washington, D.C. New Jersey also had an unemployment rate that was above the national average as of November 2020. In the summer of 2020, most states either "paused," "scaled back," or reversed their "business re-opening" initiatives. In the summer of 2021, the numbers of infections and hospitalizations related to the coronavirus were once again increasing across the country, especially in the southeast. While most businesses fully reopened in the first half of 2021, the emergence of the delta variant of the COVID-19 virus in 2021 caused many cities and communities to reinstitute mask mandates for indoor activities. An ever-increasing number of local governments and private employers have begun instituting vaccination requirements for their employees, and some local governments have begun instituting vaccine mandates for certain indoor activities including entertainment, recreation, dining and fitness settings. Last summer, New Jersey Governor Phil Murphy announced that New Jersey will require masks indoors in all schools to start the fall 2021 academic year and that New Jersey teachers (as well as other state workers) must be fully vaccinated by October 18, 2021, with those that are not vaccinated being required to tested for the coronavirus "a minimum" of one to two times per week.

In the summer of 2021, New Jersey had the tenth highest total number of COVID-19 infections in the United States, after California, Texas, Florida, New York, Illinois, Georgia, Pennsylvania, Ohio, and North Carolina. While last summer,

New Jersey had been doing well in battling the virus. As of August 2021, New Jersey, a state of 9.2 million residents, had reported over 938,000 total confirmed cases, a ratio of over 10% of the state's population, approximately 5.8 million people who live work or study in New Jersey are fully vaccinated, and about 4 million residents remain unvaccinated. and currently, New Jersey has reported almost 27,000 total COVID-19 deaths, which represents the most coronavirus deaths per capita in the U.S.

The IFA's 2022 Franchising Economic Outlook Report states that franchising had an exceptional year in 2021 and that 2022 is expected to have another strong recovery. Due to a strengthening labor market and steady consumer spending, franchising is expected to continue to expand. However, the pace of growth in 2022 is expected to moderate, due to the current headwinds in the economy. According to FRANdata, more than 75% of franchisees received federal pandemic relief funding through the PPP and other programs, and that this financial relief resulted in the average franchised small business receiving approximately $80,000 in loans saving more than 20,000 franchised small businesses from permanently closing and helping to preserve almost 500,000 jobs. While certain states are expected to see a faster "return to normalcy" as they have adopted relatively well based upon a more conducive business climate or favorable migration trends and changes regarding consumer preferences, some states including New York will take a longer time to achieve full recovery, as they were "hardest hit" by the pandemic and have experienced a loss of population. The explosion of remote and hybrid work has led to people from states such as New York relocating to states with affordable housing and low cost of living, searching for a better quality of life.

As of this writing (August 2022), New Jersey ranks eleventh in the number of COVID-19 cases, with approximately 2.66 million cases, behind New California, Texas, Florida, New York, Illinois, Pennsylvania, North Carolina, Ohio, Georgia, and Michigan. Despite high COVID-19 vaccination rates, New Jersey has recorded approximately 35,000 deaths since the pandemic began.

Law stated - 31 August 2022

Legislation

Are there any specific franchise laws in your state? What other legal regimes apply?

New Jersey is not a franchise registration state. Since federal law requirements do not require franchisors to register their franchises, franchisors offering or selling franchises in New Jersey (e.g., to New Jersey residents or for franchised outlets to be located in New Jersey) are not required to register their franchises with any state or federal agency (unless the franchisor is selling from a franchise registration state, such as New York in which case it would be required to register in that state). However, franchisors selling franchises in New Jersey must comply with federal law requirements with respect to pre-sale disclosure obligations. While federal law does not regulate the "franchisor-franchisee relationship" after the franchise purchase has been consummated, New Jersey does, to an extent, regulate the post-sale "franchisor-franchisee relationship."

The U.S. Federal Trade Commission (FTC) is the federal agency that governs the manner in which franchises are offered for sale throughout the United States. The FTC promulgated its "Franchise Rule" (16 C.F.R. Part 436) in 1978. The Franchise Rule was significantly amended in 2007 and is commonly referred to as the FTC Amended Franchise Rule (the Franchise Rule). The Franchise Rule imposes only a pre-sale disclosure obligation requiring franchisors to provide prospective franchisees (and multi-unit developers) with important information they need to make an informed decision about whether to invest in the franchise system. Required disclosure topics include: the franchise's litigation history, past and current franchisees and their contact information, any exclusive territory that comes with the franchise, assistance the franchisor provides franchisees, and the cost of purchasing and starting up a franchise. Under the Franchise Rule, franchisors provide prospective franchisees with a comprehensive disclosure document called the Franchise Disclosure Document (FDD) at least 14 calendar days before the prospective franchisee signs a

binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale. The FDD contains 23 wide-ranging categories of disclosure (referred to as "Items") (including the FDD Receipt, which is signed and dated by the prospective franchisee and returned to the franchisor), together with copies of all of the written agreements (including among others, the Franchise Agreement), which the prospective franchisee will be required to sign when it purchases the franchise. If the prospective franchisee wants to purchase the rights to open more than one franchise location, then it (or its affiliate) will be required to also enter into a Multi-Unit Development Agreement which is included in the franchisor's FDD. The Franchise Rule does not require franchisors to register their FDD with any federal administrative or governmental agency.

New Jersey has a "relationship" law that governs various aspects of the post-sale relationship between franchisor and franchisee. In this respect, the New Jersey Franchise Practices Act (N.J. Stat. Ann. § 56:101, et al.) (NJFPA or the Act) is one of the most comprehensive and franchisee protective franchise relationship laws in the United States. Probably the most important provision of the NJFPA is that it prohibits franchisors from terminating, canceling or failing to renew a franchise absent "good cause," which is defined as the franchisee's failure to substantially comply with the requirements of the franchise agreement. Further, except for limited exceptions, when the franchisor seeks to terminate, cancel or fail to renew a franchise, it must provide the franchisee with at least 60 days' written notice and the notice must set forth the reasons for the termination, cancellation or failure to renew.

Also, under the NJFPA, when a franchisee provides written notice of its intention to sell, assign or transfer its franchise, the franchisor is required to respond in writing within 60 days and if it denies its approval, it must set forth the material reasons for the denial relating to the character, financial ability or business experience of the proposed transferee. If the franchisor fails to respond to the franchisee in writing within 60 days, the franchisee's request is deemed to be approved. In addition, the NJFPA also makes unlawful and prohibits several franchisor practices. These include, for example, requiring a franchisee to sign a general release at the time of entering into a franchise agreement; requiring a franchisee to agree to any releases or waivers that would relieve the franchisor from liability under the NJFPA; imposing on a franchisee "unreasonable standards of performance"; or prohibiting directly or indirectly, the right of free association among franchisees for any lawful purpose (e.g., to join a franchisee association). Under the NJFPA, franchisees are expressly authorized to assert claims in New Jersey Superior Court and provisions in the franchise agreement (or elsewhere) purporting to require New Jersey franchisees to litigate claims in court in a foreign (non-New Jersey) forum will not be enforced under the NJFPA. However, where the franchise agreement contains an arbitration provision and a non-New Jersey forum is designated, the forum selection provision will be enforced. This is because the Federal Arbitration Act (which applies to almost all franchise systems unless the system only operates in one state in the U.S.), will likely pre-empt New Jersey's presumption of the invalidity of the forum selection clause and, pursuant to supremacy clause principles, the NJFPA will likely not preclude enforcement of the arbitration forum selection provision.

