

Review of Franchising Regulation in New Zealand

Discussion Document

August 2008

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Information for submitters

Written submissions on the issues raised by the discussion paper are invited from all interested parties. The closing date for submissions is Friday 21 November 2008.

Submissions should be sent to:

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It would be useful if submissions sent in hard copy or faxed were also provided in electronic form (Adobe Acrobat, Microsoft Word 2000 or compatible format).

Submissions will be considered by officials in the preparation of advice to Ministers concerning the regulatory framework around franchising.

Specific questions have been posed to submitters in boxes at the end of some sections. The full set of questions appears after the Executive Summary. Broader comment on the issues will also be welcomed.

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Executive Summary

'Franchising' can be viewed as a form of licensing distribution arrangement, but the term is often used loosely to refer to one or more types of these arrangements. Unless otherwise specified, this discussion document relates to business format franchising. Business format franchising is a mode of doing business based on a long-term contract. The relationship between a franchisor and franchisee in this situation is collaborative and interdependent, but it is also unequal. Because a franchisor has its name and reputation at stake, it is often able to exert considerable control over the operations of a franchisee's business.

In New Zealand, there is no specific law governing franchising. Franchise agreements are subject to a range of generic laws such as contract law, intellectual property law, consumer law and competition law. There is also self-regulation of business format franchising. This is done through the Franchise Association of New Zealand Inc, a non-profit body which requires its members to follow a Code of Practice and a Code of Ethics.

Earlier this year, reports surfaced of alleged scams involving franchises. Although these appear to be cases of fraud, which is already suitably dealt with by current laws, it has raised the question of whether the legal framework around franchising needs to be changed to provide more protection to franchisees.

Several aspects of the franchising relationship have been raised to make a case for franchise-specific law. It is important that potential franchisees do their due diligence (thoroughly investigate and evaluate the contract) before entering into a franchise arrangement however, some prospective franchisees may not know what information to ask for. Also, once an agreement has been entered into, if any disputes arise, the adversarial nature, cost and formality of court proceedings may be a barrier to some franchisees from seeking a resolution to these disputes.

It has also been suggested that in some cases the imbalance in contractual power between the franchisor and the franchisee may expose the franchisee to unreasonable commercial risks. This is particularly the case if the franchise agreement confers unilateral rights on the franchisor to amend or terminate the agreement and this right is able to be exercised without due cause. However officials do not have enough evidence to determine the existence or extent of this problem. We are interested in whether this concern is widespread, if it is limited to a particular type of franchising arrangement or industry practice and/or whether it is best addressed by facilitating due diligence and better ways of resolving disputes.

The following options are considered in this discussion document:

- maintaining the status quo
- education initiatives targeted towards both franchisees and franchisors
- introducing franchise-specific legislation, which could include:
 - i. mandatory information disclosure;
 - ii. a requirement for a potential franchisee to seek professional advice, or for a franchisor to recommend that a potential franchisee seeks professional advice;

- iii. a cooling off period;
 - iv. enhanced dispute resolution, such as a mandatory mediation process;
 - v. rules for franchise contracts; and/or
 - vi. an obligation of good faith.
- for each of the franchise-specific legislation options, possible institutional arrangements could include:
 - i. a co-regulatory regime; and
 - ii. a public enforcement regime.

Finally, interested parties are asked to submit views outlining the direct and indirect costs of possible intervention options and how to address transitional issues.

Questions for Submitters

- Q1 Are there any particular features about franchise contracts that mean that potential and existing franchisees require further protection?
- Q2 Have the problems been defined correctly? Are there other problems?
- Q3 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?
- Q4 Which of the options outlined do you favour? Why?
- Q5 Have all of the options (and sub-options) been identified? Are there other options (and/or sub-options) that should be considered?
- Q6 If information disclosure is to be introduced, which classes of information should be required to be disclosed?
- Q7 What are the benefits of each of the options (including any further options)?
- Q8 What are the costs and risks of each of the options?
- Q9 Can you give any estimates of the compliance costs associated with the options?
- Q10 With any of the regulatory options discussed are there potential conflicts with any existing law, such as securities law or company law?

Introduction

Why are we looking at franchising?

1 At the end of 2007 and the beginning of 2008 there were high profile cases of franchise deals going wrong and a number of people being left without the business they thought they had purchased. The Serious Fraud Office is now investigating some of these cases. However, these events raised questions about whether franchisees are sufficiently protected by our current laws and structures. This is why we are carrying out this review.

2 The purpose of this review is to:

- explore whether there is some form of franchise-specific regulation that could enhance the contractual process;
- ensure those entering into franchise agreements have adequate information to make good business decisions; and
- minimise compliance costs which could affect the growth of the sector if any form of regulation is introduced.

What are we interested in?

3 We are interested in hearing your views on the following:

- Is there a problem? If so, how big is it and who is affected?
- Do the current laws and structures (such as the Fair Trading Act 1986 and the Serious Fraud Office) work for franchisors and franchisees?
- What else could be done?

4 This review should not be viewed as a response to the alleged scams involving franchises. While these events have brought franchise issues into the spotlight, the purpose of this review is not to find ways to reduce the incidence of cases of fraud. Rather, it is to explore whether there are gaps in the current law as it relates to franchising, and whether there are steps the government can take to effectively address this.

5 Unconscionable conduct – unreasonable, or harsh and oppressive conduct – has been raised as an issue to be considered in relation to franchising. However, unconscionability is currently being reviewed by the Ministry of Consumer Affairs as a part of its review of the Fair Trading Act and is being considered in a wider context than just franchising. This issue is therefore outside the scope of this review.

Background

What is franchising?

6 'Franchising' can be viewed as a form of licensing distribution arrangement, but the term is often used loosely to refer to one or more types of these arrangements. For example, '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). Another type is a 'manufacturing franchise' where an essential ingredient or technical information is all that is supplied, like in the manufacturing of soft drinks.

7 Unless otherwise specified, this discussion document is primarily focused on a third category of franchising, being business format franchising. This is an internationally popular business method, providing both a growth strategy for small businesses and a competitive advantage to franchisors and franchisees. The franchise relationship can be complex as it is both interdependent and unequal.

8 This mode of doing business is based on a long-term contract and licence, where a business (the franchisor) grants a person or company (the franchisee) the right to operate a copy of its business system for a specified period. A franchisor usually then concentrates on brand building, systems development and support, purchasing and strategic issues, while the franchisee focuses on its own business operations, customer service, staffing and day-to-day matters.

9 The relationship between franchisors and franchisees is thus one of mutual interdependence. Franchisees pay to set up the business, often in a particular area, and are the owners of their own business. They will usually obtain the ability to use the intellectual property (IP), such as a name, symbol, logo or design, the business system and the know-how of the franchisor. Franchisees may also rely on the franchisor to obtain other benefits, such as those associated with national advertising campaigns and having an established support system. They receive their income from successfully marketing a product or service under a promotable brand name.

10 The franchisor is also dependent on the franchisee. The franchisor can gain its income from initial and on-going fees paid by the franchisee, or through supply and distribution agreements. It also has the goodwill associated with its IP at stake and so relies on all franchisees behaving in ways that are fully consistent with the brand. Because reputation is so important for everyone involved, franchise contracts can give broad powers to the franchisor to allow them to exert significant control over many aspects of the franchisee's business.

