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Franchising:
Singapore's
Experience

Overview of the
New Zealand Franchise Market

PLUS

Int'l News | Franchising & Globalisation | 9 Business Development Strategies to Grow Your Franchise



Fast Developing:

An Overview of the New Zealand Franchise Market

By Stuart Germann

New Zealand and franchising go together and the market in relation to franchising is both fast developing and exciting. The population of New Zealand is about 4.2 million with over 350 systems, so that is one system for every 12,000 people which is very high from an international franchising point of view.

New Zealand natives love brands and businesses which succeed and franchising offers people a chance to leave the security of employment and purchase a business which should be successful. However, franchising is not without risks, but following a robust system with an attractive brand will considerably reduce the risk of failure.

Legal Position

There are no franchising specific laws in New Zealand. However, as you would expect, there are existing laws which protect franchisees and probably the three main laws which give such protection are the Fair Trading Act 1986, the Commerce Act 1986 and the Contractual Remedies Act 1989. Those Acts focus in particular on misrepresentations and restrictive trade practices. There is no mandatory disclosure regime in New Zealand, but there is the

Franchise Association of New Zealand (FANZ), which was formed in 1996 when New Zealand broke away from the Australian Association.

The FANZ publishes the Code of Practice and the Code of Ethics and all members of it must comply with both Codes. The Code of Practice has four main aims which are as follows:

1. To encourage best practice throughout franchising.
2. To provide reassurance to those entering franchising, that any member displaying the logo of the FANZ is serious and will practise in a fair and reasonable manner.
3. To provide the basis of self-regulation for franchising.
4. To demonstrate to everyone the positive will within franchising to regulate itself.

The Code applies to all members including franchisors, franchisees or affiliates such as accountants, lawyers and consultants and all prospective new members of the FANZ must agree to be bound by the Code before they can be considered for membership.

In my opinion there are three types of franchisors in New Zealand being:

"Overseas franchisors are always welcome but a competitive analysis should be undertaken to ensure that there would be a market in New Zealand for the particular overseas product or service."

(a) Those franchisors who belong to the FANZ and agree to adhere to its Code of Practice and Code of Ethics;

(b) Those franchisors who are ethical but who elect not to belong to the FANZ; and

(c) Franchisors who are not ethical and who do not belong to the FANZ. It is this last category of franchisors who need to be stopped and their numbers are diminishing thanks in part to the growth of the FANZ in the franchising grapevine in New Zealand. The public has become far better educated in relation to the purchase of franchises and many potential purchasers are put off now if a franchisor does not belong to the FANZ.

What Does the Code Cover?

Compliance - all members must certify that they will comply with the Code and members must renew their certificate of compliance on an annual basis.

Disclosure - a disclosure document must be provided to all prospective franchisees at least 14 days prior to signing a franchise agreement. This disclosure document must be updated at least annually and it must provide information including a company profile, details of the officers of the company, an outline of the franchise, full disclosure of any payment or commission made by a franchisor to any adviser or consultant in connection with a sale, listing of all components making up the franchise purchase, references and projections of turnover and possible profitability of the business.

Certification - the Code requires franchisors to give franchisees a copy of the Code and the franchisee must then certify that he or she has had legal advice before signing the franchise agreement.

Cooling Off Period - all franchise agreements must contain a minimum 7 day period from the date of the agreement during which a franchisee may change his/her mind and terminate the purchase. This is very important and the cooling off period does not apply to renewals of term or resales by franchisees.

Dispute Resolution - the Code sets out a dispute resolution procedure, which can be used by both franchisor and franchisee to seek a more amicable

and cost-effective solution. The Code requires all members to try to settle disputes by mutual negotiation in the first instance and this process does not affect the legal rights of both parties to resort to litigation.

Advisers - all advisers must provide clients with written details of their relevant qualifications and experience and they must respect confidentiality of all information received.

Code of Ethics - all members must subscribe to the Code of Ethics which sets out the spirit in which the Code of Practice will be interpreted.

All franchisor members of the FANZ, must have a Franchise Agreement which contains a dispute resolution clause and a cooling-off provision. In order to resolve disputes, mediation is the favoured method and is working very well in New Zealand. It has a high success rate in relation to franchising disputes and that is probably because both parties respect each other and wish to continue their relationship. However, if mediation does not work then there is always litigation, which is certainly at the divorce stage of the relationship.

