

The Chair  
**CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE**

## **OUTCOMES OF THE REVIEW OF FRANCHISING REGULATION**

### **PROPOSAL**

- 1 This paper details the main themes arising out of the Review of Franchising Regulation and seeks the Committee's agreement that there is not a case for franchise specific regulation.

### **EXECUTIVE SUMMARY**

- 2 Following reports of alleged fraud involving franchises, a review of franchising regulation was initiated by the previous Minister of Commerce last year. A discussion document was released by the Ministry of Economic Development (MED) seeking information on whether there are any unique characteristics about franchising, or widespread issues in the franchise sector that would require franchise specific regulation [EDC Min (08) 15/8 refers].
- 3 MED received 33 submissions which were split roughly evenly in their support for and against regulation. However, on the basis of the submissions and the other available evidence, there does not appear to be a case for regulation.
- 4 Franchising can differ from other ways of doing business as franchise contracts are both relational (leaving many aspects unspecified) and standard form ('take it or leave it') contracts. This means they must be flexible but also cannot be negotiated. This results in a large amount of discretion being given to the franchisor, while the franchisee has an increased amount of uncertainty and risk.
- 5 There is a significant amount of debate about how to define a franchise. Legal definitions of a franchise in countries that have introduced legislation have been criticised for being too narrow, allowing people to structure their business to avoid regulation, or too wide, capturing businesses which are not franchises.
- 6 The types of disputes that can occur in franchising relationships are often either dishonesty disputes (e.g. fraud) or relational disputes. However, there is not enough data available to determine whether disputes that have arisen are widespread or symptomatic of systemic issues in the sector. The issues also do not seem to be unique to franchising and are likely to be common to the wider SME sector. Some problems appear to be the result of a lack of education amongst franchisees and/or a failure to carry out appropriate due diligence before entering into a franchise contract. It is difficult to legislate to remedy this.

- 7 Regulatory options suggested fall within three categories – facilitating due diligence (mandatory information disclosure, mandatory professional advice, cooling off periods), addressing contractual power imbalance (mandatory contractual terms e.g. good faith) and enhanced dispute resolution (mandatory mediation processes). In each case it is unclear that current arrangements are inadequate or that the proposed options would effectively address the perceived problems.
- 8 The introduction of a Franchising Code was also a proposal put to the Jobs Summit, but in light of the Review, the proposal does not appear to be justified.

## **BACKGROUND**

- 9 New Zealand has no franchise-specific laws. We rely on generic business law (e.g. contract law, intellectual property law and fair trading law) and self-regulation of the sector. This is done through the Franchise Association of New Zealand (FANZ) – a voluntary organisation which requires its members (between 40-50% of all franchise systems) to adhere to a Code of Practice and a Code of Ethics. This is a similar situation to other countries such as the United Kingdom, although some jurisdictions, such as Australia and the United States, have introduced franchise-specific laws.
- 10 FANZ estimates that there are just over 400 franchise systems in New Zealand, with approximately 350 of these considered 'active'. The sector supports around 16,000 units, employs an estimated 70,000 people, and has a turnover of around \$16 billion.<sup>1</sup>
- 11 In late 2007 and early 2008, reports surfaced of people being sold non-existent franchises by a master franchisee of Green Acres. This appears to be a case of fraud and the Serious Fraud Office has laid charges against the master franchisee, Keith Lapham.
- 12 However, these reports raised concerns that there could be other issues within the franchising sector that may need addressing. The former Minister of Commerce directed MED to review the current legal framework around franchising and a discussion document was released in August 2008.

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<sup>1</sup> Franchise Association of New Zealand, submission to Commerce Select Committee on the Financial Service Providers (Registration and Dispute Resolution) Bill, 8 March 2008.