11 Another aspect to franchising is master, or sub-franchising. This can take several forms, but usually a franchisor grants a master franchisee the right to grant its franchises, rather than dealing directly with the franchisees. This allows the franchisor to concentrate on system development and strategic issues while the master franchisee focuses on regional expansion, recruitment of franchisees and support. These multi-tiered systems can exist not only within New Zealand, but across international boundaries as well.

The franchising agreement

12 A written franchise agreement is central to the franchise relationship. It will set out the obligations of each party, the fees to be paid by the franchisee and should ensure that all likely issues related to the business efforts of the franchisor and the franchisee are addressed. This agreement is accompanied by an operations manual which sets out further details of the relationship and usually allows the franchisor to have significant control over key aspects of the business. The manual will be linked to a clause in the agreement which gives the franchisor the right to make unilateral changes to the manual, allowing them to introduce new mandatory systems requirements, for example.

13 In a recent submission to the Commerce Select Committee,¹ FANZ outlined and commented on some of the typical clauses one would see in a franchise agreement. The table below is a summary of those clauses.

Table One: Summary of Typical Clauses in Franchising Agreement

Clause	Clause Description
Parties	Identifies the parties to the contract. If the franchisee is a company, personal guarantees of directors may be required.
Grant of franchise	Identifies what intellectual property rights are granted, to whom, on what conditions and for how long? These rights are collectively described as the franchisor's system.
Limitations on the grant	Specifies any limitations on the use of the intellectual property or reservation of rights to the franchisor or other parties. The franchise may be limited to a specific location or territory. The territory may be exclusive or reserve the right for the franchisor to sell further franchises or distribute the goods or services through other channels (e.g. the internet).
Term and renewal	Specifies the term of the agreement and any rights for renewal. The term will ordinarily be long enough for the franchisee to generate an adequate return on the initial investment. Renewal may be at the franchisee's option provided preconditions are met (which may include a fee, refurbishment, refresher training, etc).
Payment and fees	Outlines who pays what, when and what happens if payment is not made. If ongoing fees are payable, they may be set as a fixed fee or as a percentage of gross sales. Non-payment may attract sanctions.
Franchisor's responsibilities	The franchisor's core responsibility is to provide the intellectual property. The agreement may provide further responsibilities, such as support, services, training, conduct of marketing activities, provision of system improvements, etc.
Franchisee's responsibilities	The franchisee's responsibilities may be extensively detailed. Key obligations may include complying with the system, only using the intellectual property in the manner authorised, meeting any performance standards, attending training, and cooperating with the franchisor and others in the network.
System compliance	The franchisee must comply with the system as described in the agreement and the operations manual. The agreement normally provides the franchisor with the unilateral right to vary the operations manual so long as the variation is consistent with the agreement.
Transfer	Specifies the circumstances when the franchisor or franchisee may transfer the franchise. Usually the franchisee must obtain the franchisor's consent to transfer. In such cases, the agreement may also specify the grounds for withholding consent or that such consent should not be withheld unreasonably.
Termination	Specifies the circumstances when either party may terminate the agreement. Usually only the franchisor will have an express right to terminate the

¹ Franchise Association of New Zealand Preliminary Submission to Finance & Expenditure Committee on Financial Service Providers (Registration & Dispute Resolution) Bill – March 8 2008
792225

Clause	Clause Description
	agreement early. The grounds for termination may include franchisee insolvency, serious breach of the agreement, or breach and failure to remedy the breach within some specified period.
Consequences of termination or expiry	Outlines what happens on termination or expiry of the agreement. This may include returning all intellectual property and stock to the franchisor, transferring of any leased premises, and taking down all signs, etc. The ex-franchisee may also be bound not to compete in a similar business for some period.
Dispute resolution	Provides for how disputes to be resolved. The clause may outline a process for mediation as a prerequisite to arbitration and/or litigation.

Franchising in New Zealand

14 In its submission to the Commerce Select Committee, FANZ reported that:

- the estimated turnover of the franchising sector is around \$16 billion;
- there are approximately just over 400 franchise systems, an estimated 350 of which are considered 'active'; and
- the sector supports around 16,000 units and employs an estimated 70,000 people.

15 Franchising is a popular business model in industries such as: motor vehicle distribution, automotive retail, servicing and repair, bulky goods retail, specialty retail, quick service restaurants, convenience stores, real estate, travel, finance and mortgage lending, petrol retail, hairdressing, fitness, health and beauty, pharmacy, and home services. Franchising is usually associated with small businesses, but it is a business format that is used by large business as well.

Status Quo

Current Regulatory Arrangements

16 In New Zealand, a franchise is treated as a commercial contract to be negotiated between parties. There is no specific law relating to franchising, but franchise agreements are subject to a wide range of generic laws including contract law, consumer law, intellectual property law, and competition law.

Contract Law

17 Franchise agreements are governed by the general law of contract. This allows contracting parties to arrange their affairs as they choose. Contract law does not inquire as to fairness or equality of the mutual obligations of the parties as it is assumed that they are capable of and will, act to protect their own interests. However, remedies are available for instances of undue influence and misrepresentation.

18 The contract between a franchisor and franchisee will usually regulate matters such as the duration, right of renewal and termination of a franchise agreement, but these matters will be governed by common law if the contract does not specifically address them. This imposes limitations on the ability of the franchisor to control the conduct of the franchisee after the termination of a franchise agreement (i.e. it cannot unreasonably restrain a franchisee from competing against a franchise system after the agreement has been terminated). The common law relating to agency and third party liability can also be relevant, particularly in tiered franchise agreements. Laws of equity may also apply in specific circumstances.

19 The Contractual Remedies Act 1979 allows damages to be obtained if a party entered into a contract as a result of a misrepresentation. It also includes termination rights in certain circumstances for a breach of contract or misrepresentation.

20 Contract law does not take into account the inequality of bargaining positions of the parties, compel a franchisor to renew a franchise agreement, or prevent it from terminating a contract pursuant to the agreement.

Consumer Law

21 Some parts of consumer law also apply to franchising agreements. In particular, the Fair Trading Act 1986 prohibits misleading and deceptive conduct and these provisions may be referred to if a franchisee has entered into a franchise agreement under such circumstances. The Fair Trading Act also has several other prohibitions relating to conduct in trade, including offences in the area of advertising misrepresentations.

Intellectual Property Law

22 Statutory and non-statutory IP rights protect against the misuse of IP. The Trade Marks Act 2002 provides the most important franchise-related statutory property rights. Also, the Copyright Act 1994 protects copyright and section 230 of the Crimes Act 1961 criminalises taking or copying trade secrets. There are common law protections for other non-statutory IP rights as well.

Competition Law

23 In competition terms, a franchise agreement is a form of exclusive dealing arrangement. Most franchising disputes do not raise competition concerns. The franchisor generally has incentives to maximise market share across its franchisees and so will be seeking contractual terms that promote its brand and benefit consumers. The general Commerce Act prohibition on the misuse of a substantial degree of market power can deal with the unusual situation where there might be anticompetitive conduct in the context of franchising. The Act also prohibits other anti-competitive conduct including price maintenance schemes which are relevant in a franchising context.

