

Franchise

Contributing editor
Philip F Zeidman



2019

GETTING THE
DEAL THROUGH 

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Franchise 2019

Contributing editor
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DLA Piper LLP (US)

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Preface

Franchise 2019

Thirteenth edition

Getting the Deal Through is delighted to publish the thirteenth edition of *Franchise*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on the Netherlands, Poland and Ukraine.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Philip F Zeidman of DLA Piper LLP (US), for his continued assistance with this volume.

GETTING THE
DEAL THROUGH 

London
July 2018

New Zealand

Stewart Germann

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Overview

1 What forms of business entities are relevant to the typical franchisor?

Most franchisors conduct business in New Zealand by way of an incorporated company. Sole traders and partnerships are used and occasionally a franchisor may be a trading trust. Joint ventures are uncommon in New Zealand.

2 What laws and agencies govern the formation of business entities?

The Companies Act 1993 applies to all companies incorporated in New Zealand and to companies with an overseas shareholding. It does not apply to companies incorporated in another country, unless such a company has been registered as an overseas company on the New Zealand Register of Companies. If a trading trust is used, the Trustee Act 1956 applies. The relevant agency is the Ministry of Business, Innovation and Employment.

3 Provide an overview of the requirements for forming and maintaining a business entity.

A new company can be incorporated online at www.companies.govt.nz. The first step is to obtain name approval. Following this, an application to incorporate must be completed, naming all the directors and shareholders of the company, who must sign written consents to act as directors and to become shareholders. The address of the registered office of the company and the address for service must be provided, and both must be New Zealand addresses.

All new companies must be incorporated online. The name approval fee is NZ\$11.50 and the incorporation application fee is NZ\$120.75. Once an overseas shareholder holds 25 per cent or more of the shares in a company, that company must file financial accounts and be audited. Otherwise, if the shareholders pass a unanimous resolution that no auditor need be appointed then the company does not have to be audited. When incorporating a new company it is wise to have a separate constitution, otherwise the provisions in the Companies Act 1993 will apply. For example, any pre-emptive rights will only exist by way of a separate constitution and not in reliance upon the Companies Act 1993.

A company must comply with the Companies Act 1993 and the Financial Reporting Act 2013. In relation to the formation of a company, there are recent changes as follows:

- all companies incorporated in New Zealand must have a director who lives in New Zealand, or lives in Australia and who is also a director of an Australian-incorporated company; and
- all directors must provide their place of birth and date of birth.

In relation to maintaining records with the Companies Office, company authority will be granted to directors and also to certain authorised persons (such as the person who incorporates the company online) allowing them to maintain up-to-date company information on the Register of Companies (such as resignation or appointment of directors, change of addresses, and filing annual returns).

4 What restrictions apply to foreign business entities and foreign investment?

If a foreign business entity holds 25 per cent or more of the shareholding in a company and the company is classed as 'large' (ie, total assets exceed NZ\$60 million or total revenue exceeds NZ\$30 million as at the balance date of each of the two preceding accounting periods), the company must be audited and must file financial statements pursuant to the Financial Reporting Act 2013. In relation to foreign investment, there are no barriers for funds coming into New Zealand. If a foreign entity wishes to buy land in New Zealand and the land is greater than five hectares in area or will result in overseas investment in other 'sensitive' land (eg, foreshore or seabed, public parks and historic land), an application must be made to the Overseas Investment Office for consent to the purchase before it can proceed.

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

The corporate tax rate for both resident and non-resident companies is 28 per cent. New Zealand has tax treaties with many countries – for example, in relation to Australia, Singapore, Japan and the United States the rate of non-resident withholding tax is 5 per cent for royalties; in relation to the United Kingdom and Canada the rate is 10 per cent; and for Fiji, Indonesia, Malaysia and the Philippines the rate is 15 per cent. The non-resident withholding tax must be deducted from all interest and royalty income before funds are repatriated. The overseas entity will be able to claim a tax deduction in the relevant country because a non-resident withholding tax certificate will be provided. If dividends are repatriated, non-resident withholding tax of 15 per cent must be deducted.