Law stated - 31 August 2022

Regulators

Which regulatory authorities are tasked with enforcing the legislation applicable to franchises and what is the extent of their authority?

All franchisors are required to comply with the FTC Franchise Rule's disclosure requirements in connection with the offer and sale of franchises anywhere in the United States. Violations of the Franchise Rule are punishable as violations under the Federal Trade Commission Act. While the FTC has the authority to sue franchisors in federal court and to impose civil penalties of not more than $11,000 per compliance violation, it often does not do so and when it does, the violations ae typically frequent and egregious. In addition, the FTC may seek to obtain preliminary and permanent injunctive relief (including the full range of equitable remedies) in federal court. Such actions may result in monetary redress made to injured consumers (e.g., franchisees). However, under the Franchise Rule, franchisees have no private

right of action and are unable to sue franchisors in a civil action whereby they would be seeking damages and/or injunctive relief).

Unlike with the FTC Franchise Rule, franchisees have a private right of action with respect to violations of the NJFPA. Pursuant to Section 56:10-10 of the NJFPA, New Jersey franchisees may bring claims against its franchisor for violations of the Act, either to recover damages caused by a violation of the Act and, where appropriate, shall be entitled to injunctive relief. If successful, such franchisee shall also be entitled to recover the costs of the action including, but not limited to, reasonable attorneys' fees. (The Act does not provide for the franchisor to recover its costs and attorneys' fees if it successfully defends the claim). Surprisingly, the NJFPA does not provide for any "statute of limitations" period (i.e., a period of time within which a claim must be asserted or else be deemed to be time-barred.) There are very few cases that discuss this issue at all, and these cases do not address this issue consistently. There does not appear to be any clear or definitive authority as to when claims brought under the NJFPA must be asserted. Out of an abundance of caution, it is recommended that any franchisee counsel who believes that his or her client has a potential claim under the NJFPA should assert it as soon as is practicable.

Law stated - 31 August 2022

Legal definition of "franchise"

Is there a legal definition of what constitutes a "franchise" in your state?

Yes, Section 56:10-3 of the NJFPA defines a "franchise" as follows:

> *'a. "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.'*

However, the NJFPA only applies to franchises that maintain a place of business in New Jersey, have gross sales of at least $35,000 in the 12 months preceding any legal action brought under the law, and where more than 20% of the business's gross sales is derived from the franchise. That being said, the NJFPA's definition of "franchise" is very broad. There is no requirement to be operating under a marketing plan or system of the "franchisor" and there is no requirement of paying a "franchise fee" to the franchisor. All that is required is a written arrangement in which someone is granted the right to license a trade name or trademark, where there is a "community of interest" (which is undefined in the NJFPA) in the marketing of goods or services. Based upon this definition, if a company were to grant someone a license to use a trademarked product or service or authorize the person to hold himself out as an authorized reseller of the company's trademarked goods or services, then the business relationship could be deemed to be a franchise under New Jersey law. Franchise counsel would be well served to carefully analyze the nature of any potential business arrangement that his or her client was considering entering into, as it might be deemed to be a franchise under the NJFPA. Although the FTC Franchise Rule contains a different definition of "franchise," the above NJFPA definition is the controlling definition of "franchise" in the State of New Jersey.

Law stated - 31 August 2022

Formal requirements

Are there any formal requirements for franchise sales activity in your state? Are any exemptions available?

Franchisors who offer or sell franchises in New Jersey must comply with the FTC Franchise Rule and are required to provide prospective franchisees with proper disclosure (e.g., a current FDD) not less than 14 calendar days before the prospective franchisee either signs a binding agreement with, or makes any payment to, the franchisor, or an affiliate, in connection with the proposed franchise sale. Since New Jersey is not a registration state, New Jersey franchisors are not required to register their franchises with any state or federal agency (unless the franchisor is offering or selling franchises in a registration state, in which case the New Jersey franchisor would be required to register in that state).

Law stated - 31 August 2022

Pre-contractual disclosure requirements

Do any special pre-contractual disclosure requirements apply?

No special pre-contractual disclosure requirements apply for franchisors offering or selling franchises in New Jersey beyond those required under the FTC Franchise Rule.

Law stated - 31 August 2022

Available company forms/business structures

Are there any state-specific considerations that franchisors should bear in mind when choosing a business model or company structure?

Franchisors often provide that their franchise and ancillary agreements are deemed to be entered into in, and interpreted in accordance with and are governed by, the laws of the state where the franchisor's principal office is located. For franchisors based in New Jersey, they run the risk that the NJFPA will be deemed to apply to all of its franchise agreements, irrespective of where the franchisee may reside or intends to locate the franchised business, if the franchisor's form of franchise agreement, contains words to the effect that the agreement is deemed to be made in, interpreted in accordance with and governed by the laws of the State of New Jersey. To avoid this potential result, New Jersey based franchisors would be prudent to avoid language that the Franchise Agreement is "deemed to be entered into in New Jersey" and to include language in the governing law provisions of the Franchise Agreement to the effect that "notwithstanding anything contained in the Franchise Agreement, the New Jersey Franchise Practices Act (NJFPA) is not intended to be applicable to this Agreement, and shall not be deemed to be applicable to this Agreement, unless the franchisee shall independently satisfy the jurisdictional and other requirements of the NJFPA."

Law stated - 31 August 2022

THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Due diligence

What due diligence should both parties undertake before entering into a franchising relationship?

The franchisor stands to gain substantial benefits from onboarding new franchisees. Not only does the franchisor expand the system, but it also achieves a financial benefit since franchisees are typically required to pay an initial franchise fee, as well as ongoing royalties and other recurring fees (e.g., advertising fees) under the franchise agreement. Small, start-up franchisors may be both so starved for the economic infusion or eager for growth that they may be inclined to make the mistake of accepting franchise candidates without properly vetting their qualifications. The franchisor should only offer franchises to prospects who have the financial wherewithal, vision and can-do attitude to succeed as franchisees in the franchise system. The stakes are especially high in the state of New Jersey where

franchisees have evergreen renewal rights that ensure that they cannot be terminated or non-renewed without good cause. It is important, therefore, that the franchisor do its due diligence to ensure that prospective franchisees are sufficiently capitalized to finance the initial investment and weather any operating losses that may accrue until the business finds its footing. The franchisor should also gauge the prospective franchisee's general business acumen and know-how, and any industry-specific experience that might make the franchisee more likely to succeed. As part of its pre-contract review process, the franchisor should require that franchise candidates fill out a franchise application that asks for this type of information. The prudent franchisor may also obtain written consent from a prospective franchisee to run a background check and credit report.

