



SUBMISSION

by

**EMPLOYERS AND MANUFACTURERS'
ASSOCIATION (N) INC.**

**Submission to
Ministry of Economic Development**

On

**Review of Franchising Regulation
in New Zealand**

Prepared on 12 September 2008

1. BACKGROUND

This submission is made by the Employers and Manufacturers Association (Northern) Inc. (EMA).

The EMA is made up of some 8500 member business units covering the New Zealand region north of Taupo. This membership includes approximately 1500 manufacturers ranging from large to SME.

Within our membership there are a significant number of companies and organisations involved in the manufacture, importation, supply, distribution and retail of most product types and the provision of services in a wide range of service sectors including governmental, contractual, tourism, IT, banking, insurance and business advisors.

As an organisation the EMA supports international best practice to be followed and compliance costs are fully addressed in any legislation.

As the leading voice of business in the upper North Island we actively participate in both the submission process and any development of regulatory proposals that may impact on our membership such as those discussed within these proposals

2. CONTACT

For further contact in relation to this submission:

Garth Wyllie
Executive Officer
Employers and Manufacturers (N)
Private Bag 92-066
Auckland

Telephone: 09-3670913
Direct: 09-3670935
Mobile: 021-649900
E-mail: garth.wyllie@.co.nz
Web: www.ema.co.nz

3. Submission Summary Statement

The EMA supports the submission made by the Direct Selling Association however this submission is based on our wider coverage of industry and business.

The EMA supports light handed regulation and where possible the use of industry lead regulation to provide appropriate rules for operation within a sector where the regulation is sector specific.

Franchising is potentially very broad and while the most obvious examples are the business models that have worked well internationally such as McDonalds or Starbucks there are a wide number of businesses that have developed a branch operation structure that has allowed the incorporation of the franchise model side by side with wholly owned branches of the business.

We believe that issues will arise if definitions are not clear and that if legislation is used this is likely to impose significant costs to start up businesses as well as potentially established businesses. We cover these issues in our specific comments.

4. Specific Comment

Definition of Franchising

We support the need to clearly identify what is and what is not franchising as identified by the Direct Selling Association in their submission and to exclude those that business might reasonably class as contracted services working under a common brand.

The EMA has independent contractors who work under the EMA brand who as independent contractors are providing advice and services to business. We do not believe that such contractors should be captured as Franchisees however we see this as a direct danger should legislation be used to provide regulation of the sector.

Therefore we support the use of clarifying the definition to capture only those that have a declared franchise model and use the term within their documentation as being captured.

Exclusion by use of entry thresholds would also assist in any definition and therefore those proposals in this regard by the Direct Selling Association would assist to leave non franchise businesses out of legislation/regulation.

Self Regulation Versus Legislation

The EMA strongly supports the use of self regulation but appreciates that some times that self regulation needs some legislative back up to allow industry led regulation sufficient teeth to deal with free riders or cowboys. Approved codes of practice would appear to be one option in addressing this in a similar manner to the UK

If legislation is required is should be as a back up only to industry and approved codes put forward by the specific industry sectors would appear to be a good delivery model.

In the case of Franchises we do not believe that specific legislation will achieve any more than some form of formal endorsement of the industry code as the benchmark on how the industry should behave

As industry would need to fund the operation any such regulation needs to be low cost however the back up by the Commerce Commission using existing laws such as the Fair Trading Act to ensure that support may be appropriate.

International Alignment

It is important that we do not impose on New Zealand inconsistent rules to those applicable elsewhere in the world however any rules that are imposed should enable New Zealand business to have some confidence that by complying with them they would be able to take their franchise model elsewhere in the world and with minimal change be able to establish that model in other markets.

If specific legislation is considered then alignment with Australia is sensible and also meets the need to provide more harmonisation with Australian law.

Fraud, Scams and Criminal Activity

The document refers to the issue of fraud or scams such as the Green Acres case where deception was used to sign up people to non-existent franchises.

Such activity is already illegal under both the Fair Trading Act 1986 (section 10) and under the Crimes Act 1961 (Section 240)

The EMA believes that no legislation or regulation, industry led or otherwise will prevent deliberate fraud but it may assist in slowing down or catching such fraud earlier.

The issue of liability when a fraud is committed by an authorised agent and where the Franchisor company has the ability to place controls and fails to do so is one area that may need to be addressed. This might be through mandatory public liability insurance or the like which would enforce commercial disciplines on businesses who offer Franchises.

Information Disclosure

We also believe that the Fair Trading Act 1986 (sections 9, 11, 12, and 22) also covers information disclosure at commencement of a Franchise so it may be that this legislation can be used more effectively in this space for those franchise business that are not getting sufficient information to make an informed decision at the time of purchase.

Education is critical to informed decision making and it appears to the EMA that there remains a gap in knowledge about the sort of business information that needs to be requested by potential franchisees or the way that information is packaged.

Such areas as failure rates of franchises, average incomes after costs such as Franchise fees of existing franchises or recourse options if the franchisor fails to deliver promised support are areas that the EMA would see as educational issues as well as information requirements.

The FANZ Code of Practice covers most if not all of these requirements even if not worded in exactly the same way. The use of plain English both within the Code and as a requirement for Franchise agreements may assist greatly in education.

Contractual Imbalance

Unfair contracts are also provided for in terms of common law, the Contractual Mistakes Act 1977 and the Contractual Remedies Act 1979. The latter of these providing the ability of the courts to cancel contracts that are unfair or where they have been entered into due to misinformation or through deception regardless of cooling off.

The problem of the application of common law or the two contractual acts is one of cost and the need to go through the high court in order to set aside a contract. Providing for an arbitrator to hear and hold the power to set aside unfair franchise agreements may be an option.

The EMA believes that the best option is to run such arbitration through a body such as the FANZ where the value of industry knowledge can be tapped into but with the requirement for some level of independence in the actual arbitrator.

Termination or Transfer of Franchises

The issue of termination can be a thorny point since by the time such occurrences happen there is usually some ill feeling by both parties. It is the view of the EMA that some form of appeal process through an appropriate industry arbitrator or mediator might be the best option in addressing this issue. Regulatory obligations outside of this would have limited value and may end up requiring court actions to resolve.

The situation where Franchisees walk away from their business is one to be avoided and providing pre-termination relief options may be a way of addressing this. However it must be noted that when you enter into any Franchise business you are still going into business and there will always be a risk. This risk cannot be regulated away or entirely placed on the Franchisor as risk must be balanced on all participants in a business model.

We do not support any great obligations in this regard being placed on the Franchisor.

The area of transfer of Franchisees can have equally difficult issues with one party wishing to exist the business and the other wanting to preserve the integrity of business model they have developed.

It is important to have clear information on what is acceptable to the Franchisor at the point the agreement is to be entered into but equally it is important to provide for an option to check unreasonable demands on potential transfers of franchises that make the exit from the business too difficult to achieve.