6 Are there any relevant labour and employment considerations for typical franchisors?

The Employment Relations Act 2000 applies in New Zealand. Union membership is voluntary, but there must be a written employment contract in relation to every employee of a franchisee. Strict procedures must be followed before employment can be terminated; breach of these procedures could give rise to a personal grievance action that may cost the employer many thousands of dollars. Any properly drafted franchise agreement should contain a clause stating that a franchisor and a franchisee are not in a relationship of employer or employee, but that any franchisee must comply with New Zealand employment law.

7 How are trademarks and know-how protected?

The Trade Marks Act 2002 is the relevant statute and all trademarks must be registered in New Zealand. The relevant body to deal with is the Intellectual Property Office of New Zealand (IPONZ). Trademark registrations last for 10 years and must then be renewed. Know-how is protected by normal intellectual property laws and would be deemed to be included in what are called trade secrets; any properly drafted franchise agreement will include know-how in the definition of intellectual property and should contain a robust intellectual property clause.

8 What are the relevant aspects of the real estate market and real estate law?

All real estate in New Zealand is recorded by Land Information New Zealand (LINZ), which provides a registered title for each piece of land. Titles can be freehold, leasehold, strata, cross-lease or some combination. If the property being purchased is on a unit title (which would mean that there would be a stratum estate of freehold under the Unit Titles Act 2010), an overseas franchisor can own land subject to the procedures set out in question 4. Franchisors can lease commercial buildings without restriction. If real estate agents are engaged, they must comply with the Real Estate Agents Act 2008.

Franchisors who request real estate agents to find them premises will have to pay an agreed commission to the relevant agents. The Property Law Act 2007 is also relevant in relation to real estate and must be consulted.

Laws and agencies that regulate the offer and sale of franchises

9 What is the legal definition of a franchise?

There is no franchise-specific legislation in New Zealand, so there is no legal definition of a franchise. However, the Franchise Association of New Zealand Incorporated (FANZ) was formed in July 1996 and all members must comply with the FANZ Code of Practice. The Code of Practice, in section 2.1, defines 'franchise' as a business operated as a franchise, and that term is further defined in the rules as follows:

'Franchise' means the method of conducting business under which the right to engage in the offering, selling or distributing of goods or services within New Zealand includes or is subject to at least the following features:

- *the grant by a Franchisor to a Franchisee of the right to the use of a Mark, in such a manner that the business carried on by the Franchisee is or is capable of being identified by the public as being substantially associated with a Mark identifying, commonly connected with or controlled by the Franchisor; and*
- *the requirement that the Franchisee conducts the business, or that part of the business subject to the Franchise Agreement, in accordance with the marketing, business or technical plan or system specified by the Franchisor; and*
- *the provision by the Franchisor of ongoing marketing, business or technical assistance during the term of the Franchise Agreement.*

10 Which laws and government agencies regulate the offer and sale of franchises?

No government agencies regulate the offer and sale of franchises. However, there are a number of laws that must be complied with, including the Commerce Act 1986, the Fair Trading Act 1986 and the Real Estate Agents Act 2008. If a broker is used by a franchisor to assist with the sale of franchises, the procedures set out in question 8 will be relevant.

11 Describe the relevant requirements of these laws and agencies.

The Commerce Act 1986 is concerned with anticompetitive behaviour and restrictive trade practices. The Fair Trading Act 1986 is concerned with representations made by any party that amount to misrepresentations that may be innocent, negligent or fraudulent. There are monetary penalties in relation to breaches of both acts.

The Commerce Act prohibits agreements that substantially lessen competition, that exclude competitors, that take advantage of a substantial degree of market power for an anticompetitive purpose, and arrangements which specify a minimum price at which goods can be sold by someone else (often called resale price maintenance).

The Commerce (Cartels and Other Matters) Amendment Act 2017 came into force on 14 August 2017. This means that some additional clauses must be inserted into franchise agreements, plus there must be explanations in plain language of why some of the clauses are necessary.

Consideration must be given as to whether a franchise agreement contains a cartel clause. For example, clauses that set or influence prices, restrict output or allocate markets will be caught. There should

be consideration as to whether there are alternative arrangements that can achieve the same or similar commercial outcome to a cartel clause. Another consideration is whether the collaborative activity exemption would apply and whether the vertical activity exemption would apply. Expert legal advice should be obtained in relation to the new Act.

12 What are the exemptions and exclusions from any franchise laws and regulations?

When the new cartels laws as explained above come into operation then some franchise systems may need to apply for an exemption.