Self-Regulation

24 As well as these laws, there is also voluntary self-regulation of business format franchising in New Zealand. This is done through the Franchise Association of New Zealand Inc (FANZ), an organisation formed in 1996 which is open to membership by franchisors, franchisees, and professional advisors with an interest in franchising. It is a not-for-profit association and does not receive ongoing government funding.

25 FANZ has over 220 members, covering between 40-50% of active franchise systems in New Zealand. Membership includes large and small franchises, ranging from the franchise divisions of large companies, to the New Zealand operations of international franchises, to independent companies and many smaller companies and other individual entities which are growing through franchising. FANZ also has a number of professional advisor members, including banks, law firms, patent attorney firms, accounting firms, business consulting firms and specialist franchise consulting firms.

26 Members pay a fee to join FANZ and in return, among other benefits, they are able to use FANZ's logo as a sign of credibility. Potential franchisees then know that a franchisor and the franchising agreement comply with certain standards and practices.

27 FANZ has established a framework to promote the growth and development of franchising in New Zealand. This framework involves a Code of Practice, a Code of Ethics and a scrutineering process. The main emphasis of the Code of Practice is on the supply of information to prospective franchisees but it also imposes obligations on franchisors and gives rights to franchisees. The Code requires franchisors to provide franchisees with much of the financial and non-financial information they need to make informed decisions about whether to enter into or renew a franchise agreement. It also provides for a cooling off period, specifies standards of conduct and establishes a mediation process.

28 The scrutineering process allows FANZ to assess and review its members' documents (franchise agreements and disclosure documents) on an ongoing basis. An independent scrutineer assesses these documents against the Code of Practice and the Code of Ethics before a franchisor is accepted as a member. They are also assessed on a regular basis to ensure these documents remain compliant.

29 FANZ operates a complaints committee to investigate possible non-compliance with the Codes. Under the Rules of FANZ, the Board has the power to deregister any member for non-compliance with the Code of Ethics or Code of Practice.

30 FANZ is affiliated with international franchise associations, being a member of the Asia Pacific Franchise Confederation and the World Franchise Council. This allows FANZ to access the latest information on franchising and to receive information on trends that

may be important to New Zealand. These links are also intended to assist New Zealand systems enter foreign markets.

Overseas jurisdictions

31 There is no common approach to the regulation of franchising overseas. Some countries, such as Australia, the USA, Canada, Malaysia, South America, China, Vietnam and several countries in Europe have adopted franchise-specific laws. Other countries, such as the UK, Singapore and Hong Kong have not, and like New Zealand, rely on a combination of generic legislation and self-regulation of the sector. The decision whether to introduce franchise laws in each case has depended on evidence of widespread problems within the sector, the availability of other legislative remedies and cultural factors, such as the general view of the public towards regulation.

32 In those jurisdictions where franchise legislation exists, the focus has tended to be on upfront disclosure of certain information to address the information imbalance between franchisors and franchisees. In Australia for example, the Franchising Code of Practice contains the following elements:

- an obligation to prepare a disclosure document which must be provided to a prospective franchisee at least 14 days prior to signing a franchise agreement;
- a seven-day cooling off period;
- 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;
- a continuous disclosure obligation in relation to material changes such as sale, legal action and insolvency;
- a mediation based dispute resolution process; and
- the rules relating to the termination and transfer of a franchise.

In most countries that have adopted franchise legislation, there is no document vetting or registration of franchisors.

33 On the other hand, some countries have decided against regulating the franchising industry. The topic has been debated several times in the UK, with successive governments concluding that there is not enough evidence to suggest that franchises are more risky than other forms of business to warrant special controls around them. Self regulation through the British Franchise Association is still considered to be the most effective way of regulating franchising.

Problem

34 As mentioned earlier, reports of alleged fraud involving franchises have recently surfaced. Fraud is a matter which is sufficiently addressed by current laws and these reports in themselves are not evidence of a widespread problem in New Zealand's franchising sector.

35 However, it has been suggested that these events show that the current regulatory framework around franchising may be open to abuse. This has brought the debate about whether there is a case for franchise-specific regulation into the spotlight.

36 Officials are not aware of any systemic problems within the franchising sector. But as a contract with commercial risks, there may be aspects of franchising that warrant a strengthening of the legal framework which surrounds it.

37 To identify the aspects of franchising that may need further investigation, officials have considered the different elements of contracting, being the negotiation stage pre-agreement; the post-agreement stage when parties are giving effect to the contract; and arrangements for enforcing rights and resolving disputes. When thinking about these different elements, consideration has been given to the extent to which the franchising arrangement is different from other business models and exposes the franchisee to risk that is not present in other contractual business relationships.

Information imbalance

38 The purchase of a new franchise (as opposed to an existing franchise business) differs from that of an existing business as it usually involves intangible assets – it is a mode of doing business that is being purchased, not the business itself. That means that a potential franchisee will have to evaluate the likely success of the business based on the success of other franchisees in different locations, rather than looking at the financial statements of an existing business.

39 However, there is an information imbalance between franchisors and franchisees who do not always have the relevant information to make an informed decision. Franchisors that are not members of FANZ are not obliged to disclose certain important information to a potential franchisee. There is thus a risk that some franchisees will not be provided with enough information to enable them to do the appropriate due diligence (thoroughly research and evaluate the contract, the system and the franchise opportunity), obtain meaningful advice and make an informed decision when purchasing a franchise.

40 This information imbalance also gives rise to the risk that some poorly structured franchises will go undetected. Anecdotal evidence suggests that some franchisors begin franchising without having good systems or the right structure in place to be profitable. Without the appropriate information, it would be difficult for franchisees to distinguish between these franchisors and those with established and proven systems.

Barriers to resolving disputes

41 Participants in the franchise sector indicate that the existing options for resolving disputes may not always be suitable or accessible, particularly for franchisees. Although complaints can be lodged with the Commerce Commission in certain circumstances, often

the only option available to parties is to take private action. Disputes can be taken to the Disputes Tribunal, but if disputes exceed the Tribunal's thresholds,² parties must look at contractual dispute resolution or going to court. The cost of taking this private legal action can be substantial, involving court costs, legal advice and representation, although these costs may be justified depending on the scale of the dispute. Often, these options can be too expensive for franchisees who, as companies, are not eligible for legal aid (although individuals may be eligible).

42 The nature and length of arbitration or litigation mean that these dispute resolution processes can also be costly and harmful to the franchising relationship. These processes are adversarial and can damage the relationship between the franchisor and franchisee, which relies on collaboration and cooperation. The relationship is also often going to continue after the dispute has been resolved and these existing options for dispute resolution may not work to preserve this.

43 FANZ rules require a member to have an alternative dispute resolution clause in its franchise agreements requiring mediation if either party wants the mediation process to apply. However, there is an exception where injunctive relief is needed to avoid irreversible damage to a party. The mediation process also does not apply to events which justify immediate termination, if such events are clearly specified in the franchise agreement. FANZ has a panel of mediators that have gone through training to ensure they are equipped to deal with franchise disputes. FANZ's mediation model is further discussed in paragraph 86.

Contractual power imbalance

44 Another issue that has been raised relates to contractual power imbalance. In particular, concern has been raised over the ability of franchisors to exercise powers such as cancelling of a franchise agreement without just cause, or unreasonably preventing the transfer of an agreement.