## Discussion Document

- 13 The release of the discussion paper was an information gathering exercise. Some potential issues were identified for discussion and feedback was sought on the nature and extent of any problems in the sector and possible options to address them. The potential issues identified were:
- a *Information imbalance:* prospective franchisees need to do their due diligence before entering into a franchise contract but may not have all the necessary information, or know the right questions to ask, in order to make a well-informed business decision;
  - b *Contractual power imbalance:* many franchise contracts confer unilateral rights upon franchisors. An example is the right to terminate the contract with 30 days notice, without due cause. However, it was suggested that this example may only be an issue in the motor vehicle or petrol retail industries;
  - c *Costs of resolving disputes:* legal processes to resolve disputes, such as arbitration and litigation, can be expensive and damaging to the franchise relationship, which relies on cooperation and collaboration; and
  - d *Public perception:* the public's confidence in the franchising sector may have been damaged following the cases of alleged fraud. Public confidence is important so that quality recruits are attracted to the sector, allowing it to continue to grow and develop.
- 14 The options put forward to address any problems within the sector were: maintaining the status quo (generic legislation and self-regulation); education initiatives; or introducing franchise specific regulation which could include information disclosure requirements, obligations to obtain professional advice, a cooling-off period, mandatory mediation processes, minimum contractual terms, and/or obligations of 'good faith' bargaining.

## Views of Submitters

- 15 33 submissions on the discussion document were received from industry associations, law firms, businesses, individual franchisees and academics, both in New Zealand and Australia. A full list of submitters is attached as Annex 1.
- 16 Submissions were split roughly evenly in their support for and against franchise-specific regulation. Those who opposed it tended to argue that there is a lack of evidence that franchising is sufficiently unique or that there are widespread problems in the sector to justify government intervention. Several submitters also expressed concern that the cause for the review appeared to be isolated incidents of apparent fraud which is already adequately dealt with by current laws. The impact of compliance costs on the growth of the sector was raised as a concern, as was introducing regulation to address perception issues.

- 17 Those that supported franchise regulation pointed to the information and power imbalances in franchise contracts. Regulation modelled on the Australian Code (further discussed below) was often supported, especially the elements of mandatory information disclosure and mediation.

### *FANZ*

- 18 FANZ favours the status quo as it does not think that there are any particular features of franchise contracts or widespread problems in the sector which necessitate franchise specific legislation. It does not believe that franchising should be singled out from other forms of business.
- 19 FANZ views the Australian regime as “draconian, too wide ranging in its application, costly in terms of compliance and often ineffective in terms of providing relevant protection to franchisees and potential franchisees”.
- 20 Some submitters expressed dissatisfaction with FANZ and the level of protection it is able to provide. In its submission, FANZ indicated that a review is planned of its Code of Practice and some amendment is expected. The review and any changes may go some way to addressing concerns and show that the sector is taking steps to develop its own solutions.

### *Fair Trading Coalition/Motor Trade Association*

- 21 The Fair Trading Coalition (FTC) is a group of 13 organisations across several industries promoting the interests of SMEs. The introduction of a franchise law has been one of the four areas the FTC has been advocating legislative reform in since it was founded. The FTC sees franchisees as a species of small business particularly vulnerable to exploitation and therefore worthy of special protection.
- 22 The FTC supports the introduction of legislation modelled on the Australian Code to help create the perception of a more equitable and efficient franchising regulatory system. In particular, it advocates *inter alia* disclosure, cooling off periods, obligations to obtain independent advice, protection of the rights of franchisees to form associations, low cost dispute resolution proceedings, and provisions relating to termination and on selling.

