

# NZ cleans up iron filings

In the first of a two-part series, **Damien Lynch** looks at franchising issues and trends across the Tasman.

New Zealand is an attractive market for international franchisors despite recent reports of an alleged \$NZ4 million (\$3.5 million) fake franchise scam in the country, according to one of the nation's top franchise lawyers, Stewart Germann.

A former franchisee of NZ's home services chain Green Acres is alleged to have sold about 200 people ironing franchises without the company's knowledge. Franchisees on average paid \$NZ20,000 for their businesses.

Green Acres chief executive Andrew Chisholm says the scheme involved an "elaborate, multi-layered deception", including fake franchise documentation, fictitious customers, workloads of clothing purchased from charity shops, a "shifting sea" of bank accounts and a courier system designed to keep all parts of the operation separate from one another.

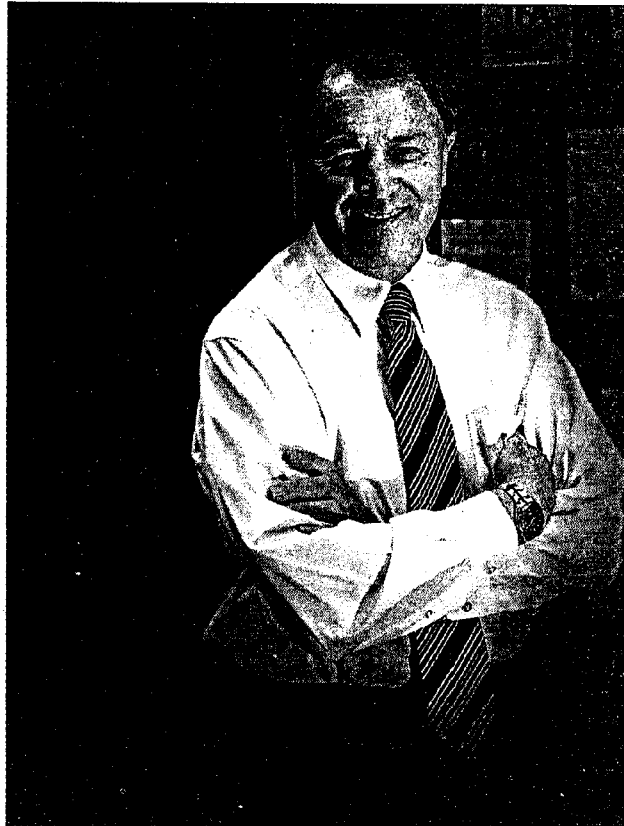
The alleged scam came to a head when 20 unauthorised franchisees made complaints to Green Acres' head office.

But Germann says the alleged scam is unlikely to prompt the NZ government to introduce specific franchising legislation.

Germann says the dearth of red tape and low costs associated with introducing franchising in NZ makes it attractive to franchisors, particularly those from Australia.

A survey of franchising in Australia, released in 2006 by Griffith University, showed 27 per cent of 960 Australian franchise systems were operating overseas. NZ was the most popular destination (76 per cent) because of its geographical, political and cultural alignment to Australia.

NZ's population is about 4.2 million and there are more than 350 franchise systems, one for every 12,000 people.



Auckland-based franchise lawyer Stewart Germann.

Photo: JOHN SELKIRK

Germann says New Zealanders have embraced franchising because they love brands and welcome the opportunity to work for themselves. He says NZ will encourage and welcome overseas systems whose master franchise agreements or unit franchise agreements usually need only minor amendments.

For example, typically the restraint of trade clause in an Australian franchise agreement is described as a "sprinkler clause", which means the franchisor tries to restrain the franchisee from setting up a similar business within a certain distance of an existing premises or territory for a certain time.

"That type of clause does not work in New Zealand for the New Zealand courts would declare such a clause unreasonable and unenforceable, so it must be changed for New Zealand conditions," Germann says. Many Australian franchisors fall into the trap of

trying to say the Australian Trade Practices Act applies in NZ, but it does not. The legislation clause in a franchise agreement must have specific NZ laws inserted.

In NZ, contract law governs the legal relationship between the parties to a franchise agreement. But NZ courts, as in

## "Low costs and red tape make New Zealand attractive."

Australia, may be willing to imply a duty of good faith for franchise agreements, which stems from an overseas trend to imply such a duty because of the special relationship between the parties involved in such agreements.

There are laws that protect those involved in franchising across the Tasman. They include the Fair Trading Act 1986, the Commerce Act 1986

and the Contractual Remedies Act 1989. These acts focus in particular on misrepresentations and restrictive trade practices.

Although there is no mandatory disclosure regime, the Franchise Association of New Zealand (FANZ) publishes a Code of Practice and Code of Ethics and all members must comply with both codes. The Code of Practice covers compliance, disclosure, certification, the cooling-off period, dispute resolution, advisers and ethics. All franchisor members of FANZ must have a franchise agreement that contains a dispute resolution clause and a cooling-off provision.

According to Germann, mediation is the favoured method of resolving disputes in NZ and it works very well.

"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,"

Germann says

In relation to the alleged scam, which did not involve an employee, manager or agent of the company, Green Acres has put forward a rescue package. The company has offered to grant a new franchise directly to each of the 200-plus people who were affected and who meet its standard qualifying criteria. No franchise fee will be payable by those who have already paid full value for what they believed was a genuine Green Acres ironing franchise.

Qualifying criteria include proof of status in NZ and eligibility to own and operate a business, security and reference checks, a current NZ driver's licence and fluency in English. Green Acres will not offer financial compensation.

But the company has met a number of the banks that provided finance and they have agreed to "come to an accommodation" with those affected in terms of interest payments until their new businesses are up and running, as will Green Acres associate company, FBL Finance.