On the other hand, it is critical that a franchisee prospect conduct its own due diligence before signing a franchise agreement and making the substantial financial investment that is often required to become a franchisee. First and foremost, the prospective franchisee must thoroughly review the Franchise Disclosure Document (FDD) it receives from the franchisor. In that context, it is strongly advisable that the prospective franchisee retain an attorney who is well-versed in franchise law and who can help the franchisee understand all the nuances of the 23 items of disclosure in the FDD. It is also worthwhile for a prospective franchisee to hire an accountant to analyze any financial performance representations that are disclosed in Item 19 of the FDD as well as the audited financial statements of the franchisor disclosed in Item 21. The accountant can also assist a prospective franchisee in preparing a business plan, which is an essential tool for the franchise candidate to assess whether, upon making the purchase, it can make the franchised business profitable over time and that it can fund the possible losses that may be incurred. A prospective franchisee should contact as many, and as diverse a group of, franchisees in the system as possible (but not less than 13 to 15 if that many exist) to obtain their insiders' perspective regarding the pros and cons of the system.

Law stated - 31 August 2022

Regulation of ongoing relationship

Do any state laws regulate the ongoing franchisor/franchisee relationship after they enter into the franchise agreement?

The New Jersey Franchise Practices Act, N.J. Stat. § 56:10-1 et seq. (NJFPA) regulates the franchisor-franchisee relationship starting from the date that the franchise agreement is signed. The law was passed to protect franchisees from being exploited by franchisors who historically had superior bargaining power. In particular, passage of the NJFPA was motivated by a desire to prevent franchisors from arbitrarily and capriciously terminating franchisees' franchise agreements. The keystone of the NJFPA's franchisee protection is that a franchisor may not terminate or fail to renew the franchise agreement unless it has "good cause" to end the relationship.

The NJFPA regulates the ongoing franchise relationship in other ways as well. For example, it prohibits a franchisor from imposing "unreasonable standards of performance" upon a franchisee and from infringing upon a franchisee's right to freely associate with other franchisees. The Act even forbids the franchisor from requiring that the franchisee agree to certain provisions which may be included in the franchise agreement.

Law stated - 31 August 2022

Amendment of terms

What rules and restrictions govern the amendment of franchise agreement terms?

The parties to an existing contract may, by mutual assent, agree to modify (i.e., make limited changes or amendments to) the contract terms. Any such agreement is only enforceable if the parties either reached an explicit agreement to modify certain contract terms or engaged in a course of conduct clearly showing the parties' mutual intent to modify

the contract terms. There must be new or additional consideration in exchange for the modifications.

A “no oral modifications” provision is enforceable if its meaning is unambiguous. Still, if the parties engage in clear conduct that evinces their intent to modify the written contract without a writing, such conduct can constitute a waiver of the writing requirement. Clear and convincing evidence of a waiver would be needed to overcome the writing requirement set forth in the contract.

Law stated - 31 August 2022

Renewal

What rules and restrictions govern the renewal of franchise agreements?

A franchisor may not terminate or fail to renew the franchise agreement of a New Jersey franchisee that meets the jurisdictional requirements of the NJFPA unless there is “good cause” to end the relationship. Typically, “good cause” to terminate or not renew only exists if the franchisee has failed to substantially comply with its obligations under the agreement. Notably, the franchisor cannot terminate or fail to renew a franchisee simply because the franchisor has a bona fide, good faith business reason for doing so. As such, New Jersey franchisees have, for all intents and purposes, an “evergreen” right to renew their franchise agreements on a continuing basis. Even in those cases where “good cause” exists, the franchisor must first provide the franchisee with 60-days’ notice before it can effectuate the termination or non-renewal. NJSA § 56:10-5.

Law stated - 31 August 2022

Sale and transfer

What rules and restrictions govern the sale and transfer of a franchised business?

The NJFPA delineates the process by which a franchisee can get permission from its franchisor to transfer ownership of a franchised business. First, the franchisee must provide the franchisor with written notice of intent to transfer or sell, which must include the buyer’s “name, address, statement of financial qualifications, and business experience during the previous five years.” The franchisor then has 60 days to either grant written approval of the sale or written notice of rejection (in which case, the notification must set forth material and bona fide business reasons as to why the proposed transferee is unacceptable). If the franchisor fails to respond within the allotted 60-day time period, the proposed sale is deemed to have been accepted and the franchise agreement is by operation of law amended to incorporate the transfer. For the sale or transfer to be valid, the transferee must agree in writing to comply with the terms of the franchisee transferor’s existing franchise agreement. N.J.S.A. § 56:10-6.

If a franchisee is not in substantial compliance with the franchise agreement, the franchisor can terminate the franchise agreement and withhold consent to any transfer. If, however, there is no good cause to terminate the franchise agreement and the franchisor unreasonably withholds consent to the transfer, the transfer is deemed effective by operation of law and the franchisee may seek judicial intervention to effectuate the transfer.

Law stated - 31 August 2022

Integration and no-reliance clauses

What effect do integration and no-reliance clauses in franchise agreements have on claims of prior oral misrepresentations?

If the franchise agreement has an integration clause, the contracting parties cannot use extrinsic evidence (i.e., any pre-

contract promises) to add to or contradict the contract's terms. However, a "no representations" or integration clause in a contract does not create an absolute defense to fraud in the inducement to contract claims. If the party perpetrating the fraud made pre-contract representations regarding facts that were peculiarly within its knowledge; and intentionally misrepresented those facts, the parol evidence rule cannot prevent the wronged party from introducing evidence of the pre-contractual misstatements to support a fraudulent inducement claim.

Law stated - 31 August 2022

Good faith and fair dealing

How have the courts and legislature in your state dealt with the implied covenant of good faith and fair dealing in relation to franchises?

Every contract in New Jersey contains the implied covenant of good faith and fair dealing. Accordingly, under New Jersey law, neither party to a contract can destroy or injure the other's right to receive its full benefits under the contract. Each contracting party must perform in a manner that meets the reasonable expectations of the other party. However, the implied covenant does not override the express terms of a contract. So, for example, if a franchisor terminates a franchise agreement due to the franchisee's failure to substantially comply with the material terms of the contract (i.e. for good cause), it is not a valid defense for the franchisee to claim that the franchisor terminated the contract due to some bad faith motive, if in fact, the franchisee had failed to substantially comply with the material terms of the contract. In the franchise context, claims for breach of the implied covenant are most often made with respect to provisions that grant the franchisor sole discretion as to how it chooses to perform under the agreement.

Notably, under the New Jersey Franchise Practices Act, a franchisor is not permitted to impose "unreasonable standards of performance" upon its franchisee. N.J.S.A. § 56:10-7(e). According to one court, this requirement imposes a statutorily mandated obligation on the franchisor to comply with the implied covenant of good faith and fair dealing in its dealings with the franchisee. DeLuca v. Allstate Ins. Co ., 2011 N.J. Super. Unpub. LEXIS 3140, *54. As to what kind of standards of performance may be "unreasonable" under the NJFPA, New Jersey courts have focused on "arbitrariness, bad intent or economic ruin" and have analyzed potential violations in terms of the cumulative effect that all of a franchisor's various actions have had on the franchisee.

Law stated - 31 August 2022

IP AND DATA PROTECTION

IP protection

How can franchisors protect and enforce their IP rights?

The licensing of intellectual property rights is central to franchising. Both the Federal Trade Commission (FTC) Amended Franchise Rule and the New Jersey Franchise Practices Act provide that the licensing of a trademark is one of the elements of a "franchise." Trademarks are a type of intellectual property consisting of a recognizable design, logo, words or phrases which distinguish a franchise's products or services (service marks) from others. It is therefore essential that franchisors seek to register and diligently protect their trademarks on an ongoing basis.