International Aspects

There is no present move by the New Zealand Government to introduce franchising legislation, so that makes New Zealand an attractive market for international franchisors. New Zealand encourages and welcomes overseas systems whose current master franchise agreements or unit franchise agreements usually need minor amendments. For example, the restraint of trade clause, legislation and the governing law clauses are the usual areas where changes need to be made.

Professional taxation advice should be obtained and New Zealand has Double Tax Agreements with numerous countries overseas, including USA, UK and Australia. These Agreements generally limit the taxing rights of each country (depending on the type of income derived), as well as helping to reduce double taxation. For example, most Agreements limit the foreign country's tax on royalty payments to 10%.

Good Faith

Contract law governs the legal relationship between the parties to a franchise agreement. The Courts in New Zealand may be willing to imply a duty of good faith into franchise agreements, which stems from an overseas trend to imply such a duty because of the special relationship between the parties. Since the *Dymocks* case in the High Court and the subsequent appeal cases to the Court of Appeal and the Privy Council in 2004, a number of legal writers have argued whether the contractual relationship between the franchisor and the franchisee, is of such a special nature that a duty of good faith and fair dealing can be implied. Hammond J put this view forward in the High Court, but it was firmly rejected by the New Zealand Court of Appeal. It was discussed briefly by the Privy Council on final appeal, but the judgment of their Lordships did not require them to make any final decision in respect of that issue. However, Lord Browne-Wilkinson when commenting on the Court of Appeal suggestion that "there is no room for superimposing a general duty of good faith, that to do so conflicts with requirements of certainty in commercial contracts" stated:

"These comments suggest that, in their view, the development of the law so as to make an obligation of good faith implicit in the relationship between franchisor and franchisee, (as in the case of partnerships and other joint venture agreements), is not desirable. Their Lordships proposed to express no concluded view on these comments and wish to reserve their opinion on the suggestion that the implication of an obligation of good faith and the relationship between franchisor and franchisee would be an undesirable development."

In Australia there was a recent Court of Appeal decision, *Esso Australia Resources Pty Limited v Southern Pacific Petroleum NL*, which stated that no general duty of good faith arises in commercial contracts and such a duty would only arise where it is necessary to protect a vulnerable party from exploitative conduct. However, the franchising relationship is different and, like New Zealand, the Australian Courts are ready to imply a duty of good faith and fair dealing.

Choose the Party Carefully

It is important to make sure that all parties are correctly described. It is quite common for a franchisor to operate under more than one company so, if that is the case, you should ensure that the

company which is described as the franchisor, is the one under which the franchise is operated and also that it is the company which has the rights to franchise. Where the franchise system has originated from overseas, it is important to ascertain that the franchisor named in the agreement is the company carrying on the business in New Zealand and that it has authority to do so.

Franchisor Dangers

It is crucial for franchisors, whether they be New Zealand franchisors or franchisors based overseas, not to overstate the financial position and success of their franchised businesses in New Zealand. Existing laws which cover misrepresentation are robust and dangerous and great care must be taken. As I said earlier, franchisors who belong to the FANZ, must publish a disclosure document to give to prospective franchisees, before the franchise agreement is executed. It is acceptable for overseas franchisors to give the New Zealand master franchisee or the unit franchisee, whichever is the case, a copy of the disclosure document being used or the UFOC if it is a US franchisor. However, if this course of action is followed, then there should be a caveat provided to the New Zealand master franchisee or franchisees, along the lines that the overseas disclosure document or UFOC of the franchisor, is being provided by way of background information only, it has not been amended for New Zealand conditions and it must be read in that light.

New Zealand is a sophisticated market and is very deregulated in relation to small to medium sized business. Overseas franchisors are always welcome, but a competitive analysis should be undertaken to ensure that there would be a market in New Zealand for the particular overseas product or service. Food franchises go down well as we are big eaters, but we are also keen on fitness, leisure activities and home services. From a legal point of view, New Zealand has a robust legal system which can be relied upon. The FANZ is very successful by promoting self-regulation and high standards in franchising, and its Code of Practice is widely understood and accepted by the majority of franchisors in New Zealand.



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