

SUBMISSION

TO THE

MINISTRY OF ECONOMIC DEVELOPMENT

ON THE

REVIEW OF FRANCHISING REGULATION

BY

FOODSTUFFS (NZ) LIMITED

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Introduction

This submission is made by Foodstuffs (NZ) Ltd on behalf of the Foodstuffs group of companies.

The Foodstuffs group is the leading retail and supermarket organisation in New Zealand, the second largest business organisation in New Zealand, based on revenue, and the largest franchise operator in New Zealand.

The Foodstuffs group, comprising Foodstuffs (Auckland) Ltd, Foodstuffs (Wellington) Co-op Soc. Ltd, and Foodstuffs South Island Ltd, operate as three independent retailer owned co-operatives that each run integrated grocery retailing, grocery wholesaling, and private label operations.

The Foodstuffs companies own the intellectual property in the following retail brands: PAK'nSAVE, New World, Write Price, Shoprite, Four Square, On-the-Spot, Duffy & Finn's, Henry's Beer Wine and Spirits and Liquorland. With the exception of the recently acquired Liquorland business, retail stores are owned and operated by co-operative members under franchising or licensing arrangements. Liquorland franchisees are expected to become co-operative members in the future.

At the time of writing, 747 retail stores trade under franchising or licensing arrangements with the Foodstuffs companies. The collective turnover of these stores is estimated to exceed \$8 billion.

Summary

Franchising systems appear to operate well within the framework of generic commercial laws and there is no evidence further regulation is warranted.

Before Government considers any new regulation, it is imperative that it more clearly define what problems it is trying to solve. If real problems exist, a regulatory intervention should only be considered if the problem is significant, and then only after non-regulatory measures have been considered and discounted. If a problem is specific to an individual industry or sector, then industry/sector specific measures should be initiated.

In the absence of evidence of any real problems, Foodstuffs supports option 1: Status Quo. Further education may provide some assistance for prospective franchisees and franchisors however, as the industry already provides education services, we believe Government efforts should support and promote existing industry services rather than "re-inventing the wheel".

Foodstuffs do not support mandatory information disclosure, requirements for prospective franchisees to obtain independent advice, a mandatory cooling-off period, prescription around dispute resolution, or provisions for acting in good faith. These various measures would increase business compliance costs and reduce flexibility for individual franchisee systems, while providing no real benefits for the industry.

We believe the current self-regulatory model, operating within the framework of generic laws, continues to be the best option for the management of franchising systems into the future.

Response to Questions for Submitters

Q1. *Are there any particular features about franchise contracts that mean that potential and existing franchisees require further protection?*

The Foodstuffs companies have been operating franchised retail operations successfully for several decades and the organisation believes the franchise system has been pivotal to the success of its business.

We are not aware of our members facing any significant problems in engaging with Foodstuffs through our franchising model. To the contrary, franchising arrangements have enabled many of our members to achieve success and wealth beyond their initial expectations.

The incidence of disputes with franchisees is very rare and on the very few occasions disputes have arisen, we have always been able to negotiate resolutions that are satisfactory to both parties.

We do not believe there is any evidence of market failure of franchising arrangements in our sector. Nor are we aware of any issues with other franchising systems. In these circumstances we would caution against any intervention by Government.

Q2. *Have problems been defined correctly. Are there other problems?*

We believe the public discussion document has failed to identify any real problems of significance in franchising in New Zealand.

The paper discussed perceived problems, notably around an imbalance of power between the parties, but there is no evidence that the perceived imbalance of power has given rise to “market failure”.

The first identified problem “information imbalance” certainly does not apply to our own franchising arrangements.

Contrary to what is stated in the paper, virtually all new Foodstuffs member franchisees will purchase an existing business as a going concern and therefore have access to historic financial data for the business.

The scale of the businesses and the associated financial and reputational risks are such that only experienced grocery retailers would be given the opportunity to purchase a newly developed store. In such circumstances, extensive business case modelling will have been undertaken which is shared with the selected franchisee.

Further, as all franchisees are individual members and shareholders of one of the Foodstuffs co-operatives, they will have access to all the information that shareholders are legally entitled to.

Also, because our companies operate as co-operatives, franchisees collectively elect the Board of their respective regional company and have further opportunity for input into management through member-committees (training, product ranging etc).

The second identified problem relates to perceived barriers to resolving disputes, particularly the cost of arbitration and litigation. We accept that this may be a problem (although no specific evidence is presented) but would argue the problems associated with dispute resolution are relevant to all commercial contracts, particularly those between parties of unequal size, and are not specific to franchising.

The third problem to be identified relates to contractual power imbalance, particularly the ability of franchisors to terminate franchise agreements without just cause. The discussion paper suggests this may be an issue specific to the petrol and motor vehicle industries and while we are unable to comment on this, we can say that it is not an issue for our own franchising system, which provides protections for franchisees against such actions.

Before the Government decides whether regulatory intervention is needed, it is imperative that it more clearly define what problems it is trying to solve. It must then demonstrate that these problems are real rather than perceived. If real problems exist, a regulatory intervention should only be considered if the issue is significant, and then only after non-regulatory measures have been discounted. If a problem is specific to an industry/sector, then industry/sector-specific measures should be implemented.