### **Australian Franchising Code of Practice**

- 23 Australia introduced the Franchising Code of Practice in 1998 following a report by the 1997 Reid Committee. The Committee found that franchising relationships are open to abuse and, on the basis of complaints made to it as well as other enquiries, it believed that widespread abuses were occurring in practice. The key aspects of the Code are:
- a an obligation to prepare a disclosure document which must be provided at least 14 days prior to signing a franchise agreement;
  - b a seven-day cooling off period;

- c a process to strongly encourage a franchisee to obtain professional advice, supplemented by a certification process that obliges a franchisor to ensure the prospective franchisee is aware that advice should be sought;
  - d continuous disclosure obligations regarding material changes such as sale, legal action and insolvency;
  - e a mediation based dispute resolution process; and
  - f rules relating to the termination and transfer of a franchise.
- 24 There have been numerous inquiries and reviews of the Code since it was introduced, at both the State and Federal levels – three in 2008 alone. This has resulted in several amendments, creating onerous and complex disclosure requirements, leading to increasing compliance costs for franchisors and an ‘information overload’ for franchisees.
- 25 Discussions were held with Australian officials regarding the Code. Graeme Samuel, Chairman of the Australian Competition and Consumer Commission (ACCC), estimated that approximately 1% of the complaints made to the ACCC relate to franchises, a small number given the significance of the sector in Australia. He advised that the concerns often arose due to a failure to take proper precautions prior to entering into a contract i.e. a failure to apply fundamental business practices and due diligence to manage business risk.
- 26 Officials also had discussions with officials from the Department of Innovation, Industry, Science and Research (DIISR), which has policy responsibility for the Code. They suggested that regulation has raised expectations of what the Code can do for people, possibly making it easier for people to complain and contributing to its constant review. The fact it is codified as secondary legislation under the generic provisions of the Trade Practices Act for Industry Codes has meant that governments are subject to significant lobbying pressure to amend the Code every time there is a high profile case in the public. This has created regulatory uncertainty for franchisors.

## **ANALYSIS**

### **Problem**

*Is franchising unique compared to other commercial relationships?*

- 27 Franchising is a mode of doing business based on a long term contract and can be considered as a form of exclusive licensing arrangement. The term is often used loosely to refer to different variations of these arrangements. Business format franchising is where a unique system of doing business is undertaken with a certain amount of control, usually with a trade name or trade mark involved. Product franchising is where a distributor supplies the product of a manufacturer, often with exclusive right to sell within a specific market (e.g. motor vehicles or petrol). In manufacturing franchising, an essential ingredient or technical information is all that is supplied (e.g. manufacturing soft drinks).

- 28 There are several aspects of this way of doing business which differ from some other standard contractual relationships:
- a It is an ongoing relationship, rather than a single buy and sell transaction which may typically be covered by contract law;
  - b Issues of disagreement often cannot be usefully litigated as a court case is likely to destroy an ongoing relationship, whatever the outcome;
  - c There are power imbalances in many franchise agreements and, while these exist in other contractual relationships, the fact that the franchisor controls the use of the trademark and marketing system gives rise to particular market power imbalances. This is because a franchisee's entire business may depend on the trademark and marketing system;
  - d As there are usually a number of franchisees, there can be problems of equity of treatment and there can also be difficulties when a franchisor operates outlets which may compete with franchised outlets; and
  - e Obtaining information prior to an agreement can be difficult.<sup>2</sup>
- 29 Franchise contracts are, to varying degrees, both relational and standard form contracts, which creates some tension.<sup>3</sup> Relational contracts create continuous and long-lasting relationships. They are defined by features of incompleteness and longevity, and must be flexible. Often a high level of discretion is accorded to the parties and the contracts rely on reciprocity and trust developed over time. On the other hand, the individual terms of standard form contracts are not generally negotiated – they are presented on a 'take it or leave it' basis. An imbalance of power results and the lack of negotiation can make it more difficult for the terms of the contract to be fully understood. The combination of these in a franchise contract gives a large amount of discretion being given to the franchisor, while the franchisee has an increased amount of uncertainty and risk.
- 30 Another aspect of franchising is that it is often marketed or seen as less risky than other forms of business because it involves 'proven' systems.<sup>4</sup> It is thus seen by many as a good way to own a first business, especially for young people, immigrants, or those with little business experience looking to be self-employed. This means that there can often be vulnerable groups involved in franchising who may rely to an unreasonable extent on the name and reputation of the franchisor, may not know the information to ask for or fully understand the information they are given to carry out the appropriate due diligence.