13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

There is no law in New Zealand that would create such a requirement. To become a member of FANZ, the association's rules require a franchisor member to have a written franchise agreement and disclosure document, be financially sound and have the appropriate authorities to franchise, and provide the board with such documentary verification as it requires to support membership.

14 Are there any laws, regulations or government policies that restrict the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers?

There are no laws, regulations or government policies that provide any restrictions in terms of this question. If a franchisor is a member of FANZ it has to provide any franchisee with its disclosure document, the FANZ Code of Practice and Code of Ethics. The Code of Practice states that 'All members shall act in an ethical, honest and lawful manner and endeavour to pursue best franchise practice'. It also provides a cooling-off period for the franchisee and sets out a dispute resolution process to be followed.

15 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

Again, there are no franchising laws requiring pre-contractual disclosure but great care must be taken to ensure that all representations are true and do not amount to misrepresentations that will fall foul of the Fair Trading Act 1986. A member of the FANZ must provide a potential franchisee with its disclosure document at least 14 days before the franchise agreement is executed, and the disclosure document must be updated at least annually by the franchisor.

16 In the case of a sub-franchising structure, who must make presale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Legally, none is required. However, if a franchisor belongs to the FANZ, it must comply with the Code of Practice and publish a disclosure document. A sub-franchisor would have to provide a disclosure document to a potential sub-franchisee if that sub-franchisor was a member of the FANZ.

17 What information must the disclosure document contain?

The disclosure document must provide:

- the name, registered office and physical business address of the franchisor;
- the names, job descriptions and qualifications (if any) of the franchisor's directors, executive officers or principals;
- a detailed curriculum vitae of the business experience of the franchisor (and any related entities) and its directors, secretary, executive officers or principals;
- a viability statement with key financial information of the franchisor;
- details of any bankruptcies, receiverships, liquidations, placements in administration or appointment of a statutory manager, or materially relevant debt recovery;
- details of criminal, civil or administrative proceedings within the past five years;
- a summary of the main particulars and features of the franchise;
- a list of components making up the franchise purchase;

- details of any financial requirements by the franchisor of the franchisee;
- details of existing franchises, number of outlets and franchisor-owned outlets, those franchises terminated over the past two years, any unresolved litigation; and
- other information listed in the Code of Practice.

18 Is there any obligation for continuing disclosure?

The short answer is no, in relation to the Code of Practice of the FANZ. The Code of Practice does, however, provide that the disclosure document be updated at least annually, including the financial disclosure contained in the disclosure document. Also, if there have been any material changes since publication of the disclosure document and a franchisor does not disclose these to a potential franchisee who subsequently signs a franchise agreement, the franchisee may have grounds to cancel the franchise agreement in the future pursuant to the Contractual Remedies Act 1979.

19 How do the relevant government agencies enforce the disclosure requirements?

There is no enforcement by government agencies in relation to disclosure requirements. Nevertheless, as stated in question 10, if a franchisor is a member of the FANZ and it does not comply with the Code of Practice in relation to disclosure requirements, that franchisor can be ousted from the FANZ. If any franchisee suffers a loss at the hands of such a franchisor, the franchisee's remedies would be according to normal contractual laws and the franchisor would be vulnerable to an action for damages by the franchisee. As stated above, if there are any misrepresentations, the person suffering a loss may be entitled to make a complaint pursuant to the Fair Trading Act 1986 to the Commerce Commission.

20 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

Franchisees can make an official complaint to the Commerce Commission if information contained in any disclosure document is false or misleading. Furthermore, a franchisee could sue the franchisor for misleading conduct pursuant to the Fair Trading Act 1986. Damages are normally calculated from the date of loss and can include both actual and consequential damages. A franchisee may be entitled to cancel or rescind the franchise agreement pursuant to the Contract and Commercial Law Act 2017, and may be entitled to reimbursement or damages or both.

21 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

If a sub-franchisor misrepresented the position without recourse to a franchisor, the franchisor should not be liable in any way. If a representation is made by a director or employee of the franchisor or the sub-franchisor, the protection of a limited liability company may not protect that individual, who may be personally liable pursuant to the Fair Trading Act 1986. There is a specific provision in that Act in relation to employees being liable for personal misstatements while in their employment.