Q3. *What is the magnitude of these problems? Do they apply to the franchising sector as a whole, or are they specific to types of franchising or industries?*

We note that the MED has not been able to find evidence of any significant problems and as far as our industry is concerned, we have not experienced any problems ourselves. However, if there are problems that are specific to other sectors or industries, then the Government should consider how it might resolve those with initiatives that are industry/sector specific. Further, we note that commercial activity is inherently risky and that franchising is no exception. The fact that some individual franchisees fail is not a reason for further regulation.

Q4. *Which options outlined do you favour? Why?*

Foodstuffs favours Option 1 – status quo – generic legislation and self-regulation. The fact that the Ministry has to date been unable to provide any evidence of any market failure in franchising systems is in-itself proof that existing legislation is sufficient to meet the requirements of sector.

Q5. *Have all the options been identified? Are there others to be considered?*

As far as we are concerned, all the valid options have been explored.

Q6. *If information disclosure is to be introduced, which classes of information should be required to be disclosed?*

Mandatory information disclosure is not necessary because the market is working effectively without this requirement. However, if the Government wished to proceed with this option, a separate and more detailed consultation process should occur.

Q7. What are the benefits of each of the options?

Option 1: Status Quo

Under this, our preferred option, franchising systems will continue to operate under generic laws and frameworks as they have successfully done so for many years.

Continuing with this option would be least disruptive to the industry and would provide a high degree of flexibility for market participants to develop arrangements that suit their individual circumstances and needs. Continuing with the status quo would also be the least cost option for both the industry and Government.

Option 2: Education

Education, if properly designed and targeted, can provide benefits, however, we note that FANZ already provides a wide range of information on its website, advising potential franchisees of the things they need to think about in considering buying a franchise. Rather than re-invent the wheel, perhaps Government could work with FANZ to fill any gaps in this information, and further, use its existing public websites to promote this source of information.

Option 3: Franchise-specific regulation

Foodstuffs does not believe there is a need for any further regulation and believes the Government should establish a need for it before it undertakes any further work on possible regulatory tools. If the Government were to decide that franchise-regulation was warranted; further public consultation should be undertaken.

We would however like to make some preliminary comments on the potential tools that are discussed in the consultative paper.

Mandatory Information Disclosure

Mandatory information disclosure has some intuitive appeal, however, is likely to raise the cost and complexity of administering franchise systems. We also note that a one-size-fits-all approach will generally reduce flexibility and responsiveness. In the absence of evidence of market failure in the provision of relevant information to prospective franchisees, we do not support mandatory information disclosure requirements.

Mandatory professional advice

A requirement for all franchisees to obtain independent professional advice will inevitably increase the cost of entry to franchising, particularly for those entering into small business ventures. Further, a requirement that independent advice is taken does not guarantee a prospective franchisee will receive good quality advice.

While we believe it is advisable that prospective franchisees obtain independent professional advice before entering into a franchise arrangement, we do not believe it should be a mandatory requirement. Further, we cannot see the justification for requiring independent professional advice for a franchise agreement, when it is not required for other forms of commercial contract.

In our own circumstances, many of our franchisees have had long-standing relationships with our companies and to mandatorily require them to obtain independent professional advice each time a new franchise agreement is signed e.g. when a new store is purchased, would be an unreasonable burden.

Cooling-off period

The discussion document considers whether there should be a mandatory cooling-off period, enabling a franchisee to change their mind, within a defined period, after they have signed a contract.

Foodstuffs does not support a mandatory cooling off period because in our circumstances a franchise agreement is a significant commercial undertaking and a decision to proceed or not proceed needs to be made before a contractual commitment is made. In the case of a supermarket, the franchisee will be entering a contract which may involve financial commitments from each party in the millions of dollars – it is not something that should be treated lightly.

The ability to cancel a franchise agreement after it has been signed, would, in our view, be an unreasonable risk to the franchisor.

Notwithstanding our views on the matter, a cooling-off period is something that the individual parties may wish to include in a contract and we note that the parties to a franchise agreement are able to negotiate such a clause.

Enhanced dispute resolution

We understand that FANZ already provides a mediation resolution process and we do not believe a Government facilitated mediation service is therefore merited.

Rules for franchising contracts

This option contemplates statutory minimum requirements regarding such matters as the transfer, termination, or renewal of a franchise agreement.

Foodstuffs does not support mandatory provisions in this area, as the diversity of franchise systems and their complexity requires greater flexibility that could be accommodated in standardised minimum statutory requirements.

A supermarket franchise is a significant commercial venture and one that carries substantial risk for the franchisor as well as the franchisee. The scale of the business and associated financial and reputational risk is such that Foodstuffs exerts considerable control over the selection of its franchisees. Currently, franchisees may only sell their business to “approved operators” and Foodstuffs has stringent criteria to vet prospective franchisees for business and financial acumen. Similarly, our franchise agreements enable Foodstuffs to manage the exit of franchisees who fail to meet minimum performance standards or else bring our brands into disrepute. Any mandatory provisions that cut across these arrangements and reduce our flexibility to manage our business as needs dictate would represent a significant and unreasonable increase in the risk profile of our business model.

Good Faith

This option would impose an obligation of good faith on franchisors in relation to their post-contractual conduct. While such a proposal appears reasonable on face value, we oppose a mandatory good faith provision for the disadvantages that are set out in the discussion paper. Good faith is a concept that is both difficult to define and identify in terms of practical application. In our view, the inclusion of a mandatory good faith provision is likely to lead to more litigation, than it will avoid.

Institutional Options

Foodstuffs continues to support a self-regulatory model.

End.