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<sup>2</sup> Warren Pengilly, "The Franchising Code of Conduct: Does its Coverage Address the Need?", *Newc LR Vol 3 No 2* (1999).

<sup>3</sup> Gehan Gunasekara, submission 10; Liz Spencer, submission 30; Jenny Buchan, submission 32.

<sup>4</sup> Confidential submission.

*Definitional issues*

- 31 An issue that was raised by many submissions is how a franchise would be defined for the purposes of regulation and whether all types of franchise arrangements would be covered. The complexities in defining a franchise could have a significant impact on the effectiveness of potential regulatory measures.
- 32 The discussion document focussed on business format franchising rather than product or manufacturing franchising given the strong relational nature of the contracts. However, the FTC questioned the distinction arguing that these categories are academic and, in practice, a franchise agreement can have elements of all these.
- 33 Other submitters, who did not consider their business a franchise, questioned whether they would fall within the scope of regulation. For example, Foodstuffs is a cooperative company and queried whether it would be considered a franchise. The Direct Selling Association and the Employers and Manufacturers Association also expressed concern that they could be captured by some definitions of a franchise even though they do not consider themselves to be.
- 34 Therefore, a risk arises that any definition would either be too narrow, allowing people to structure their business so as to avoid legislative requirements, or too wide, capturing business structures that are not franchises.
- 35 In a discussion with Rupert Barkoff, an American lawyer specialising in franchise law and an ex-Chair of the American Bar Association on Franchising, he estimated that 20% of his work as a franchise practitioner is in advising clients on how to design their business model so that it did not fall under the definition of franchise. Conversely, the definition used in Australia has been criticised as being too broad, capturing a wide range of business structures and creating uncertainty for other businesses who are unsure whether they have to comply with the Code or not.

*Types of problems that can arise*

- 36 These characteristics of franchise contracts can contribute to the occurrence of various types of problems and the disputes they lead to fall broadly into two classes. 'Dishonesty' disputes often arise from an information deficit and relate to misleading or inaccurate statements or disclosures, regarding profitability for example. 'Relational' disputes can come about as a result of a power imbalance and can concern issues such as encroachment, or transfer and renewal rights.<sup>5</sup>

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<sup>5</sup> Gehan Gunasekara, submission 10.

- 37 Instances given in submissions of problems that have arisen in franchise contracts include: allegations of unfair termination and an unwillingness to mediate<sup>6</sup>; failure to disclose additional costs and unauthorised charges<sup>7</sup>; and exercising excessive control and lack of options for redress.<sup>8</sup> There has been some media coverage recently of examples of encroachment. In 2008 for example, Subway was accused of flooding the Christchurch market with too many stores and failing to provide appropriate support, with one franchisee entering into bankruptcy.<sup>9</sup>
- 38 However, the submissions did not provide evidence of how widespread these problems are, or whether they are indicative of systemic issues in the sector. Some pointed to a lack of franchising data making analysis of the issues difficult.
- 39 It was suggested that problems and disputes are more common in lower value franchises and those involving less sophisticated business people. One submitter indicated that issues more commonly occur where the initial investment is under \$100,000 and/or involves an 'unsophisticated' business person, especially in the home services sector where many franchisees are immigrants with little or no local knowledge and poor English skills, making them particularly vulnerable.<sup>10</sup> In 2008, there were nearly 4,000 franchisees whose total capital outlay was less than \$50,000.<sup>11</sup>
- 40 In terms of how these issues may affect the success of franchises, there is no indication that the failure rate of franchises is inconsistent with other forms of business. A 2001 National Bank survey of franchising found that 95% of franchisees survive the first three years.<sup>12</sup> In comparison, Statistics New Zealand data shows that of the 62,370 new businesses in February 2007, 83% were still operating in 2008.
- 41 Franchisor failure and insolvency is another issue that was raised. The complexity of the interrelations in a franchise system and the number of franchisees can have a significant impact in the event of franchisor insolvency. If this issue does need to be addressed, it would need to be considered as part of broader insolvency law and not from a franchising perspective.
- 42 Many of these issues do not appear to be exclusively problems with franchising, but issues which can occur in commercial relationships generally. This is supported by the submissions, with several submitters signalling that the extent of the problems was not out of step compared to other contractual arrangements, particularly those involving small to medium sized enterprises (SMEs).