45 This issue has been raised specifically in relation to the petrol retail and motor vehicle dealing industries, which typically use 'product franchising' agreements. There is concern over the ability for large motor vehicle and petrol companies to unilaterally terminate contracts without just cause, imposing significant distress on a franchisee. However, others in the franchise sector indicate that this issue may be specific to the petrol and motor vehicle industries, and is not something that affects the franchise sector or business format franchising as a whole.

46 Common law principles may apply in such cases and officials do not yet have sufficient evidence that contractual power imbalance is an aspect of franchising that needs to be considered. Furthermore, it may be that it is captured by the issue of information imbalance and the lack of full disclosure by some franchisors.

² The Disputes Tribunal will consider disputes for amounts up to \$7,500, or if everyone involved agrees, up to \$12,000. The Tribunal is not like formal courts as there are no lawyers or judges. Disputes are heard by a referee who will either help the parties come to their own solution, or will determine the dispute for them. Any ruling the referee makes is binding and will be enforced by the Courts if necessary.

Public perception

47 These issues, combined with the reports of alleged fraud, may affect the public's confidence in the franchising sector. The whole sector must deal with reputational issues and a perception that franchising may have broader problems could be a harmful one.

48 This uncertainty can impact the decision by a prospective franchisee not only in relation to purchasing a particular business operation but to a franchise generally, affecting the growth of the sector. On the other hand, if potential franchisees have the confidence to invest in a franchise and feel secure that they are not exposed to risk beyond normal business risk, the sector is more likely to grow and develop.

49 Thus there is an argument that regulation may help the growth and innovation of franchising by contributing to high public confidence and attracting a stream of quality recruits to the sector.

Questions

- Q1 Are there any particular features about franchise contracts that mean that potential and existing franchisees require further protection?
- Q2 Have the problems been defined correctly? Are there other problems?
- Q3 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?

Options

Option 1: Status Quo – generic legislation and self-regulation

50 With a few exceptions, the status quo appears to be working well and there is no evidence of widespread problems with the current framework. The generic law prohibits people from things such as making false and misleading claims, and FANZ offers a higher level of supervision. People buying a FANZ franchise know that they are covered by Codes of Practice and Ethics and that they have access to good information about the nature of the arrangements they are entering into.

What are the likely impacts?

51 If the status quo were to continue, the sector would be allowed to develop its own solutions to address the issues identified and the franchise sector would continue to be regulated by those that know it best. FANZ has reported an increase in the number of applications for membership it has received following the cases of alleged fraud. This indicates that franchise businesses are already taking steps to protect and promote their reputation. If a central government agency were to take over the core function of a voluntary organisation like FANZ, there is a sense of potentially reinventing the wheel. There is also a risk that the quality of the regulation would be reduced because of the lack of specialist knowledge of franchising.

52 Another benefit of this option is that it would not impose additional compliance costs on the industry and it would avoid the risk that regulation could slow the growth of franchising in New Zealand. Also, there would be no increase in cost for the government as there would not need to be mechanisms for sanctioning non-compliance.

53 However, the current self-regulatory regime only applies to FANZ members and, although its membership is growing, there are a significant number of franchise systems that are not members. Franchisees of those systems only have the protections provided by generic law and may face high costs to resolve disputes. Furthermore, even in the case of FANZ franchises, FANZ essentially has 'no teeth' to enforce its Codes. It can only sanction (e.g. through some form of publicity), suspend or expel a member for not complying with its rules, which may not be enough of a deterrent for some franchisors.

54 This option is also unlikely to address any adverse perceptions the public has of franchising.

Option 2: Education

55 A non-regulatory option is to launch education initiatives. These could be targeted at franchisees to make them aware of the things to look for and the questions to ask when purchasing a franchise, as well as the importance of seeking advice from professionals experienced in franchising. Education initiatives could also be aimed at franchisors, on the importance of correctly structuring a franchise business and having established systems and procedures in place. The education of immigrants who have English as a second language, and/or may be unaware of New Zealand laws could be another element of this option.

What are the likely impacts?

56 A benefit of this option is that it would increase the awareness among potential franchisees on the steps they should take before purchasing a franchise, and increase the knowledge of franchisors on how to structure and manage a franchise system. As with Option 1, this option would not impose extra compliance requirements on the sector and would avoid the risk that regulation could slow the growth of the franchising.

57 One question this option raises is who would be responsible for designing and carrying out such education initiatives. This leads to another issue regarding whether the government or the sector would bear the costs of this option.

58 FANZ already has a wide range of information on its website advising potential franchisees what to do if they are considering buying a franchise. This information includes the questions that should be asked and the importance of seeking professional advice, and has recently been translated into Korean, Chinese and Hindi.

59 This option could be implemented either alone or in combination with any of the other sub-options outlined in Option 3 below.

Option 3: Franchise-specific regulation

60 Option 3 is to implement some form of franchise-specific regulation. Those that support franchise-specific regulation tend to focus on the need for full disclosure, independent advice and dispute resolution. The following sub-options have been identified as potential forms of regulation and have been grouped in relation to the issue that they address. These sub-options are not mutually exclusive and any, some, or all of the following could be adopted.

Information imbalance

Option 3.1: Mandatory information disclosure

61 This option would require franchisors to give certain information to potential franchisees before an agreement can be entered into to ensure that potential franchisees have the information needed to do their due diligence.

62 Information disclosure is a key aspect of the FANZ Code and the mandatory code in Australia. However, the Australian regime requires considerably more information to be disclosed and information must also be disclosed annually, if requested, to any franchisee, not just to potential franchisees before a contract is signed. The information that members of FANZ are required to disclose is outlined in clauses 14 and 15 of the Code of Practice (see Appendix 1).

What are the likely impacts?

63 The benefits of this option are that it would help to address the problem of the information imbalance, as potential franchisees would be supplied with the information they need to do their due diligence and make informed business decisions. This could then have flow-on effects, possibly reducing the number of contractual disputes that may arise and the need to go to court.

64 The costs of this option could be relatively low. Once the franchisor has set up the basic information, it would not be too costly to keep it up to date for release to other prospective franchisees. This however depends on the nature of the information to be disclosed and whether disclosure is only required before a contract is entered into, or if disclosure is on-going. In Australia, the disclosure requirements have grown significantly from when the code was first introduced and concerns have been expressed that the compliance costs for franchisors are onerous.³

65 For example, a member of the Franchise Council of Australia has indicated that when disclosure was voluntary, his company's disclosure document was around ten pages. After the introduction of the Franchising Code it was around 20 pages, and following the latest review of the code, it is now almost 50 pages.

66 In the case of multi-tiered franchise systems, there would be questions around who would be responsible to disclose the information (i.e. the franchisor or the master franchisee) and who would be liable if there was a failure to comply with the disclosure requirements. If the franchisor held the responsibility for disclosure and the liability, this could undermine the purpose of the master franchising model – allowing the franchisor to concentrate on strategic issues while the master franchisee focuses on regional expansion, recruitment and support. One option is for the obligation and liability to fall on whoever is party to the franchise agreement. That means that if a master franchisee grants a franchise, it would be their obligation to meet the disclosure requirements, and they would be liable if they did not comply, not the franchisor. The master franchisee could also be required to disclose information regarding the master licence arrangement.

