Franchise Renewals: When Renewal Doesn’t Mean Renewal

While franchisors are not universally obligated to renew franchises, they must comply with state-specific requirements, including providing advance notice and having legitimate reasons for nonrenewal. State laws on franchise renewal vary significantly, addressing issues such as non-renewal provisions, good cause requirements, and the enforceability of certain contract terms. These laws aim to balance the power dynamics between franchisors and franchisees, often providing protection for franchisees against arbitrary or unfair non-renewal or termination of franchise agreements.

Under California law, non-renewals require a 180-day notice period and allow nonrenewal under specific conditions, such as the franchisor withdrawing from the market or the franchisor and the franchisee agreeing not to renew. §20025. Requirements; Procedure. California's Franchise Investment Law (CFIL) under California Corporations Code section 31201 makes it unlawful to offer or sell a franchise through untrue statements of material fact. Disputes often arise regarding the statute of limitations and the scope of counterclaims under this law. Meineke Franchisor SPV LLC v. CJGL, Inc., 2024 U.S. Dist. LEXIS 131921. Franchise agreements may include conditions for renewal, such as signing a new agreement that may differ from the original terms. California courts have upheld the enforceability of general release provisions in franchise renewal agreements, provided they are not obtained by fraud or misrepresentation. Franchisees are free to decline renewal if they do not wish to release their claims against the franchisor. Haitayan v. 7-Eleven, Inc., 2018 U.S. Dist. LEXIS 123178.

Under New Jersey law, the enforceability of a non-renewal provision depends on a good cause analysis of the underlying facts rather than the provision's terms. The New Jersey Franchise Practices Act (NJFPA) aims to protect franchisees from indiscriminate terminations and non-renewals, requiring good cause for non-renewal but not mandating a renewal offer prior to termination. Scion Hotels LLC v. Holiday Hosp. Franchising, LLC, 2024 U.S. Dist. LEXIS 168081.

Under New York law, CLS General Business § 199-c allows a distributor to elect not to renew a franchise due to the sale or lease of the service station premises, provided the distributor does not supply the service station with motor fuels for one year after the sale or lease. Non-renewal is also permitted for good cause, including the dealer’s failure to comply with the franchise agreement or act in good faith. §199-c Termination or refusal to renew a franchise without good cause prohibited; notice requirement; right of action.

Under Federal law, 15 USCS § 2802 prohibits franchisors engaged in the sale, consignment, or distribution of motor fuel from terminating or failing to renew a franchise without meeting specific notification requirements and having a valid ground for non-renewal, such as the franchisee’s failure to comply with significant franchise provisions. § 2802. Franchise relationship. 15 USCS § 2805 provides that courts may not compel the renewal of a franchise if the franchisor demonstrates that the non-renewal decision was made in good faith and in the normal course of business, such as converting the premises to a different use or withdrawing from the market.

Franchisors generally do not have an absolute obligation to renew a franchise. However, various state laws impose conditions and procedural requirements that franchisors must meet if they choose not to renew a franchise.

Federal New Jersey Court Slams Hotel Franchisee in Recent Case on Renewal

A recent case in New Jersey involving a dispute between a hotel franchisee and its franchisor ended very poorly for the franchisee. The case, *Scion Hotels LLC v. Holiday Hospitality Franchising, LLC*, was decided by the United States District Court for the District of New Jersey on September 18, 2024. The case involved allegations of violations of the New Jersey Franchise Practices Act (NJFPA) by the Holiday Hospitality Franchising, LLC ("Holiday") toward Scion Hotels LLC ("Scion").

On June 4, 2019, Scion entered into a 22-month franchise agreement with Holiday for a Holiday Inn hotel near Newark Liberty International Airport, which was not renewable. Despite Scion entering negotiations with Holiday in July 2020 for a potential extension of the franchise agreement, Holiday rejected the request.

Holiday sought a long-term franchise agreement for the Newark Hotel to continue as a Holiday Inn or Holiday Inn Express after the franchise agreement expired, but Scion did not request a full-term agreement. Holiday pursued other opportunities, including converting another hotel called the Ramada Plaza to a Holiday Inn, which was approved and executed in late 2019.

Scion began negotiations with Hilton Worldwide ("Hilton") to convert the Newark Hotel to a Hampton Inn on August 7, 2019. On November 12, 2020, a franchise agreement was executed between Hilton Franchise Holdings LLC and Scion Hotels, LLC for a Hampton Inn at Newark Airport, with renovations to begin in March 2021. The Hilton agreement happened before the expiration of the Holiday Inn franchise agreement.

The Holiday Inn franchise agreement expired on April 11, 2021, and the Holiday Inn hotel closed. Scion opened the hotel as a Hampton Inn in May 2022.

The NJFPA does not require renewal of a non-renewable franchise agreement. A non-renewal provision alone does not constitute a violation but may indicate non-substantial compliance, with enforceability depending on a good cause analysis of the facts. The NJFPA aims to protect franchisees from unreasonable terminations but does not prevent severance for those who disregard contractual obligations.

The concept of "substantial compliance" under NJFPA requires franchisees to avoid directly defying terms of the agreement, focusing on the franchisee's actions rather than the franchisor's motivations.

Holiday filed a motion for summary judgment on April 28, 2023, which Scion opposed on May 26, 2023, and Holiday replied on June 16, 2023. The counts in this case are as follows: (1) wrongful non-renewal, (2) constructive termination, and (3) unreasonable standards of performance.

As to count one, the court found that Scion did not substantially comply with the franchise agreement, as they engaged in negotiations with Hilton for a franchise while under a Holiday Inn franchise agreement. Scion's request for a franchise agreement extension was made only once, nearly a year after starting negotiations with Hilton. The court dismissed count one with prejudice, finding Scion's actions demonstrated a lack of substantial compliance and voluntary abandonment of the franchise relationship.

As to count two, Scion alleged that Holiday's actions, such as licensing nearby hotels like the Ramada Plaza, constructively terminated its franchise. Under NJFPA, a franchisor cannot terminate a franchise without "good cause," even if the termination aligns with a sound business strategy. In another case, *Maintainco, Inc. v. Mitsubishi Caterpillar (2009)*, the court found constructive termination when a franchisor's conduct was aimed at terminating a franchise.

Scion in this case alleged that Holiday's actions, such as licensing nearby hotels, constructively terminated its franchise. The court found Scion's claims of constructive termination unsubstantiated, as Holiday did not intend to cease business with Scion. Scion's own actions, such as negotiating with Hilton, were seen as evidence of constructive termination. Count Two, the constructive termination claim, was dismissed with prejudice.

As to count three, Scion claimed that Holiday imposed unreasonable standards of performance by placing a competing hotel in close proximity, making it difficult for Scion to operate profitably. The New Jersey Franchise Practices Act (NJFPA) prohibits franchisors from imposing unreasonable standards of performance. Courts have identified arbitrariness, bad intent, or economic ruin as indicators of unreasonable standards.

Scion failed to provide evidence of arbitrariness, bad intent, or economic ruin. Scion's allegations included that Holiday converted a nearby Ramada hotel to a Holiday Inn without proper notice, but evidence showed Scion was informed of the conversion. Scion's claim of financial loss due to the conversion was disputed, and Scion's own actions, such as entering into a conflicting franchise agreement with Hilton, undermined their claims. The court dismissed Count Three, regarding unreasonable standards of performance, with prejudice due to lack of evidence.

The court granted Holiday's motion for summary judgment, dismissing Scion's amended complaint with prejudice, and ordered the case closed.