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<sup>6</sup> Alec and Vina Pointon, submission 26; MTA, submission 27.

<sup>7</sup> Confidential submission.

<sup>8</sup> Details withheld, submission 8.

<sup>9</sup> The Press, "Subway franchisee faces bankruptcy", 27 June 2008.

<sup>10</sup> MacDonald Pilcher Partnership, submission 9.

<sup>11</sup> Ken Billot, submission 11.

<sup>12</sup> National Bank & NZ Franchise Association, *Survey of Franchising 2001*.

## Options

- 43 Given the characteristics of franchising described above and the issues they raise, options suggested for franchise specific regulation can be grouped into three themes – facilitating due diligence, addressing contractual power imbalances, and enhancing dispute resolution.

### *Facilitating due diligence*

- 44 Facilitating due diligence by franchisees to address information imbalances is a key aspect of franchising regulation overseas and the FANZ Code of Conduct. This is usually done through mandatory information disclosure – requiring franchisors to give certain information to potential franchisees before an agreement can be entered into to assist them in obtaining the information needed to do due diligence.
- 45 Information disclosure can also be supplemented by mandatory professional advice and/or cooling off periods. Mandatory professional advice would require franchisors to require of their franchisees that they obtain professional advice (e.g. from a lawyer, accountant, business consultant or franchise advisor) on a contract before entering into a franchisee agreement, unless the franchisee waived this requirement. Cooling off periods would allow franchisees to withdraw from a contract within a certain time after signing a franchise agreement if they decided it was not suitable for them.
- 46 However, it is unclear that current arrangements which encourage due diligence are inadequate, or the extent to which the options above would be effective in addressing information imbalances.
- 47 Current processes already contribute to due diligence. For example, a 2003 survey of franchising in New Zealand found that the average total start up costs for franchisees was \$132,000.<sup>13</sup> Most franchisees would need finance for this and would go to a bank, which would require a business plan and sufficient due diligence to have been carried out before a loan is approved.
- 48 Many franchisors already voluntarily comply with some type of disclosure requirements. FANZ's Code of Conduct requires its members to prepare a disclosure document, as well as providing for cooling off periods and strongly encouraging prospective franchisees to obtain professional advice. FANZ has over 220 members, covering between 40-50% of active franchise systems in New Zealand. Furthermore, some reputable franchisors that are not members of FANZ have their own disclosure requirements, such as McDonalds.

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<sup>13</sup> The National Bank, *Survey of Franchising 2003*, p.2.