67 Another issue to consider is that overseas franchisors, who already comply with disclosure requirements in other jurisdictions, are not deterred from selling franchises in New Zealand because of a different set of disclosure requirements. Thought needs to be given to the extent to which these franchisors can use the disclosure documents they already prepare to comply with any requirements in New Zealand. One option to address this issue could be to empower the New Zealand regulator to recognise overseas disclosure documents which have a New Zealand supplement.

68 Although this option would help to address the information imbalance, there is still a risk that franchisees will be given all the relevant information but not understand what it means or do their due diligence and use it to make an educated decision. One way of looking at this is that the government should go no further than correcting the information imbalance, and if potential franchisees fail to use the disclosed information effectively then they must take responsibility for that failure. In this sense, this option is related to Option 3.2 below, requiring franchisees to seek professional advice.

Option 3.2: Mandatory professional advice

69 This option would require franchisors to require of their franchisees that they obtain professional advice (from a lawyer, accountant, business consultant or franchise advisor

³ See for example, 'Franchising code flawed: experts', <http://smallbusiness.smh.com.au/managing/management/franchising-code-flawed:-experts-908809376.html> (23 June 2008), which outlines why some of the requirements of the code may be difficult to implement and lead to higher compliance costs. For example, the mandatory inclusion of commencement dates on contracts before signing may be difficult to implement in practice and leave franchisors liable for the initial upfront investments in fit-out and leasing deals.

for example) on a contract before entering into a franchise agreement, unless the franchisee waives this requirement.

70 This is a feature of the Australian Code. Under the Code, before an agreement can be entered into, a franchisor must receive statements signed by an independent legal adviser, business adviser or accountant certifying that the prospective franchisee has been given advice about the franchise agreement. Alternatively, the prospective franchisee can sign a statement saying that they have been given professional advice on the agreement, or that they have been told that they should seek advice but have decided not to.

71 FANZ also has a similar provision in its Code of Practice (see clause 11.2 of the Code and FANZ's recommended statement for franchisors to include in the disclosure document regarding independent advice).

72 A variation of this option would be to require the party to the contract (the franchisor or the master franchisee) to advise the franchisee to obtain professional advice from franchise experts before signing an agreement.

What are the likely impacts?

73 The benefits of this option are that potential franchisees would be encouraged to do their due diligence before entering into a franchise agreement. An independent third-party would be able to review the contract and explain how it would affect the potential franchisee. This would help to address the problem of information imbalance.

74 If franchisees understand more fully the terms of the contract and how it will affect them, this could possibly prevent some disputes from arising and in turn would help to address the problem of the high cost of going to court.

75 The costs of this option would be those borne by the franchisee in getting professional advice. Sector participants estimate that the cost of obtaining legal advice for example could range from \$1000 to \$2000, although this could be higher depending on several factors such as the size of the documents, the complexity of the franchise, or if the franchise is a multi-tiered system.

76 This requirement would not prevent people seeking advice from the wrong sources. Some professionals may not have the suitable experience with or specialist knowledge of the franchising sector to give appropriate advice and franchisees could end up making poor decisions as a result.

77 Another aspect to consider is that while some franchisees may be vulnerable groups and do not have the sufficient business knowledge, other franchisees may be experienced enough to not need professional advice. For example, they could have purchased a franchise before, or they could be a lawyer and are fully qualified to make their own assessment. Therefore, a requirement to seek professional advice may not be suitable for all franchisees. However, these problems would be overcome under the variation of this option described in paragraph 72.

78 A possible concern with this option is a situation that has occurred in Australia where in one franchise agreement, there was a minor technical fault in the certificate confirming the franchisee obtained advice and this created an opening for a legal dispute. The recent Australian judgement in *Ketchell vs. Master of Education Services Pty Ltd* ([2007] NSWCA 161) found that a franchise agreement was illegal and unenforceable as a

result of a franchisor's non-compliance with this requirement. This has created uncertainty for the sector in Australia and the matter is now before the Australian High Court.

Option 3.3: Cooling off period

79 A cooling off period is a safeguard designed to allow someone the opportunity to change their mind after entering into a contract. This would mean that a franchisee could withdraw from a contract within a certain time after signing a franchise agreement if they decided that the agreement was not suitable for them.

80 A seven-day cooling off period is a feature of both the FANZ Code of Practice and the mandatory code in Australia.

What are the likely impacts?

81 A benefit of this option would be that it would help prevent pressure sales, offering potential franchisees protection from high pressure sales and negotiations. In this respect, it would add a layer of protection to franchisees in response to the information imbalance between franchisors and franchisees.

82 Another benefit is that the compliance costs would be relatively low. It is already standard practice for FANZ members to include a cooling off period in their contracts and it would be relatively simple for other franchisors to include this in their agreements.

83 A possible cost of this option is that a franchisee may be subject to restraint of trade provisions following the termination of the agreement which could be harsh in effect, although if these are unreasonable the generic law will usually hold them unenforceable. Another situation to consider is where a franchisee has already paid a fee and decides to withdraw from the contract as issues may arise around the refunding of money. In Australia, the franchisor must fully refund all payments made by the franchisee within 14 days, less any reasonable expenses if the expenses or their method of calculation have been set out in the agreement. FANZ has a similar provision (see Clause 8 of the Code of Practice).

Barriers to resolving disputes

Option 3.4: Enhanced dispute resolution

84 As mentioned, the current options available to resolve disputes are not always suitable or accessible for franchises. Not only can arbitration or litigation be expensive, but the interdependent nature of a franchising relationship means that these adversarial processes are not always the best way to resolve disputes.

85 Providing for an alternative dispute resolution process, a feature of both the FANZ and the Australian Codes, is one option which could offer a low cost way for disputes to be settled. FANZ requires mediation as a prerequisite if either party wants it before turning to arbitration or litigation, although there is an exception for urgent injunctive relief where needed. There is also an exception if the events in question justify immediate termination of the agreement, if these events are spelt out in the agreement. FANZ has a panel of mediators that have gone through training to ensure they are equipped to deal with franchise disputes.

86 Clause 9 of FANZ's Code of Practice outlines the mediation process. In summary:

- i. Where a dispute arises, the complainant must set out in writing the nature of the dispute and both parties must make every effort to resolve it by mutual negotiation.
- ii. If they are unable to reach a resolution within 21 days, either party may notify the other that it seeks to have the party resolved by mediation.
- iii. If a mediator cannot be agreed upon within 10 days, then either party can apply to FANZ or the New Zealand Law Society for them to nominate one.
- iv. The proceedings are intended to be informal, confidential and on a "without prejudice" basis (i.e. statements made between the parties cannot subsequently be used as evidence in Court). The mediator is required to act fairly, in good faith and without bias and must have regard to the fairness and reasonableness of all matters.
- v. The mediation must be determined within 14 days after referral to the mediator and the parties must report back within 14 days of the end of the hearings on the actions taken as a result.
- vi. If the dispute is not resolved within 45 days of referral to mediation, a party may then commence court proceedings and/or take other action as it sees fit.

The costs of this process are split equally between the parties. FANZ estimates that this is around \$3000 for each party, plus legal costs. Mediation that extends into a second day can incur higher costs.

87 Those systems outside of FANZ can also go through mediation, but only if both parties agree. Otherwise, they can arbitrate or litigate without first going through a mediation process.

What are the likely impacts?

88 This option could help to address the costs of resolving disputes, potentially providing a cost-effective mechanism to settle disputes as well as a more flexible process than arbitration or litigation. This offers a better chance that the relationship between the franchisor and the franchisee will remain intact after the dispute.

