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Review of Franchising Regulation
Ministry of Economic Development
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(By email to franchisereview@med.govt.nz)

REVIEW OF FRANCHISING REGULATION – DEPARTMENTAL COMMENT BY COMMERCE COMMISSION

Thank you for the opportunity to comment on the Review of Franchising Regulation.

The franchise area is squarely covered by the existing provisions of the Fair Trading Act. Section 22 of the Act states:

Fair Trading Act 1986 (the Act)

22. Misleading representations about certain business activities—

(1) No person shall make a representation that is false or misleading in a material particular concerning the profitability or risk or any other material aspect of any business activity that that person represents as one that can be, or can be to a substantial extent, carried on at or from a person's place of residence.

(2) No person who invites, whether by advertisement or otherwise, persons to engage or participate, or to offer or apply to engage or participate, in a business activity requiring—

(a) The performance by the persons concerned of work; or

(b) The investment of money by the persons concerned and the performance by them of work associated with the investment—

shall make, with respect to the profitability or risk or any other material aspect of the business activity, a representation that is false or misleading in a material particular.

Over the last twelve months, apart from the high profile cases taken up by other agencies, (i.e. Green Acres and the SFO), the Commission has registered approximately 40 enquiries/complaints in regards to franchising issues. The most common types of franchise complaints concern:

- misrepresentations in relation to the profitability of the venture;
- guarantees of volume of work;
- misrepresentations about the goods/services which are the subject of the franchise; and
- misrepresentations about the area covered by the franchise, or the extent to which it is an exclusive area.

The Commerce Act 1986

The experience of the Competition Branch of the Commission has been that few if any enquiries or complaints are received that raise the issue of whether a franchise arrangement might have breached the Commerce Act.

The better known franchises (such as for fast food brands) operate in competitive markets, and the operation of these franchises is unlikely to be in conflict with the Commerce Act. However, given that the MED discussion document reveals that there are about 350 active franchise arrangements in New Zealand, it is possible that some of the less well-known arrangements might have market power.

Given our lack of information on the full range of the markets in which franchisors operate, it would require more information than is currently available on what these markets are to identify those where the possibility of market power might be an issue.

In principle, a situation of market power could exist if the franchisor controlled most of the supply of a key input required by the franchisees. It could arise also if there were barriers to entry in the market served by the franchisees. These are hypothetical situations, as no likely cases come readily to mind.

One provision of the Commerce Act that reduces the likelihood of franchise arrangements breaching the Act is s.33. This provides that joint buying and promotion arrangements are exempt from the application of s.30 (the section that deals with price fixing).

In an unusual situation where a franchise arrangement did have market power, there could be issues under s.27 (which prohibits contracts, arrangements or understandings that substantially lessen competition), under s.30 (in relation to selling prices), and s.36 (taking advantage of market power).

However, given the virtual absence to date of any requirement for the Competition Branch to investigate complaints about franchise arrangements, there does not appear to be any need either for additional powers in the Commerce Act or for new legislation to cover competition in markets in which franchise arrangements are found.

Evidence

Conditions are often not clearly stated on contracts, or are supplemented with verbal assurances made by the franchisor or their agent - which from an evidential point of view pose difficulties in proving an offence. Often problems become apparent some time after the initial contract is signed and rely on the memory of the parties involved as the disputed matters usually include verbal representations. Although a mandatory disclosure requirement may be beneficial and may assist in preventing some franchising issues from arising, in the Commission's view the ability of general consumer law to secure compliance in this sector should not be underestimated.

Although the Commission has historically taken some enforcement actions in the franchise area, more recently the Commission has declined to investigate the majority of complaints received were more suitable for private action. In this sector, fair trading complaints are often intertwined with contractual issues wherein evidence can be difficult to establish - particularly in the criminal context - with much of the allegations being based on future events and verbal representations.

It would appear that many people entering into franchising agreements are not seeking independent legal advice, even though they have had little or no previous experience in running a business. Education in this area should be part of any solution, to ensure that independent advice is sought.

The Commerce Commission as sole enforcement agency

In our submission the Commission is the most effective and efficient enforcement agency, rather than a co-regulatory approach or an industry-specific regulator. Any co-regulatory approach or the setting up of a new body would involve costs in setting up of that body.

The Fair Trading Act sets out clear generic rules based on a number of clear principles. Over time these have effectively been extended via case law. One of the benefits of this approach is that those principles can be applied to any new area of commercial practice which may develop. It is not easy for traders to find ways around the application of the Fair Trading Act and consequently they must operate in a way that is mindful of the risks and uncertainty associated with conduct which may be in breach.

Ideally the Commission's role in this sector would be restricted to taking policing actions where there was evidence of widespread or significant breaches or where there was a substantial level of economic detriment or significant public interest considerations. It is not considered appropriate for the Commission to become involved in the detail of franchise disputes.

Yours faithfully

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