- 49 Mandatory information disclosure may also be ineffective, especially in targeting vulnerable groups who may not understand or use the information that they are given. Some submitters indicated that often once someone has made the decision to purchase a franchise, further disclosure or encouragement to obtain professional advice is unlikely to change their mind.<sup>14</sup> The cost of obtaining professional advice to help in understanding the information can also be prohibitive, especially in relation to the size of a smaller investment. Despite encouragement to seek professional advice, these groups are likely to turn to family or friends for advice instead.
- 50 Information disclosure only relates to the formation of the contract and not its performance, where issues would usually arise. For example, MTA raised issues with franchisors exercising their rights in regards to three month termination clauses. However, these contracts clearly disclose such clauses yet MTA dealers will still sign. Therefore there is a failure among some franchisees to act on information even when it is clearly presented to them.
- 51 The Australian experience also suggests that options to facilitate due diligence may not achieve the desired outcome. Submitters outlined that while there is extensive disclosure requirements in Australia, there are still major problems as the information is not well understood or acted upon. The numerous reviews since the Code's introduction have led to piecemeal approaches to improving regulation. Critics see the current requirements as overly prescriptive and lengthy. As well as being burdensome and costly to franchisors, franchisees are presented with so much information they can fail to understand it. Or, they are led to believe that they are being presented with everything they require and they fail to carry out adequate due diligence.
- 52 Some submitters also pointed out that there are various ways franchisors are able to avoid providing full disclosure. For example, 10% of franchisors in Australia are trusts so provide limited financial disclosure, making due diligence difficult. By operating through numerous legal entities, a franchisor can also avoid giving the full financial picture of its business network. Getting a credit agency rating was recommended as easier and more effective than disclosure.<sup>15</sup>
- 53 The compliance costs for franchisors of mandating disclosure could be significant. One submitter estimated that if a franchisor engages professional advice in the preparation of a disclosure document, the fees range anywhere from \$1000-\$10,000.<sup>16</sup> McDonalds estimates that the cost of updating its disclosure document in Australia following the last amendments to the Franchising Code of Practice was around \$150,000.<sup>17</sup>

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<sup>14</sup> For example, MacDonald Pilcher Partnership, submission 9.

<sup>15</sup> Jenny Buchan, submission 32.

<sup>16</sup> MacDonald Pilcher Partnership, submission 9.

<sup>17</sup> McDonalds, submission 31.

- 54 There is not strong evidence to suggest that options to address information imbalances would result in better outcomes than the existing processes to encourage due diligence. If information is disclosed which is untrue or misleading, there is the Fair Trading Act in place which prohibits the making of false and misleading statements and several submitters saw this as already providing robust protection.

*Addressing contractual power imbalance*

- 55 A second group of options relates to addressing power imbalances and the unilateral rights conferred upon franchisors under franchise contracts. This could be done by mandating for certain contractual terms to be included in franchise agreements, for example 'good faith' bargaining, or mandatory right of renewal.
- 56 These were options supported by [ ]<sup>18</sup> and FTC/MTA. Others expressed concern and strong opposition, especially regarding 'good faith' because of the uncertainty created by such an obligation and the added potential for litigation.
- 57 'Good faith' is a term which is not unusual in relational contracts. However, there is no consistent or accepted definition of good faith and the courts in New Zealand have been cautious about implying a general duty of good faith into contracts. There are diverging judicial views about whether good faith is to be implied either in all commercial contracts, types of commercial contracts (e.g. franchises), or on a case by case basis, what the precise content of good faith obligations might be, what would constitute a breach of these obligations, and what the consequences should be.
- 58 The common law is therefore unclear and if good faith was legislated for, it would likely take some time before the court established the key principles that would underpin such an obligation in the context of franchising. Where good faith has been introduced overseas, it still does not override the provisions of a contract. In particular, the US has said that good faith does not confer an automatic right of renewal of contracts.
- 59 There is no evidence of widespread abuse of the three month termination provisions referred to by MTA which would justify the introduction of good faith or mandatory right of renewal. The Motor Industry Association (MIA) advised that these clauses are seldom used. From a survey of 16 MIA members, in the five years to October 2008, distributors (the franchisors) exercised their right to terminate a dealership on a no cause basis on 19 occasions. Over the same time period, dealers (the franchisees) exercised their equivalent right 20 times.<sup>19</sup>
- 60 If good faith or mandatory right of renewal was the preferred option, it is unclear that this should only be done for franchising and not other types of contracts. Note that the Ministry of Consumer Affairs is considering whether a prohibition against unconscionable conduct needs to be included in the Fair Trading Act. This would have a wider application than just franchising.