89 A mandatory mediation process has been quite successful in overseas jurisdictions. Both the ACCC and the Franchise Council of Australia confirm that the mediation process is effective.

90 However, the success of the mediation process is not guaranteed. Mediation only settles disputes if the parties can both agree – no binding decision is imposed on them without their agreement. This is different from arbitration and litigation where decisions can be imposed on the parties.

91 Establishing a new process and institutional framework for mediation could also be complex. The FANZ mediation process provides a potential model to work from, but this is only one model. A number of issues would need to be addressed, including:

- when mediation is required to take place, whether it is mandatory and if there are exceptions where parties may go directly to court;

- what time frames would apply;
- who can be eligible to be a mediator;
- what happens if the parties cannot agree on a mediator;
- where the mediation is to take place;
- where the costs lie; and
- the relationship to FANZ's existing mediation process and/or any dispute resolution provisions specified in existing franchise agreements.

92 In its recent announcements relating to tribunal reform, the government has also expressed some concerns with ad hoc statutory approaches to resolving certain types of disputes.

93 Given these issues, it may be that the issue of the costs of resolving disputes is better addressed by improving access to existing options for dispute resolution. This could be done through exploring the possibility of providing targeted subsidies for franchisees, similar to legal aid, or by looking at the current thresholds for the Disputes Tribunal for example.

Contractual power imbalance

Option 3.5: Rules for franchising contracts

94 This option would require statutory minimum requirements regarding matters such as the transfer, termination or renewal of a franchise agreement.

95 The Australian legislation contains provisions to regulate conduct in this way. It clarifies the rights of the parties on termination, prevents consent to transfer from being unreasonably withheld, prohibits waivers of liability and ensures the capacity of franchisees to freely associate. See Appendix 2 for an outline of these requirements.

What are the likely impacts?

96 This is an option to be considered if there is sufficient evidence that there is a problem of contractual power imbalance with franchise agreements generally, not just in certain industries or with certain types of franchising. If there were certain statutory requirements, this may help to balance the power between franchisors and franchisees as all franchise agreements would have to meet certain minimum standards. This in turn may reduce the number of disputes that arise over franchise agreements.

97 However, there is a risk that a 'one size fits all' approach to franchise contracts in legislation would be inappropriate. For example, what is suitable for a larger franchisor to include in its contracts may not be suitable or necessary for a smaller franchisor, and could create unnecessary and high compliance costs. Also, what may be suitable for a product or manufacturing franchise may not be suitable for a business format franchise.

98 There are already implied duties in law for a party to act reasonably in certain circumstances within the terms of a contract. This can include giving reasonable notice of the termination of a contract if no notice period is outlined in the agreement.

Option 3.6: Good faith

99 This option would impose an obligation of good faith on franchisors in relation to their post-contractual conduct. What this would require would depend upon the specific circumstances in question. However, a good faith obligation would be likely to have the effect of, amongst other things, requiring a franchisor to have regard to or take into consideration a franchisee's interests when it came to issues such as the termination or renewal of a franchise agreement.

100 Some franchise agreements already contain good faith provisions, and it is a term which is not unusual in relational contracts.

What are the likely impacts?

101 The benefit of this option is that it could provide an additional safeguard for franchisees in relation to the conduct by franchisors after a contract has been signed. A general obligation of good faith may also have the advantage of being flexible enough to cover a broad range of circumstances, and could go some way towards addressing any circumstances, to the extent that they exist, that are not expressly covered by other aspects of the law.

102 However, good faith is a term which is both difficult to define and identify in practice and to date, the courts in New Zealand have been cautious about implying a general duty of good faith into contracts. If such an obligation was introduced, it would be unclear for many franchisors what this obligation would mean, and it would be likely to take some time before the court established the key principles that would underpin a good faith obligation in the context of franchising. In the meantime, there is a risk that this could create uncertainty and confusion in the law, rather than providing protection for franchisees. It may be that it is more appropriate to allow this area of law to develop on a case by case basis as part of existing established principles of law and equity.

103 It is possible that the desired effect of an obligation of good faith could be better achieved by upfront disclosure and a cost-effective mediation process. Pre-contractual disclosure would make a franchisee aware of the terms of termination and renewal and if they were unhappy with these terms, they could reject the contract. A cost-effective mediation process could provide an avenue for franchisees to seek a resolution if they believe that the post-contractual behaviour of a franchisor goes against the franchise agreement.

Institutional Options

104 With all of the sub-options of Option 3, options relating to which institution should be responsible for rule-making, enforcement and mediation need to be considered.

Option 3.7: Co-regulatory regime

105 As outlined, the current self-regulatory model operated by FANZ is operating well for its members. Most of the features discussed above can already be found in the FANZ Code of Ethics and Code of Practice. In considering institutional arrangements, an option is to give statutory backing to this model and create a co-regulatory regime. This could be achieved in one or more of the following ways:

- making membership of FANZ mandatory;

- making the FANZ code mandatory (for example as a mandatory ISO standard); and/or
- creating a statutory franchising body, with membership from the franchising sector, to oversee franchising arrangements (for example, based on the New Zealand Institute of Chartered Accountants model, which is discussed in Appendix 3).

106 A co-regulatory model may be preferred where the technical expertise is held outside of government, where there is a high level of coherence within the sector and flexibility of rules is important. However, such models may suffer if they enable anticompetitive conduct through rule-making by private parties or the public sector has a significant comparative advantage in enforcement. Any co-regulatory regime must ensure alignment of public and private interests, including protection for natural justice of individual parties.

107 Ensuring the quality of regulation provided by a co-regulatory model through funding and the expertise available is also important. Funding of co-regulatory bodies is likely to be through cost recovery on the sector (see 'Costs of Regulation' section below). Having a sufficient pool of available experienced people to draw from is also important to ensure the quality of regulation provided under this model.

Option 3.8: Other institutional options

108 Other institutional options include that a public agency or department could be responsible for enforcing and monitoring all or part of any legislative requirements. This would most likely be the Commerce Commission, as any franchise-specific regulation would be closely linked with the Commission's fair trading enforcement responsibilities. The Commission also has a lot of experience in monitoring information disclosure regimes, although it does not have specific experience with franchising. This raises institutional and funding issues regarding the Commission's capacity to fulfil such a role.

109 Private enforcement is another option, allowing parties to take private action against non-compliance with any legislative requirements. A mixture of public and private enforcement could also be considered.

110 For some of the options, thought could be given to how existing regulatory structures could be used. For example, if mandatory mediation were to be introduced, the possibility of using FANZ's panel of mediators on a cost-recovery basis could be explored.

Costs of regulation

111 As well as the costs mentioned for particular options, there are also general costs associated with any form of regulation. These relate to monitoring and enforcing compliance, or the costs of maintaining a tribunal. This raises the issue of who would meet these ongoing costs. Options for meeting the costs of regulation include government funding or potentially cost recovering on the sector either by franchisee, franchisor or franchise contract for example.

Transitional issues

112 How any legislation applies to new and existing franchise contracts will need to be considered. If it were only to apply to new contracts, this may cause problems for franchisors having one set of contracts that comply with the legislation and another set that

do not. However, as franchise contracts are usually set for a specific term, it is likely that all contracts would eventually come under any new legislation.

