



21 November 2008

Review of Franchising Regulation
Ministry of Economic Development
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RESPONSE TO REVIEW OF FRANCHISING REGULATION - AUGUST 2008

The Commercial and Business Law Committee (the Committee) of the New Zealand Law Society welcomes the opportunity to comment on the discussion document for the review of franchising regulation in New Zealand August 2008 (Discussion Document).

Reasons for Review

The reasons for initiating a review of franchising regulation in New Zealand appear somewhat unusual. As noted in the Discussion Document, alleged scams involving franchises earlier this year concern potential fraudulent activity. Any franchise-specific regulation is unlikely to protect franchisees from fraud, any more than the current law already does. In short, the alleged scams and the proposal to change the legal framework for franchising appear disconnected.

The Committee's view is that, if there is no "demand" for regulation in the area of franchises, such initiative should not be driven by the recent alleged fraudulent activity. If there is such a demand, any regulation should be tailored carefully to ensure the appropriate balance is struck between additional cost and the protection that is afforded.

Anecdotally, the Committee is aware of concerns with the Australian franchise regulation. In particular, it is considered by some (Australian lawyers) to be overly burdensome and costly to franchisors. As is noted in the Discussion Document, given the size of the franchising sector in New Zealand is considerably smaller than in Australia, any over regulation in the area could be seriously damaging to businesses relying on the franchising model.

Question 1

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

The Committee considers that this question is best answered by those with experience as franchisees in New Zealand. As with individual employment agreements, it is commonly recognised that there is a power imbalance between franchisors and franchisees in favour of the franchisor. Having said that, the same imbalance can be identified in distribution agreements, sales and marketing agreements and other contractual arrangements between parties where one party is a large business and the other is an individual. The policy where the line should be drawn and specific regulatory protections implemented, for the party that is regarded as having less negotiating power and/or "more too lose".

As indicated in the Discussion Document, there are good reasons both for and against specific regulation regarding franchise arrangements. Ultimately it may come down to the voice of franchisees, both members of FANZ and others, to establish a case for specific regulatory protection. In the Committee's view there appears to be no urgent need for specific franchise regulations, although there may be good reason for these if the current general law and voluntary FANZ membership are not seen as adequate by franchisees.

Question 2

Have the problems been defined correctly? Are there other problems?

The Committee considers the problems in the Discussion Document accurately identify the "perceived problems" with franchising arrangements, although the Committee is not certain that the "perceived problems" are actually real or have any material adverse impact in New Zealand. There will always be rogue franchisors and rogue franchisees that, for whatever reason, enter into inappropriate franchise agreements without adequate provision for respective rights and obligations. The Committee is cautious about introducing regulation that addresses those operators on the "fringe" when market forces might be the best means of removing the rogues.

The Committee would prefer to see efficient access to the Courts improved generally, rather than specific and *ad hoc* tribunals or equivalent established to deal with particular areas of law, unless there are convincing reasons to the contrary. Although outside the scope of this Discussion Document, the Committee would welcome consideration of the monetary threshold for the Disputes Tribunal being increased in an effort to ease the pressure on the District Courts and higher authorities.

Question 3

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

The Committee does not believe that the problems outlined in the Discussion Document are significant in terms of magnitude, but defers to those who have greater experience in the franchising sector, particularly those with experience as franchisees.

The Committee considers that there may be a valid distinction between franchises where the franchisee is both owner and operator of the franchise (operational franchisees) and those where the franchisee owns the franchise but employs or contracts other third parties to operate the business day to day (owner franchisees). An operational franchisee is thought likely to be more vulnerable because the relationship with the franchisor is more akin to an employment arrangement than owner franchisees where the position of the franchisee is more akin to an investor. If regulation of franchises is introduced as a consequence of the Discussion Document, it may be that this distinction would enable regulation to apply to operational franchisees but not owner franchisees, to focus the regulation toward franchisees that are likely to be more in need of the protection that regulation offers.

Question 4

Which of the options outlined do you favour? Why?

As identified above, the Committee does not consider the problems outlined in the Discussion Document as being significant in terms of magnitude and therefore retaining the status quo is a preferred option if the demand for regulation from franchisees is not high.

As a general rule, empowering franchisees with information through effective educational materials is considered preferable to imposing regulation on a sector that appears, in general, to be operating successfully.

If regulation is regarded as a preferred option, the Committee prioritises the sub-options as follows:

1. mandatory information disclosure (limited in a clear and prescriptive manner to material information together with educational material about what further information might be requested by a franchisee before entering into a franchise agreement);
2. enhanced dispute resolution;
3. the imposition of a mutual good faith requirement;
4. a cooling-off period; and
5. specific rules for franchising contracts in the form of a minimum code.

The Committee is of the view that mandatory professional advice is not appropriate for the reasons outlined in the Discussion Document, together with the fact that some franchisees may be “experts” themselves and therefore requiring such persons to seek independent advice adds cost without necessarily adding any benefit.

Question 5

Have all of the options (and sub options) been identified? Are there other options (and/or sub-options) that should be considered?

The Committee does not have additional options or sub-options to put forward.

Question 6

If information disclosure is to be introduced, which classes of information should be included?

As set out in the FANZ Code of Practice, as well as information regarding other comparable franchise operations operated by the same franchisor in New Zealand, and information provided in response to paragraph 11 of Appendix A to the FANZ Code of Practice, specifically include franchise operations that have failed and the reasons why those operations failed (i.e. the Committee does not believe paragraph 11 should be limited to previous franchises in the same territory or site).

Question 7

What are the benefits of each of the options (including any further options)?

The Committee concurs with the benefits generally outlined in the Discussion Document in respect of the various options. The important thing is that the benefits are assessed against the potential cost of the options.

Question 8

What are the costs and risks of each of the options?

Again, the Committee concurs with the Discussion Document in this regard and reiterates that the potential cost to over regulating the franchise sector would be to discourage franchisors from extending global operations to New Zealand.

Question 9

Can you give any estimates of the compliance costs associated with the options?

The Committee considers the cost of advice to a prospective franchisee would typically be higher than the \$1,000 to \$2,000 identified at paragraph 75 of the Discussion Document. Franchising agreements are typically unique to franchisors (i.e. there is no generally accepted "standard" agreement), incorporate by reference various detailed documents regarding policies and systems and, depending on the level of sophistication, can take considerable time to explain the legal effect to clients. Fees in excess of \$5,000 would not be uncommon for comprehensive advice and assistance with negotiations to franchisees. This is a further reason why the Committee considers mandatory legal advice as an undesirable option.

Question 10

With any of the regulatory options discussed, are there potential conflicts with any existing law, such as securities law or company law?

The Committee is not aware of any potential conflicts with existing laws with any of the options outlined in the Discussion Document.

The Committee trusts the comments above are of assistance and it welcomes any further queries. Please address these in the first instance to the Committee Secretary, Diana Brown on (04) 463 2967 or email diana.brown@lawsociety.org.nz.

Yours sincerely

A handwritten signature in black ink, appearing to read "John Horner". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.

John Horner
Convener, Commercial & Business Law Committee