# Test the waters first before diving in

In the second of a two-part series, **Damien Lynch** looks at some of the issues for Australian franchisors considering franchising in New Zealand.

Rod Young, executive director of franchise consultant DC Strategy, says the biggest mistake many Australian franchisors make when entering the New Zealand market is to assume the people and culture are similar to that of Australia.

"It is a different country," he says. "It has grown up with its own culture. The key to successfully moving there is to treat it as an international franchising strategy."

"For example, New Zealand has more large country towns with populations exceeding 50,000 people than does Australia, so with a small, dispersed population, a good local area marketing program is essential for success."

Young cites the example of Donut King, which was hugely popular in Australia almost from the day its branded food arrived in the country. When the company moved to New Zealand, there was an assumption "that New Zealanders would love the donuts too."

But Donut King found the going tough across the Tasman in the early days and had to work hard on selling the product to New Zealanders.

Young says another mistake that some franchisors tend to make is to not understand that most New Zealanders rely on using EFTPOS or credit cards on a daily basis for even the smallest transactions such as a coffee purchase.

Cash-only businesses in New

Zealand can lose up to 30 per cent of their potential sales by not offering the relevant operating facilities to manage card transactions.

Young says Australian franchisors must test their business model, systems and procedures in New Zealand before entering the market, otherwise the exercise may end in tears and disputes.

The majority of franchising litigation in New Zealand stems from misrepresentations made in franchise agreements.

A leading franchise lawyer, Stewart Germann, says one case that clearly illustrates the dangers of not having clear terms in a franchise agreement is *Video Ezy International (NZ) Limited v Cameron* in 2004.

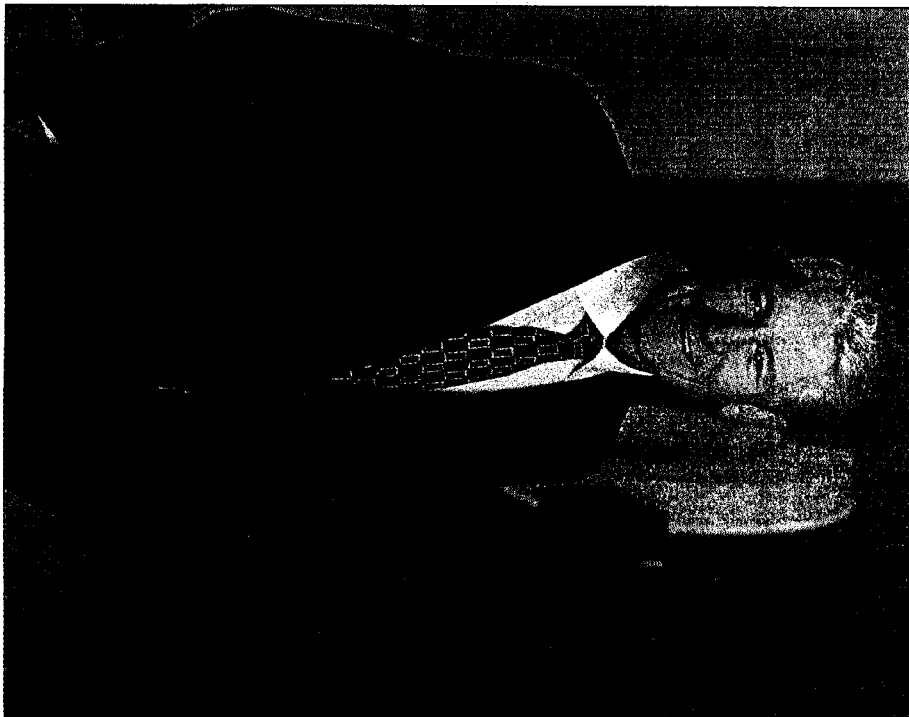
In this case, the franchisor took out an injunction to prevent the former franchisee from starting and operating a rival business after the term of the franchise agreement had expired. The franchisor also wanted to protect confidential material.

After considering the terms of the franchise agreement at some length, the judge refused to grant the injunctions. The problem basically lay in the fact that clause 6.3 of the franchise agreement contained several references to "the franchised business".

But in other clauses within the agreement there were references to "franchised business", a term that was not defined in the agreement. Germann says clause 6.3 had been drafted without care and was ambiguous.

The judge said: "This contract is a muddle, as a result of 6.3. It is a muddle of the parties' own making. I do not think an equitable remedy should be available taking sides in this muddle."

When drawing up a franchise agreement, it is important to make



**DC Strategy's Rod Young says New Zealand is a very different market to Australia.**

sure that all parties are correctly described. Germann says it is quite common for a franchise system to operate under a different company name. If that is the case, you should ensure that the company which operates and has the rights to the franchise is the one named in the

franchise agreement. Where the franchise system has originated 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. Germann warns that a failure to

include confidentiality provisions in a franchise agreement can come back to haunt the franchisor after the expiry or termination of the agreement. He says that it is crucial for franchisors, whether they be New Zealand ones or those based overseas, not to overstate the financial position and success of their franchised businesses in New Zealand.

Franchisors who belong to the Franchise Association of New Zealand must publish a disclosure document to give to prospective franchisees before a franchise agreement can be executed.

## "The key is to treat it as an international franchising strategy."

Overseas franchisors can give their New Zealand master franchisee or unit Franchisee, whichever is the case, a copy of the disclosure documents they use in their own country. For example, an Australian franchisor might provide these people with a copy of the Australian Franchise Agreement or a United States franchisor could provide a uniform franchise offering circular (UFOC), which is tantamount to the disclosure document.

"However, if this course of action is followed, there should be a caveat provided to the NZ 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," Germann says.

"It has not been amended for New Zealand conditions and must be read in that light."