Compliance cost implications

113 The compliance cost implications for each option and how would they impact on the growth of the franchising sector need to be considered. After the introduction of the mandatory code in Australia, there was a decline in the growth of the franchising sector. Franchising has since recovered and continues to grow steadily. However, it is unlikely that the New Zealand sector could afford an even temporary decline, given the size of the sector is considerably smaller than in Australia.

Questions

- Q 4 Which of the options above do you favour? Why?
- Q 5 Have all of the options (and sub-options) been identified? Are there other options (and/or sub-options) that should be considered?
- Q 6 If information disclosure is to be introduced, which classes of information should be included?
- Q 7 What are the benefits of each of the options (including any further options)?
- Q 8 What are the costs and risks of each of the options?
- Q 9 Can you give any estimates of the compliance costs associated with the options?
- Q 10 With any of the regulatory options discussed are there potential conflicts with any existing law, such as securities law or company law?

The following clauses have been taken from FANZ's Code of Practice. The FANZ Code also covers other important issues including standards of conduct for members, the requirement for contractual compliance with the FANZ Rules, Code of Practice and the Code of Ethics, "Cooling Off" provisions and dispute resolution processes, as well as independent advice certification and scrutineering processes. A copy of the full FANZ Code can be accessed from their website www.franchiseassociation.co.nz.

Franchising Association of New Zealand Incorporated

Code of Practice

14. DISCLOSURE DOCUMENTS

- 14.1 Franchisor Members will provide disclosure by way of a Disclosure Document in accordance with the provisions of this Code.
- 14.2 The Disclosure Document will be updated at least annually and be provided to all prospective Franchisees at least fourteen (14) days prior to signing a franchise agreement (or, if preceded by the signing of a preliminary agreement, fourteen (14) days before the prospective Franchisee becomes bound by the preliminary agreement to proceed. A Disclosure Document is required to be provided to an existing Franchisee in conjunction with the renewal of the franchise agreement within one month of being requested by the Franchisee.
- 14.3 The Disclosure Document is to comply with such of the contents of this Code as are applicable to the relevant franchise system and the contents of the Disclosure Document shall set a minimum standard which may be exceeded by supplying more information than is necessary.
- 14.4 The financial disclosure contained within the Disclosure Document shall be updated on an annual basis, and shall be provided to any existing Franchisee at any time upon request by the Franchisee.
- 14.5 Franchisors shall be at liberty to add further comment to further explain or clarify the financial disclosure, eg where the Franchisor is a company which is part of a group of companies and the basic information may not present the financial position most appropriately.
- 14.6 Where a Franchisor and a Master Franchisee/Sub-Franchisor both enter into a contractual arrangement with a Franchisee, the Disclosure Document will contain material information in relation to both the Franchisor and Master Franchisee/Sub-Franchisor including financial disclosure relating to both the Franchisor and the Master Franchisee/Sub-Franchisor.
- 14.7 Where the Franchisor is not in a direct contractual arrangement with the Franchisee and the Franchise is granted only by the Master Franchisee/Sub-Franchisor then the Disclosure Document need only contain information relating to the Master Franchisee/Sub-Franchisor and to the franchise system generally.

14.8 Financial disclosure shall be provided by a vendor Franchisee which is a member of the Association to an approved purchaser of that Franchisee's business and such financial disclosure will include the accountant's or auditor's reports as the case may be.

15. DISCLOSURE DOCUMENT CONTENTS

Each Disclosure Document will contain the information required to be shown as set out in Appendixes A and B.

APPENDIX A

Disclosure Document Contents

Each Disclosure Document will contain the following information (and Members are encouraged to show the information in the following order):

- (1) Name and registered office of the Franchisor. State if a member of any other relevant trade or industry association
- (2) Names, job descriptions, qualifications (if any) of the Franchisor's directors/executive officers/principals.
- (3) A detailed resume of the business experience of the Franchisor (and any related entities) and its directors/secretary/executive officers/principals including:
 - (a) Length of experience in the type of business offered in the franchise.
 - (b) Length of experience in operating or offering the franchise.
 - (c) Length of experience in operating or offering other franchises and a description of those franchises.
- (4) A viability statement with key financial information in respect of the Franchisor from the Franchisor's directors/principals in accordance with Appendix B (provided that the requirement to supply the information specified in paragraph (a) of Appendix B does not apply if the statement provided in paragraph (b) of Appendix B is supported by an independent audit provided by an auditor within the preceding 12 months and a copy of the auditor's report is supplied). The information and statements set out in Appendix B shall not be required to be provided by a Franchisor which is a wholly owned subsidiary of a public company whose shares are publicly traded on the New Zealand Stock Exchange where:
 - (a) The Franchisor or its parent company has obtained from the New Zealand Securities Commission an exemption for the provision of separate accounts for subsidiary companies; and
 - (b) The Franchisor provides in place of the information and statements set out in Appendix B the audited annual report of the parent company containing consolidated financial statements including those of the Franchisor.
- (5) Details of any bankruptcies, receiverships, liquidations, or materially relevant debt recovery, criminal, civil or administrative proceedings which are current or have occurred or for which judgment has been entered against the Franchisor (and any

related entities) or any of its directors/executive officers/principals within the last five (5) years.

- (6) A summary of the main particulars and features of the franchise including:
 - (a) The nature and period of existence of the franchise system and how it has developed.
 - (b) Examples of any trade mark, logo, symbol, etc used to market the Franchisor's goods or services and steps taken to protect these and details of any threatened or pending litigation in relation to these.
 - (c) Details of payments to be made by the Franchisee to the Franchisor (including the method of calculation if applicable, and the amount to be refunded by the Franchisor if the Franchisee terminates the franchise agreement within the cooling off period).
 - (d) Particulars of any restrictions imposed on the Franchisee (eg territorial, or the offer of competing franchises).
 - (e) A summary of the terms and conditions for the purchase of services, goods, fixtures, property, etc from the Franchisor and the situation applying if the source of goods/products supplied by the Franchisor fails, plus relevant comments/conditions with respect to rebates etc from suppliers.
 - (f) The basis of Franchisor's involvement/approval for site selection.
 - (g) A summary of the terms and conditions relating to termination, renewal, goodwill and assignment of the franchise.
 - (h) A summary of the main obligations of the Franchisor (including initial and ongoing training to be provided).
- (7) A tabulated list of components making up the franchise purchase eg franchise fee, stock, fixtures/fittings, working capital, etc with (estimated) individual costs, totalled to reflect the full outlay. A summary of those items which could be leased and (estimated) costs involved.
- (8) Details of any financial requirements by the Franchisor of the Franchisee, eg a specific amount of non-borrowed capital towards the franchise purchase price.
- (9) Regarding franchises, Franchisees, and outlets:
 - (a) The number of existing franchises, the number of outlets, and details of Franchisor owned outlets. A list of existing Franchisees (including address and phone number of each and year commenced business) should be available for reference purposes. Should a full list be impractical then a list of all Franchisees in each city or town or region (as appropriate to the circumstances) should be provided.
 - (b) The number of franchises terminated or not renewed over the past year.
 - (c) Details of any current unresolved litigation with any existing or former Franchisees.