Franchisors can register trademarks both federally with the United States Patent and Trademark Office (USPTO) and at the state level. (Of course, it is well advised to seek federal registration of trademarks, given the broad rights provided to trademark owners under federal trademark law.) In New Jersey, trademark registration is provided by New Jersey's Department of the Treasury. Trademark registration in New Jersey is generally modeled on the federal scheme in that registrability hinges upon whether the applicant's goods or services "may be distinguished" from those of others. (N.J.S.A. 56:3-13.2.)

The registration process in New Jersey varies from registration with the USPTO in a variety of ways. There is no "Supplemental Register" for descriptive marks that may acquire distinctiveness. There is also no "Trademark Office Gazette" in which marks are Published for Opposition. New Jersey also does not provide for electronic registration—applications must be submitted in paper form.

The New Jersey Trademark Act includes remedies for infringement of both common law (unregistered) and registered marks that are similar to those provided by federal law. With respect to infringers, the New Jersey courts may provide injunctive relief, the destruction of goods or materials bearing infringing marks and the disgorgement of profits and damages. The New Jersey courts may also provide the aggrieved party with treble damages and attorneys' fees if the infringement was knowing, in bad faith or "egregious." (N.J.S.A. 56:3-13-16.d.)

The Act lacks several significant protections that are provided by federal law. The Act does not spell out what legal rights are granted by state trademark registration (contrast this to the federal law which provides presumptions of validity, ownership and exclusive rights). The Act is also silent as to whether there is statewide "priority" in the use of the mark. Given that the Act's protections do not extend outside of New Jersey's borders, it is always advisable to seek federal registration, as applicable.

Unlike federal trademark registration, the Act does not recognize an "intent-to-use" basis for registration; a trademark application cannot be filed in New Jersey until the trademark has already been used in commerce.

Law stated - 31 August 2022

Data protection

What rules and restrictions govern data protection and privacy in your state, and how do these apply in the context of franchising?

New Jersey currently has no comprehensive data privacy law. However, in 2019, New Jersey governor Phil Murphy signed into law an amendment (New Jersey S52) to the New Jersey Identity Theft Protect Act (the state's data breach notification law). Under the previous law, businesses were required to notify consumers if an individual's first name or first initial and last name, linked with any one of the following data was exposed: social security number; driver's license number or state ID card number; or account, credit or debit card number in combination with any security, access code or password required to access the account.

The amendment adds the following personal information, if compromised, to the notification requirement: online account username; and email addresses or any other account holder identifying information, in combination with any password or security question and answer that would permit access to the online account.

In the event of a breach, the notification must be provided to the affected consumer electronically in a form that would direct the customer to change his or her security credentials. If the email account that would otherwise receive such notification is itself compromised, then the business must provide notification by other means (or by clear and conspicuous notice when the customer has accessed the account from an IP address that the customer is known to use).

The 2019 amendment also amends the New Jersey Consumer Fraud Act to provide for civil penalties and an award of treble damages to affected consumers filing suit in connection with the willful knowing and reckless violations of the law's requirements by a business suffering such a breach.

While the 2019 amendment is not groundbreaking, it brings the state in line with other states that have recently updated their data privacy laws between 2019 and the present. Franchisors should ensure that their franchisees are advised to update and implement policies that comply with New Jersey's expanded data beach notification requirements, which are protective of customers and, in all likelihood, franchisees as well.

Ransomware attacks are a growing threat to New Jersey businesses and governmental entities, as is the case throughout the United States and the world. The New Jersey Cybersecurity & Communications Integration Cell (a component of the New Jersey Department of Homeland Security and Preparedness) noted that, in the first half of 2022, there was a 42% increase in weekly cyberattacks globally and ransomware remained the number one threat towards the public and private sector. As of May 12, 2022, the current cyber threat level in New Jersey is set to "elevated" due to the ongoing war in Ukraine and potential for attacks from Russian state-sponsored threat actors.

Law stated - 31 August 2022

Cybersecurity

What legal and practical considerations should franchisors bear in mind to address cybersecurity threats?

New Jersey has no comprehensive data privacy laws (apart from the mandatory reporting of data breaches [N.J.S.A. 56:8-163]). However, the New Jersey legislature has a mandate to follow other states in implement more expansive data protection laws.

In any event, franchisors offering or selling franchises in New Jersey should be keen to implement a variety of best practices, to protect its franchise system (and franchisees) from data breaches and other cyber-attacks including, but not limited to:

- keeping aware of changes in data protection laws;
- obtaining cyberthreat insurance, if available;
- implement multi-factor authentication with respect to all user accounts;
- updating franchisee training to include data security programs; and
- updating franchise agreements to require franchisees to utilize appropriate data protection and security.

None of these measures are foolproof and are only the tip of the iceberg, as security threats continue to grow. The franchisor should be careful to balance the protection of its franchisees against interfering too extremely in their franchisees' independent business practices, which in theory could trigger vicarious liability for a franchisor. It is clear, however, that franchisors will have to expand their efforts to protect against digital security threats and attacks.

Law stated - 31 August 2022

COMPETITION LAW

Applicable laws

What competition and antitrust laws apply to franchises in your state?

In the U.S. "competition law" is generally referred to as "antitrust law". On the federal level, the major "antitrust" statutes that impact franchising are the Sherman Act, (15 U.S.C. §1 et seq.) (generally prohibiting anti-competitive or monopolistic conduct), the Clayton Antitrust Act (15 U.S.C. §§12 et seq.) and the Robinson-Patman Act (at 15 U.S.C. §13) (generally prohibiting anti-competitive price discrimination, exclusive dealing, and tying). The New Jersey Antitrust Act (N.J.S.A. § 56-9) generally prohibits contractual restraints on trade and monopolization et al. However, antitrust matters have receded as an area of franchise litigation in recent years. In most circumstances, the presence of a clear franchise agreement and a transparent Franchise Disclosure Document (FDD), that includes contractual requirements to purchase specific goods, or restraints on conducting business, will overcome most antitrust claims. New Jersey franchise agreements often incorporate restrictive covenants. As stated by the Supreme Court of New Jersey on

several occasions, a restrictive covenant will be enforceable, if it "simply protects the legitimate interests of the employer, imposes no undue hardship on the employee and is not injurious to the public." Ingersoll-Rand Co. v Ciavatta , 110 N.J. 609 (1988); see also Solari Indus., Inc. v Malady, 55 N.J. 571, 576 (1970). In considering undue hardship to the employee, courts consider the time and territory and "the likelihood of the employee finding work elsewhere."

On May 2, 2022, the New Jersey legislature introduced assembly bill A3715, which outright banned the use of post-employment restrictive covenants against a broad range of workers, and otherwise limits the restrictive period to a maximum of 12 months. In addition, the proposed law would require employers to pay 100% of the separated employee's compensation during the restricted period. If passed, the legislation would add New Jersey to the growing list of states which are hostile to non-compete agreements which, historically, have been included in most franchise agreements

Law stated - 31 August 2022

EMPLOYMENT AND LABOR

Joint employer liability

How have the courts and legislature in your state addressed the issue of joint employer liability in the franchising context?