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<sup>18</sup> Note that [ ] submission is confidential.

<sup>19</sup> MIA, submission 12.

*Enhanced dispute resolution*

- 61 A third option is to facilitate dispute resolution in ways that are less costly and may help to preserve the ongoing, interdependent franchising relationship. However, low cost dispute resolution is a generic issue for small business and there does not appear to be anything specific about this to franchising.
- 62 As mentioned, franchising disputes can be divided into two types – dishonesty and relational disputes. Dishonesty disputes mostly relate to breaches of the Fair Trading Act (but also the Crimes Act) and can be resolved through both public and private enforcement. With regard to public enforcement, the Commerce Commission advises that it received around 40 complaints relating to franchises last year and it declined to investigate the majority of them as they were more suitable for private action. The complaints tended to involve fair trading issues intertwined with contractual issues where evidence can be difficult to establish. The Commission has however historically taken enforcement action in the franchise area and the Serious Fraud Office also takes action – for example, against Keith Lapham for the Green Acres case.
- 63 On private enforcement, analysis of court cases involving franchises shows a number of dishonest-related cases being successfully taken by franchisees. Remedies in these cases have included losses being awarded and the cancelling of the contract.
- 64 Relational disputes are not a public enforcement issue as contractual disputes are not public interest matters. Thus, the way to address resolution of these types of disputes would be through mandatory mediation. Again however, it is unclear that there is a problem with current arrangements or the extent to which mandatory mediation would be effective.
- 65 Some submitters stated that franchisees could not afford dispute resolution but there is not significant evidence of a problem with resolving relational disputes in franchising. A survey of court cases involving franchises shows that litigants include small businesses successfully taking cases. Some of these proceedings related to issues such as breach of the franchise agreement and the remedies include losses being awarded and injunctions granted.
- 66 Some contracts also already provide for alternative dispute resolution and this trend seems to be increasing.<sup>20</sup> Mediation is also a requirement of the FANZ membership, although there has been some questions regarding the independence of its process and its limited coverage of franchises.<sup>21</sup> Other organisations, such as the Arbitrators' and Mediators' Institute (AMNIZ) provide dispute resolution services if both parties agree to the process. AMINZ estimates that 70-80% of disputes that enter mediation are successfully resolved.

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<sup>20</sup> MacDonald Pilcher Partnership, submission 9.

<sup>21</sup> AMINZ, submission 33.

- 67 Mediation is only successful if both parties cooperate and are willing to work towards a solution. Therefore, making mediation compulsory for franchise disputes may not necessarily work and could provide an opportunity to further draw out the resolution of disputes. Some disputes would also not be suitable for mediation, such as those relating to trademarks. In some cases, parties may need interlocutory relief to act urgently and mediation would not be appropriate.
- 68 Thus there is not a strong case for making mediation mandatory for franchising. While the costs involved in accessing current dispute resolution processes may be prohibitive for smaller businesses, there are examples of cases being taken, and this 'access to justice' issue is not limited to franchising.
- 69 Note that a recent review of the Disputes Tribunal thresholds resulted in these being increased from \$7,500, or \$12,000 with the consent of both parties to \$15,000 and \$20,000 respectively. This will increase the number of disputes which can go to the Tribunal, particularly helping small businesses.

## **Conclusion**

- 70 Overall, I do not believe that there is a need for the introduction of franchise-specific regulation at this time. There is little evidence of widespread problems within the sector and it is difficult to argue that franchising is unique enough from other types of businesses or contracts to necessitate specific regulation.
- 71 There is also insufficient evidence to indicate that current processes are inadequate to address any issues and it is unclear that regulation would be the answer to any perceived problems. While some see an information imbalance between franchisors and franchisees, others see a lack of understanding among franchisees and a willingness to enter contracts without doing the proper research or due diligence which lead to disputes. It is difficult to legislate to remedy this.
- 72 It is also likely that the risks and costs of regulation would outweigh the possible benefits. These include the small size of the sector in New Zealand which would suffer from potential compliance costs and the difficulty in defining 'franchise'.