(10) Regarding financial projections provided:

- (a) Where written projections are provided with respect to levels of potential sales, income, gross/net profits or other financial projections etc from the franchise or franchises of a similar nature particulars of the basis/assumptions upon which the representations are made shall be provided.
- (b) Each page of the projections should be qualified with respect to its basis/assumptions, for example:

These figures represent ACTUAL performance by either the Franchisor or a Franchisee. There is no guarantee that you will achieve these figures and nor is it intended that you should rely on them as a guarantee.

OR

These figures indicate the gross profit margins and revenue expenses at stated turnover levels which have been experienced by (the Franchisor in its own operations) or (the Franchisees on average in the last profit and loss accounts which have been supplied to the Franchisor). There is no guarantee that you will achieve the same results, nor is it intended that you should rely on them as a guarantee.

And Franchisors should be aware that the issue of these warnings does not, by itself, provide protection from legal claims.

- (c) A clear statement whether or not depreciation and any salary/wages for the Franchisee and the cost of servicing loans are included.
- (11) A statement as to whether the territory or site to be franchised has been subject to any trading activity, particularly a previous franchise in the same franchise system within the previous 5 years, and if so, the history and details including the circumstance of any cessation of the franchise.
- (12) A statement in it indicating that *“this Disclosure Document should help you make up your mind. While it includes some information about your Franchise Agreement, do not rely on it alone to understand your Franchise Agreement. Read all of your Franchise Agreement carefully. Buying a franchise is a serious undertaking. Take your time to decide. You are also required to have the Franchise Agreement explained to you by a solicitor experienced in franchising and you should seek financial advice on the franchise proposition from an accountant experienced in franchising.”*
- (13) A Certificate in the following form or to the same effect *“The Directors (or, if the Franchise is not owned by a Company, the “Proprietors”) of the Franchisor have reasonable grounds to believe that the Franchisor will be able to pay its debts as and when they fall due and the Franchisor is solvent as at today’s date.”* Each Director or Proprietor providing the certificate should sign it, date it and add his or her name legibly underneath their signatures and their office (eg “Director” or “Proprietor”).

- (14) Each Disclosure Document should also be signed and dated at the end by the same persons as are required to execute any Franchise Agreement for the Franchisor each of whom shall also add his or her name legibly underneath their signatures and their office (eg “Director” or “Proprietor”).

APPENDIX B

Franchisor Financial Data Certificates

(a) Franchisor Financial Data

The Franchisor will supply the Franchisee with at least the following minimum Key Financial Data extracted from accounts prepared in accordance with generally accepted accounting practice, together with a signed Statement as below:

Key Financial Data concerning [name] the franchisor, for the last two financial years, extracted from accounts prepared in accordance with generally accepted accounting practice:

	/ /20	/ /20
<i>Current assets</i>	\$	\$
<i>Non-current tangible assets</i>	\$	\$
<i>Non-current intangible assets</i>	\$	\$
<i>Total assets</i>	\$	\$
<i>Current liabilities</i>	\$	\$
<i>Non-current liabilities</i>	\$	\$
<i>Shareholders' equity (proprietors/trust funds, if applicable)</i>	\$	\$

(b) Franchisor Financial Data Certificates

(To be placed at the end of the Franchisor Financial Date section of the Disclosure Document)

We certify that there have been no significant material changes [or as the case may be] in the Franchisor's financial position since the (latest date above) and the Franchisor has reasonable grounds to believe that it will be able to pay its debts as and when they fall due and the Franchisor is solvent as at today's date.

Dated _____

Signed for and on behalf of the Franchisor

Signature: _____

Position*: _____

Signature: _____

Position: * _____

Note: The position of all signatories must be shown eg “Director” or “Proprietor”: Where the Franchisor is a company with two or more directors at least two directors need to sign; where there is only one director, that director must sign. Where the Franchisor is a partnership or a trust a minimum of two partners or trustees must sign; where there is only

one partner or trustee that partner or trustee must sign. Where the Franchisor is a sole trader he or she must sign.

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Requirements of Franchise Agreements in the Australian Code

Association of franchisees

Franchisors are prohibited from inducing franchisees or prospective franchisees not to form an association or associate with other franchisees or prospective franchisees for a lawful purpose.

Waiver of liability

A franchise agreement must not contain, or require a franchisee to sign, a statement that releases a franchisor from general liability towards the franchisee. A franchise agreement must also not contain, or require a franchisee to sign, a waiver of any verbal or written representation that a franchisor has made.

Transferring an agreement

The code provides for the transfer of a franchise agreement to a third party and a franchisor must not unreasonably withhold consent to the transfer. However, in certain circumstances, a franchisor is entitled to withhold consent. These include when:

- the proposed transferee is unlikely to be able to meet the financial obligations under the franchise agreement;
- the proposed transferee does not meet a reasonable requirement in the franchise agreement for the transfer of a franchise;
- the proposed transferee does not meet the franchisor's selection criteria;
- agreement to the transfer will have a significantly adverse effect on the franchise system;
- the proposed transferee does not agree in writing to comply with the obligations of the franchisee under the agreement;
- the franchisee has not paid or made reasonable provision to pay an amount owing to the franchisor; and/or
- the franchisee has breached the franchise agreement and has not remedied the breach.

Termination

The code sets out the specific requirements where parties seek to terminate a franchise agreement, covering three circumstances. These are: where there has been a breach by the franchisee; where there are special circumstances; and where there is provision for the termination of a franchise agreement in the agreement and there has not been a breach of the agreement by the franchisee, and they have not consented to termination.

Co-Regulatory Model: Institute of Chartered Accountants

The Institute of Chartered Accountants is set up under the Institute of Chartered Accountants of New Zealand Act 1996 (hereafter referred to as 'the Act'). While the Act applies to the regulation of an occupation, similar principles may be applied to the regulation of franchising arrangements.

Co-regulatory body

The Act provides for the Institute of Chartered Accountants and outlines its statutory functions. The statute and the rules of the Institute provide for the creation of a number of subsidiary bodies that have specialist functions. The purpose of these separate bodies is to create a clear separation between disciplinary functions, rule-making functions and functions related to providing services to members.

The subsidiary bodies outlined include:

- A governing Council that provides oversight of the executive and is responsible for setting rules, including a Code of Ethics.
- An Executive Board that carries out the work of the Institute and provides services to members.
- A Professional Conduct Committee, which is independent of the Board. It is responsible for investigating complaints about members. It is empowered to make rulings (including imposing sanctions or remedial action), accept consent orders in the case of agreed settlements, or refer serious matters to Disciplinary Tribunal.
- A Reviewer of Complaints Procedures considers complaints regarding the handling of complaints by the Professional Conduct Committee.
- A Disciplinary Tribunal, which is independent of the Board. It runs an adversarial based process to hear serious complaints referred to it by the Professional Conduct Committee. In such cases, a member of the Professional Conduct Committee will be a party to the proceedings and the person subject to the complaint could also have legal representation.
- An Appeals Council which hears appeals from the Disciplinary Tribunal.

Rules are binding

The Rules of the Institute and its Code of Ethics are mandatory for the members. These rules are subject to oversight by the Parliamentary Regulations Review Committee. The Committee may review the content and process by which the rules were set, consider complaints relating to the rules, and call for the rules to be debated in Parliament, including their disallowance.

Protection of 'title'

It is prohibited for any person to use a title holding out to be a member of the Institute of Chartered Accountants when they are not a member.