As anticipated, with the new Biden administration coming into power along with the "changing of the guard" at federal agencies (including new appointments by the Biden administration), the joint employer standards have again shifted (or are in the process of shifting) at the federal level. The Biden administration is apparently returning to the standard under the 2015 NLRB matter called Browning-Ferris Industries, whereby a franchisor could be considered a joint employer—even if it only exercised "indirect" control over a franchisee's employees, including the "ability to exercise such control." Such indirect control is troublesome in the franchise industry, since it is typically necessary for a franchised system to exert some degree of control over the operations of its franchisees. Although the Trump administration sought to reverse this course (including by promulgating rules through multiple federal agencies, including the U.S. Dept. of Labor (DOL), and the EEOC), it did not do so until February 20, 2020, when the NLRB issued a new joint employer rule under the National Labor Relations Act (NLRA), which removed the prior "indirect" control language, and in relevant part states "the entity must possess and exercise such substantial direct and immediate control over one or more essential terms or conditions of their employment…" In a suit brought by multiple state Attorney General's offices, a court struck down much of the Trump administration's 2020 rulemaking, in State Of New York et al v. Scalia , Index No. 1:20-cv-01689-GHW (Sept. 8, 2020). In late July 2021, the Biden administration formally rescinded the prior 2020 DOL rule, reverting back to the 2015 standard. See DOL Notice for 29 CFR Part 791, RIN 1235-AA37 (July 29, 2021) ("This action finalizes the Department's proposal to rescind the final rule titled "Joint Employer Status Under the Fair Labor Standards Act," which was published on January 16, 2020, and took effect on March 16, 2020. This rescission removes the regulations established by that rule."). Other federal agencies have already, or are in the process of, doing the same. Therefore, franchisors and franchisees should assume that the Browning-Ferris standard applies on the federal level, and adopt a more protective stance.

Importantly, New Jersey has its own independent wage and labor statutes, such as the New Jersey Wage Payment and Wage Collection Law (NJ Stat. 31:11-4.1 et seq.; NJ Stat. 34:11-56.1 et seq.; NJ Stat. 34:11-57 et seq.), and the New Jersey Law Against Discrimination (NJ Stat. 10:5-1), which have their own joint-employment standards, and may not necessarily follow the new federal rules and regulations. The New Jersey Supreme Court, in Hargrove v. Sleepy's LLC , 220 N.J. 289 (2015) (not in the franchise context, but dealing with whether independent contractors were actually employees), has already substantially adopted the "ABC" test for employment, which, in short, departs from a more traditional "totality of the circumstances" approach towards finding whether "employment" exists, to a test that starts

with the presumption that an employment relationship exists, a troubling standard for franchisors. Franchisors operating in NJ should take note, as NJ's use of the ABC test, coupled with one of the strongest wage-theft laws in the country, represents a significant risk for franchisors if they should try to become overly involved in individual franchised units' employees, particularly with respect to any wage and hour issues. Unwary franchisors that mandate franchisees actions with respect to employees work hours or wage levels in an operations manual, or even that mandate the use of proprietary POS systems whose time entry system violates local wage laws, may find themselves liable, or at least subject to litigation risk.

Therefore, the prudent franchisor in New Jersey should consult with knowledgeable counsel, and should tread carefully where it seeks or plans to exert even "indirect" control over a franchisees' employees, particularly within the realms of wage and hour, labor relations, or other terms and conditions of their employment. Franchisors should remember that joint employer liability is a problem with a solution grounded in how much control a franchisor ought to exert over its system. The application of the joint employer doctrine is limited to issues within the employment context, and therefore, it only has the potential to impact those franchisors who directly—or indirectly (given the likely standard)—exert control over the terms and conditions of their franchisees' employment relationships. Franchisors who specifically choose to involve themselves in opposing the union activities of employees of their franchisees, or mandate that franchisees' employees work certain hours or at certain pay rates, or become involved with collective bargaining with respect to their franchisees' employees, are very likely asking for trouble. Franchisors that do not seek to impose any significant control over the employees of their franchisees, especially in the labor relations arena, or wage and hour concerns, will significantly reduce their risk of being considered joint employers, or subject to NLRB scrutiny or NLRA liability. Regardless, franchisors who are contemplating such actions, ought to consult with counsel, particularly where it seeks to exert some control over a franchisees' employees, particularly within the realms of wage and hour, labor relations, or other terms and conditions of their employment.

Law stated - 31 August 2022

Other employment and labor laws

Are any other employment and labor laws particularly relevant to franchises in your state?

In the current pandemic climate of COVID-19, the employment relationship has been impacted by executive orders issued by Governor's offices, legislative acts, and local mandates, which have required business closures, limited or substantially changed business operations, and regulated employee and customer interactions and safety requirements (See e.g. NJ's Governor's Office's COVID-19 Webpage: https://COVID19.nj.gov/, which is an excellent source of information regarding current requirements). These requirements are shifting on an almost daily basis and are well beyond the scope of this article. At the time of this article, the NJ Governor's prior COVID safety mandates had been allowed to expire on July 4, 2021, along with Exe. Order 192, which provided for additional worker rights and protections. Those rights and restrictions were at times difficult to implement and navigate, particularly with the introduction of new variants and changing guidance, along with how safety concerns intersected with particular franchise systems. Regardless, the pandemic is still not over, and prudent franchisors should continue to make sure that they do not seek to require anything that might conflict with local, state, and federal COVID-19 related mandates, including health and safety measures. Indeed, OSHA regulations concerning COVID (and generally) may still impact franchised operations, and what measures are required to protect employees. See osha.gov/coronavirus . Certain industries in NJ, where franchises may exist, still remain under strict mandates that impact operations (such as healthcare, transportation, or childcare centers). Others, such as amusement parks, bars, restaurants, gyms, and personal care services, have been issued "recommendations" by NJ's DOH, which while they are not mandates, should generally be abided by, as the failure to do so will likely increase liability risk. Well-crafted franchise agreements generally require a franchisee to comply with all local rules and regulations, and any system requirement that conflicts with them is void. However, franchisors and franchisees alike must be guided by their localities' restrictions, and make

sure that system standards are adjusted to adhere to what is required under pandemic-related restrictions. Each franchised unit must be mindful of their employees' rights, including rights that exist under the ADA, FMLA, and other applicable NJ statutes and local laws (including, significantly, NJ's Mini-FMLA, the NJ Wage and Hour Laws, NJ's Conscientious Employee Protection Act (CEPA) and NJ's Law Against Discrimination, and how each of these function during the COVID-19 pandemic. These may include paid leave, and other statutes and executive orders that give employees rights to stay at home, take leave to care for an impacted person under their care, such as caring for children or sick loved ones, prohibit discrimination, or that require a level of safety at the workplace, including whistleblower protections (e.g. NJ CEPA), and protection for those who are immune-compromised and therefore may be protected as "disabled"). Franchisors must be flexible, and work with their franchisees in each jurisdiction, including NJ and its own unique labor and employment laws, as each jurisdiction may be markedly different. Cooperation between franchisors and franchisees is a necessity in this uncertain climate, and franchised systems should do what they can to minimize the financial impact of the virus, protect their franchisees' employees, and protect brand image and reassure customers by working together so that each franchisees' employees are doing what is required by local authorities, and as customer and employee safety requires.