## **JOBS SUMMIT PROPOSAL**

- 73 The introduction of a franchising code was also a proposal put to the Jobs Summit, under the 'Helping Firms Survive' work area. It was a Tier II proposal, requiring Government response and Cabinet delegated me policy responsibility for this proposal. With the benefit of a full review process, the proposal does not appear to be justified. Introducing a code is likely to have significant compliance costs and the connection between a code and the creation or preservation of jobs is unclear.

## **CONSULTATION**

- 74 A discussion document was released and 33 submissions were received. Officials also consulted with FANZ, the New Zealand Law Society and the Fair Trading Coalition in the course of developing the discussion paper.

- 75 The Ministry of Consumer Affairs, the Ministry of Justice and Treasury have been consulted on the proposals in this paper. The Department of Prime Minister and Cabinet was informed.

**FISCAL IMPLICATIONS**

- 76 There are no fiscal implications.

**HUMAN RIGHTS**

- 77 There are no human rights implications.

**LEGISLATIVE IMPLICATIONS**

- 78 There are no legislative implications.

**REGULATORY IMPACT ANALYSIS**

- 79 Not required.

**PUBLICITY**

- 80 I propose to post this paper on MED's website. I am also speaking at the 'Franchise Law Reform Symposium', organised by the University of Auckland Business School, to be held 25 June 2009, to discuss where franchising fits in New Zealand's Regulatory Framework.

**RECOMMENDATIONS**

81 It is recommended that the Committee:

- 1 **Note** that the discussion document *Review of the Regulation of Franchising* was released in August 2008 and 33 submissions were received;
- 2 **Note** that while submissions were split roughly evenly for and against regulation, there is not strong evidence that franchise contracts are unique from other forms of doing business, or of widespread problems in the franchising sector, which require franchise specific regulation;
- 3 **Note** that where there have been issues raised, the current regulatory framework of generic business law and self regulation is sufficient to address these and officials do not believe that the regulatory options put forward would result in better outcomes;
- 4 **Agree** that there is not a case for franchise specific regulation;
- 5 **Note** that a Franchising Code was a Tier II proposal to the Jobs Summit but in light of the findings of the review, the proposal is not justified;
- 6 **Agree** to the posting of this paper on MED's website; and
- 7 **Note** that I am also speaking at the forthcoming 'Franchise Law Reform Symposium' on 25 June 2009.

Hon Simon Power  
**Minister of Commerce**

Date signed: .

**ANNEX 1 – LIST OF SUBMITTERS**

<b>No.</b>	<b>Name of Submitter</b>
01	Clive Neifeld
02	Franchise Watch [confidential]
03	Cher Borrodale [confidential]
04	Direct Selling Association of New Zealand
05	Employers and Manufacturers
06	Stewart Germann
07	Duncan Cotterill
08	Details withheld
09	MacDonald Pilcher Partnership
10	Gehan Gunasekara
11	Ken Billot
12	Motor Industry Association
13	Foodstuffs (NZ)
14	Franchise Association of New Zealand
15	Barriches Investment Group [confidential]
16	Green Acres
17	Simon Lord [confidential]
18	New Zealand Law Society - Commercial and Business Law Committee
19	Business New Zealand
20	NZ Retailers' Association
21	Restaurant Brands [confidential]
22	Contact Energy
23	DLA Phillips Fox
24	Davenports Harbour Lawyers
25	Westpac
26	Alec and Vina Pointon
27	Motor Trade Association
28	New Zealand Fair Trading Coalition
29	Commerce Commission
30	Liz Spencer
31	McDonalds
32	Jenny Buchan
33	Arbitrators' and Mediators' Institute of New Zealand