In addition, as discussed above, federal and local employment laws can sometimes cause an unwary franchisor to be liable for employees of its franchisees, particularly where the franchisor exerts too much control over the terms and conditions of a franchisees' employees, and federal and local employment laws, with potentially different standards, might also find an unwary franchisor to be a joint employer with a franchisee, or even a single employer.

Another area where employment law can become a factor is within post-term restrictive covenants. Often franchisors seek to impose restrictive covenants not only upon a business, but also upon a former franchisee's principles, family members, and key employees (or employees in general). In New Jersey, such clauses are narrowly construed, and will only be enforced where they are reasonable in scope and duration. The restraint must be necessary to protect a legitimate interest (such as trade secrets, customer lists, or other confidential information), must not cause undue hardship for the former employee (such as preventing a person from readily finding alternative employment), and may not be against the public interest. Therefore, while there is no prohibition in New Jersey from having such covenants, enforcement may be difficult, costly, and unsuccessful where a franchisor (or franchisee) seeks to apply such clauses to a franchisee's principles, family members, and key employees (or employees in general). Further, a "blue pencil" provision in any such restraint, allowing a Court to modify any such clauses to provide the maximum protection allowed under the law, is prudent. Further, on the federal level, the Biden administration's July 9, , 2021 Executive Order on Promoting Competition in the American Economy, signaled that the Federal Trade Commission (FTC) may now become active in utilizing its powers to regulate restrictive covenants under anti-competition laws. This will likely be an active area in the coming years, and franchisors will likely need to revisit their franchise agreements where restrictive covenants are mandated.

Law stated - 31 August 2022

REAL ESTATE

Laws and practical considerations

What real estate laws and practical considerations should franchises bear in mind when operating in your state?

New Jersey may be a small state, but it contains a diverse real estate market that includes rural, suburban and urban areas. A prospective franchisee that intends to open a location in New Jersey must be aware of the challenges it will face when entering the real estate market.

It is common for franchisees to lease their franchise location rather than purchase the location. It is therefore advisable for franchisees to hire experienced leasing counsel because commercial landlord-tenant relationships in New Jersey

are largely left up to the parties to negotiate—New Jersey's otherwise robust landlord-tenant laws are designed to protect residential tenants, not commercial tenants (e.g., the protections of New Jersey's Security Deposit Law do not extend to commercial leases). New Jersey franchisees should also be conscious of the high stakes in commercial leasing. The typical lease term may be as long as 10 years (not including renewal terms), which is a significant financial obligation for the franchisee to undertake (which often will include a personal guaranty from the franchisee's principal).

When negotiating a commercial lease, the franchisee's counsel must not only consider what terms will be most favorable to the tenant, but also must incorporate certain requirements of the franchisor that may be imposed by the franchise agreement. For example, many franchisors provide their franchisees with a "form of lease rider" and/or other ancillary documents for the franchisee and landlord to negotiate and incorporate into their lease. However, sophisticated landlords are generally aware that franchisors will seek to reserve certain rights with respect to the franchisee's lease (e.g., the franchisor will usually want the landlord's pre-approval to "step-in" to the lease in the event that the franchisee is in default of its franchise agreement or arrange for an assignment of the lease to a new franchisee).

Additional difficulties are presented when a prospective franchisee is purchasing an existing location. For example, an existing franchise may likely have less than a full term remaining in either or both of the franchise agreement and the lease. Franchisee's counsel has the added burden of negotiating with an additional party—the franchise seller.

In some circumstances, the franchisor itself (or its affiliate) will be the franchisee's landlord—either because the franchisor owns the franchise location or the franchisor is the primary leaseholder of the location (and subleases the location to its franchisee). From the franchisor's perspective, this has some advantages with respect to protecting the system and having more control over the franchise location (e.g., a franchisee in default of its franchise agreement may also be in "cross default" with respect to its sublease or lease). This situation may (but may not) be less advantageous to the franchisee because of the fact that the franchisor, as opposed to an independent landlord, will have more control over the franchised location. It will, of course, depend on the parties and their respective interests.

The COVID-19 pandemic has presented significant difficulties to New Jersey commercial landlords and tenants. A decline in economic activity (due to a prolonged period of shutdowns and capacity restrictions) have made it difficult for franchisees to maintain their rent payments; and also for landlords to collect rent and pay their mortgages.

In March 2020 the New Jersey Courts postponed all commercial landlord/tenant trials and barred the issuance of writs of possession in connection with commercial foreclosure judgments. After more than a year, the moratorium on commercial landlord-tenant eviction trials was lifted on June 2, 2021. While restrictions have been lifted, commercial real estate activity is not returned to the same levels as it was pre-COVID. Due to the continuation of remote work in many industries, the commercial leasing market remains favorable to tenants.

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TAXATION

Applicable taxes

What tax liabilities arise for franchisors and franchisees in your state?

Franchises (and companies in general) that operate in New Jersey as traditional corporations are subject to its corporation business tax (CBT). However, New Jersey does not have an applicable franchise tax. In New Jersey one must pay the highest amount calculated under the following bases; a graduated tax based on adjusted net income; where the CBT rate is 9% with segmented gradual reductions for corporations with net income of $100,000 or less; or an alternative minimum assessment based on gross receipts; or an alternative minimum assessment based on gross profits. If formed as a limited liability company (LLC), both the federal government and New Jersey generally recognize the LLC as a pass-through entity that will not be required to pay income tax.

Franchisees and franchisors that are part of a multi-state model should note that from 2019 onwards, the New Jersey Corporation Business Tax Act requires corporations that have a taxable status in New Jersey to pay taxes based on the portion of their net income apportionable to New Jersey. In 2019, New Jersey transitioned to using "market-based sourcing" that allocates business income to the single receipt based on where the benefit of the service is received. If all the benefits of the service are received in the state, then the receipt is entirely sourced in New Jersey. If only some of the benefits of the service are received in New Jersey, the receipts will then be apportioned as appropriate. On Sept. 8, 2020, the New Jersey Division of Taxation released final regulations providing detailed rules for sourcing receipts from service transactions for (CBT) purposes. The final rules provide industry-specific examples for allocating service receipts from multistate customers in accordance with the statute's requirement that receipts be sourced to the location where the benefit of the service is received.

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Nexus

How is nexus defined for state tax purposes, and how does this affect liability for state income tax on franchisor royalties?

New Jersey law provides that any company that derives receipts from activity conducted in New Jersey, does business in New Jersey, has contacts in New Jersey or employs or owns capital in New Jersey will be deemed to be subject to an evaluation as to whether it has a New Jersey nexus for state corporate income tax purposes. The evaluation, or "subjectivity standard", is determined by the facts in each case. Consideration is given to such factors as: the nature and extent of the activities of the corporation in New Jersey; the location of its offices and other places of business; the continuity, frequency, and regularity of the activities of the corporation in New Jersey; the employment in New Jersey of agents, officers, and employees; and the location of the actual seat of management or control of the corporation (N.J. Admin. Code § 18:7-1.9(b)). As of November 2018, for sales tax considerations, New Jersey deems a business without a physical presence to have nexus if it has sales revenue exceeding $100,000 or 200 or more separate transactions, in the immediately preceding four sales tax quarters. Such a business is required to register, collect and remit New Jersey sales tax. After the COVID-19 pandemic brought about a significant shift to telecommuting, New Jersey made temporary rule changes relating to the "geographic nexus" for the corporate-business tax and for the sales tax. However, those temporary rule changes were lifted on October 1, 2021.

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DISPUTE RESOLUTION

Common disputes

What issues are typically the subject of disputes between franchisors and franchisees in your state?

The gateway issue that is frequently the subject of litigation is whether or not a certain business qualifies as a "franchise" and meets the jurisdictional requirements for protection under the New Jersey Franchise Practices Act (NJFPA). This is an important threshold question because a franchisee has substantially more rights if it is protected under the NJFPA. Disputes commonly arise under the NJFPA where a franchise has been terminated or "not renewed." The NJFPA is very protective of a franchisee's rights and does not allow a franchisor to terminate or fail to renew a franchise unless it has "good cause" to do so.

Franchisees can assert common law claims for negligent misrepresentation and fraud if the franchisor made pre-contract misrepresentations or omissions. In certain cases, franchisees that are not protected by the NJFPA may be

able to assert claims under New Jersey's Consumer Fraud Act against franchisors that engage in unconscionable commercial practices. If the franchisor fails to meet its contractual obligations to provide ongoing support and training, the franchisee can also assert claims for breach of contract.

Franchisors often assert breach of contract claims against wayward franchisees. Such claims typically arise if the franchisee fails to pay its royalties or fails to adhere to the system's operations standards. To the extent that the franchisee does not cure its default and the franchisor then terminates the franchise agreement, the agreement often mandates compliance with a number of post-termination obligations. If for example, the franchisee fails to promptly de-identify, the franchisor may seek damages (which may include treble damages and attorney's fees), or an injunction for trademark violations under the federal Lanham Act; the franchisor may also seek to enforce a non-compete provision if it has a legitimate business interest to protect.

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Venue and governing law

What legal and practical considerations should be borne in mind when choosing a litigation venue and governing law for franchising disputes arising in your state?

As a practical matter, the franchisor usually prefers to apply the law of its home state to the franchise agreement, and to litigate any franchise disputes in a venue near its corporate headquarters. The advantage to the franchisor is that it and its counsel will ordinarily have an in-depth understanding of the local state law. Additionally, the franchisor benefits from having its witnesses nearby and available for a trial or arbitration. However, because of the NJFPA, the franchisor cannot gain all of the advantages it might enjoy when it contracts with franchisees outside of New Jersey.

Under the NJFPA, a franchisor is not permitted to include in any agreement relating to the franchise, a term or condition which would directly or indirectly violate the statute, nor may the franchisor require that the franchisee waive its rights under the NJFPA. N.J.S.A. § 56:10-7(a), (f). So, no matter what state law the franchisor may have chosen to be included in the governing law provision of the franchise agreement, the NJFPA will still protect the New Jersey franchisee which meets its jurisdictional requirements. Additionally, a venue provision that designates a forum outside of New Jersey is presumptively invalid if the NJFPA applies to the franchise. Such a provision is only enforceable if the franchisor can show that the forum selection clause was negotiated at arm's length and was not adopted merely because of the franchisor's superior bargaining power. New Jersey's Supreme Court adopted this rule upon finding that an out-of-state forum selection clause would undermine the public policy interest of the NJFPA in protecting New Jersey franchisees from more powerful franchisors.

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Document retention

What document retention considerations and policies are pertinent for parties to franchise-related litigation in your state?

A prospective party to a lawsuit has a duty to preserve documents when:

- litigation between it and another party is pending or probable;
- the party has knowledge that such litigation exists or is likely to be commenced;
- it is foreseeable that the loss of evidence would prejudice the opposing party; and
- the evidence in question is relevant to the litigation.

Arguably, in the franchise context, the issuance of a demand letter, default notice, and/or termination notice likely triggers the duty to preserve.

The duty to preserve requires that each party take steps that are "reasonable under the circumstances" to preserve its documents. Counsel should notify the franchisor or franchisee, as the case may be, to place a "litigation hold" on all documentary evidence that may be applicable to the case. Once a party has a duty to preserve, it must suspend any automated deletion processes for its electronic data (e.g., the purging of emails) and institute a "litigation hold" that will preserve all potentially relevant documents in their hard copy or electronic form. New Jersey law also requires that the parties preserve the metadata for electronic documents, if reasonable. Comments to N.J. Ct. R. 4:18-1. It is not enough for a company to direct its employees to initiate a litigation hold; counsel must oversee the process (with the technical assistance of competent IT professionals) to ensure that the litigation hold is being properly implemented.

In franchise disputes—unless the franchisee has been terminated—the parties continue to have an ongoing business relationship and, so the preservation of documents is complicated by the fact that the franchisor may have control over or access to certain of the franchisee's documents. For example, the franchisee's business emails may be on the franchisor's server and the franchisee's POS system may offer the franchisor a direct feed to the franchisee's business information. In that respect, the franchisor has a distinct advantage. If the franchisor terminates the franchisee's franchise agreement, the franchisor may (and often does) lock the franchisee out of its company email account and deny the franchisee further access to its business emails and/or POS system. In anticipation of a threatened termination, the franchisee should back up its emails and business information so that it is not fully in the dark if and when litigation is commenced.

If it is discovered that there was spoliation of evidence, a court may grant a negative inference or issue a discovery sanction against the spoliating party. Additionally, the non-spoliating party may amend its pleadings to add a claim for fraudulent concealment of evidence, which is recognized as a separate cause of action under New Jersey law. Under the most egregious circumstances, a court may go so far as to strike the answer of the offending party.

Law stated - 31 August 2022

Remedies

What remedies are available and commonly awarded in franchise-related litigation?

Aggrieved franchisees who maintain a place of business in New Jersey; generate gross sales of over $35,000 between it and the franchisor during the 12 months prior to suit; and derive over 20% of their gross sales from the franchise, can assert powerful statutory claims against franchisors who have violated the NJFPA. If a franchisee prevails in a suit under the NJFPA, it can recover damages or obtain injunctive relief. In the context of an unlawful termination, the franchisee can go into to court to obtain temporary injunctive relief or restraints to maintain the status quo while it seeks to move or close the business, or to achieve some other equitable result. Its only available remedy otherwise, is damages, which are calculated as the actual or reasonable value of the business as of the date of termination. It is significant that, given the typically unequal financial resources of the franchisor and franchisee, only the franchisee has a statutory right to recover its court costs and attorney fees if it prevails on its NJFPA claims.

Franchisors may recover damages for a franchisee's breach of contract. If the franchisee wrongfully terminates the franchise agreement prior to expiration of the term, the franchisor may be entitled to recover lost future profits (including the lost royalties' stream for the duration of the franchise term). Franchisors will often aggressively seek an injunction and damages for any post-termination failures to de-identify, return the company's confidential materials, and/or abide by the terms of any restrictive covenant.

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Alternative dispute resolution

Is alternative dispute resolution (ADR) commonly used for franchising disputes in your state? What considerations should be borne in mind when opting for ADR?

Many franchisors prefer to litigate their franchise disputes in the relatively private confines of an arbitration proceeding rather than in open court. In theory, if not in practice, arbitration is more cost-effective and expeditious than litigation in court (where motions and appeals may predominate) would be for the parties. Accordingly, the dispute resolution provision in most franchise agreements provides that the parties must submit their dispute to arbitration. Sometimes dispute resolution procedures also require, as a condition precedent, that the parties first engage in mediation before an arbitration is commenced. Typically, the dispute resolution provision has a carve-out granting the franchisor the right to seek an injunction and sue for trademark violations, and/or breaches of restrictive covenants, in court.

The arbitration provision in a franchise agreement should clearly and unambiguously state that, by consenting to arbitration, the parties are waiving their right to go to court and have a jury trial. Additionally, for the provision to be enforceable, it must identify the agreed-upon arbitration forum.

Some arbitration provisions call for a three-arbitrator panel, which can increase the costs of an arbitration significantly. Discovery is usually more limited and the rules of evidence are "relaxed" in arbitration. Further, any attempt to set aside an arbitration award is unlikely to succeed (e.g., only if the award was procured by corruption or fraud, or the arbitrator exceeded his powers), and therefore motions to vacate or modify arbitration awards are uncommon and when they are made, they are often made for "strategic" or "settlement posturing" purposes. Despite these factors, arbitration remains a popular means of resolving franchise disputes in the State of New Jersey.

Law stated - 31 August 2022

UPDATE AND TRENDS

Key developments of the past year

What have been the most notable recent developments and trends in relation to franchising in your state?

The COVID-19 pandemic continues to be the most notable development, and continues to impact virtually every aspect of business in the U.S. Almost every franchised system has had to adjust or adapt in some way. There continues to be uncertainty about the future, and with the introduction of the Delta variant, the situation is constantly evolving. At the time of this article, there also remains a significant discrepancy between regions with respect to how impacted they are by the pandemic, and franchisors and franchisees (and would-be franchisees) should carefully assess the conditions in a specific region. However, there is hope that the worst impacts of the pandemic are behind us, particularly as the U.S.'s vaccination rates climb, and indications are that COVID variants are responding well to existing vaccines, or imminently available booster shots. Economic forecasts for the U.S. are relatively strong, and franchising may provide a very attractive option for those looking to enter marketplaces that are now less saturated, particularly where competition has not survived the pandemic. Franchised systems, by virtue of having proven methods of operation and high brand recognition with established marks, have a distinct advantage in market entry as industry and business restarts. Customers are far more likely to inherently know what a franchised business offers, particularly over unknown and unproven start-ups. Therefore, many in the industry are anticipating an increase in franchising, and purchases of franchised units in established brands.

The COVID-19 pandemic has also, for better or worse, hastened the transition to e-commerce in most industries. Some systems have not been able to adapt, and others find that their customers now expect to purchase goods and services

entirely online. Traditional “brick and mortar” models may need to adjust to survive in the new economic climate. However, with the contraction of many office spaces (as more people work from home), and loss of many retail businesses, commercial real-estate may be more affordable, at least in the near term. The concept of a set geographic “territory” is also becoming more fluid in franchising with e-commerce increasingly driving sales. Franchised systems may need to take a hard look at how their franchised territories are defined, and how e-commerce is addressed in franchise agreements, not only to understand the present, but to also plan for the future growth of the franchise. The new reality is that businesses without an e-commerce component are generally now at a significant disadvantage, and if franchisees under an older system model are prohibited from engaging in e-commerce, or a franchisor is competing against its local franchisees, individual franchised units may not be able to survive.

Other factors that are just beginning to be understood in franchised businesses, are the impacts of the pandemic on demographics and customer population distribution. There have been changes to, and in many instances, significant declines in commercial foot traffic and commuter business. This is usually more pronounced in urban locations or city centers where businesses rely upon commuters for business. Many people are now working from home, or in hybrid arrangements, and therefore are not commuting as often. This is reducing customer bases in locations that previously could count on high levels of foot traffic or commuter business. It remains to be seen if these trends subside, and the workforce returns to previous levels of commuting, or if this has become a more permanent aspect of the U.S. economy. Previously lucrative franchised territories may now be untenable. In contrast, opportunities may now present themselves in areas where people previously rarely sought to eat out, or purchase goods or services, but there now exists a new demand. For example, areas where workers reside, who are now working from home, may be far more lucrative than before. Franchisors and franchisees are going to have to pay close attention to these trends. Systems should try and mitigate against negative shifts in customer demographics, as well as be poised to take advantage of any “new normal” trends that may emerge.

The pandemic is not over, and with the Delta and other variants still threatening to complicate matters, franchisors and franchisees continue to be well-advised to cooperate with each other and adjust system standards to function wherever practicable based upon a locality’s governmental mandates, employee and customer safety, liability concerns, and customers’ new preferences and needs. Franchisors and franchisees should remain in active communication, provide insight as to how to adjust the franchise model as necessary, and franchisors would be well advised to have a forum for discussion about what works (and what does not). Franchisors should also consider what steps might be prudent to ensure survival of their franchised units (who may be under extreme financial pressures), and be willing to relax or altogether alter system standards. Struggling franchisees may be saved by a franchisor’s judicious temporary deferment or reduction in royalties or other payments, and survival of a unit in the long run benefits franchisors and franchisees alike.

It is a possibility that certain franchised systems may never recover from COVID-19, or that they cannot recover in their present form and must significantly change their system. Franchisors in this position are well advised to listen to their franchisees for ideas and potential guidance as to changes that can be made, or must be made, and decide if they are possible or practicable. To fit within the “new normal” adaption is a necessity, and one of the greatest strengths of a functional franchised system, is the ability of a franchise to draw upon all of its franchisor’s expertise and existent developed model, as well as a system’s individual franchisees’ ideas and experiences. Franchisee associations can provide much needed insight and potential ideas that can positively impact an entire system. A franchised system at its best is a community, where no single business should feel alone or abandoned during a crisis, and shared leadership and ideas may be the most valuable asset for franchises in weathering the COVID-19 crisis.

In addition to COVID-19 related developments, there have been several other notable issues and trends. The joint employer doctrine continues to be an issue in franchising. While federal regulators have now moved for a more aggressive concept of “joint employer,” the feared associated onslaught of litigation has not yet materialized. However, this remains a hot topic, and franchisors should continue to be wary of pitfalls associated with becoming a joint employer. Also discussed above, another area deserving of attention is non-competition clauses (including “no-

poaching" provisions in franchise agreements that restrict franchisees from hiring the employees of another franchisee in the system). These provisions continue to be scrutinized by regulators. Franchisors and franchisees alike should really examine whether such clauses are truly necessary, or are even enforceable. It may be that the benefits of having these no-poach provisions, which previously were often considered "standard," may not outweigh the risks or costs of enforcement.

Finally, lurking in the background of COVID-19 and the increased use of e-commerce, are the perils of cybersecurity breaches and online crime. Cyber-threats and online crime continue to increase in the U.S., and 2020 was no exception, with 2021 trending upwards as well. While the attention of the nation has rightfully been upon COVID, franchised systems continue to be a target of malicious cyber-attacks, particularly where customer information and online sales are at risk. With many workers now working online, and away from centralized locations, the risks of compromise has increased. Franchised systems also inherently have a centralized franchisor, and often, each franchisee, all of which can be access points if systems are interconnected. This may place franchised systems at greater risk of compromise. Franchisors should continue to insist upon best practices to avoid any data breaches where customer information is stored, and retain competent IT professionals to safeguard systems

Law stated - 31 August 2022

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