22 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

Contractual principles under the law of contract would apply to the first question. The second question is not applicable where a franchisor is a member of the FANZ in which case both the Code of Practice and the Code of Ethics would apply.

23 Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub-franchisee regarding predecessors, litigation, trademarks, fees, etc, are there any general rules on presale disclosure that might apply to such transactions?

See questions 18, 19 and 20.

24 What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under franchise sales disclosure laws?

Franchisees could make a complaint to the Commerce Commission and request an investigation in relation to such activity. Such protection differs due to the fact that fraudulent or deceptive conduct should not occur in relation to franchise sales. Also, such franchisees could bring a civil action against the franchisor and it may be possible for the directors of the franchisor company to be called as separate defendants as they could be personally liable for damages if the franchisor company has no assets. This protection does not differ from the protection provided pursuant to existing civil laws in New Zealand.

Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship

25 Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

No specific laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect.

26 Do other laws affect the franchise relationship?

Some changes to the Fair Trading Act 1986 (FTA) and the Consumer Guarantees Act 1993 (CGA) may affect the franchise relationship in a minor way in some areas. The FTA contains new rules about business-to-business contracting out of certain provisions and new obligations and restrictions that relate to unfair contract terms in standard-form consumer contracts. The acts named above should be checked carefully in relation to any proposed franchising in New Zealand as the penalties for contravening the FTA are up to NZ\$200,000 for individuals and NZ\$600,000 for companies.

27 Do other government or trade association policies affect the franchise relationship?

No government or trade association policies affect the franchise relationship.

28 In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Events that could lead to termination must be specified in the franchise agreement. There must be some fault or misdemeanour on the part of the franchisee for a valid termination to be confirmed. Also, it is usual for a notice of breach to be issued by a franchisor to a specific franchisee and for the time limit for remedying the breach to have expired before the termination takes place. If a termination is unlawful, a franchisee would be able to seek redress from a court, with the remedies being either damages or an order from the court that the franchise be reinstated to the franchisee, which may then continue to conduct business pursuant to the franchise agreement.

29 In what circumstances may a franchisee terminate a franchise relationship?

A franchisee may terminate a franchise relationship only if the franchisor has engaged in misrepresentations or fraudulent conduct as an inducement for the franchisee to enter the franchise agreement in the first place. Termination would be pursuant to specific sections as set out in the Contract and Commercial Law Act 2017. Further, if a franchise agreement specifically allows the franchisee the right to terminate on, for example, six months' notice, the franchisee would be able to give such notice if required to exit the franchise but would lose the

Update and trends

The most important update is the new Cartels legislation as contained in the Commerce (Cartels and other Matters) Amendment Act 2017. The new legislation came into effect on 14 August 2017, and an important aspect to note is that if a franchisor is not in competition with its franchisees then it should have no problem with the Cartels legislation. However, that is often not the position, in which case there must be full compliance of the Commerce (Cartels and other Matters) Amendment Act 2017.

right to sell its business and recoup the upfront franchise fee together with any goodwill paid to the franchisor.

30 May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

A franchisor may refuse to renew its franchise agreement with a franchisee if some provisions in the franchise agreement allow it to do so. If a franchisee has breached the franchise agreement in a material way during the term, or if two or more breach notices have been issued within a 12-month period, the franchisor may be able to block any renewal, provided the franchise agreement contains such a relevant clause. Further, if a franchisee is in default at the time of purporting to renew a franchise agreement, the franchisor could prevent such renewal.

31 May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

A franchisor may restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity provided the franchise agreement contains a right of first refusal clause in favour of the franchisor. Further, any transfer or sale of a franchise by a franchisee is always subject to the consent of a franchisor, who should be able to say no without giving any reasons. The precise wording in any assignment or transfer clause is very important and if a franchise agreement contains such words as 'with such consent not to be unreasonably or arbitrarily withheld', then it would be harder for a franchisor to refuse consent.

32 Are there laws or regulations affecting the nature, amount or payment of fees?

There are no laws or regulations affecting the nature, amount or payment of fees, but should an unfair interest rate be imposed – for example, 30 per cent or 40 per cent – the equitable doctrine of unjust enrichment may be available to assist a disgruntled and unfairly treated franchisee.

33 Are there restrictions on the amount of interest that can be charged on overdue payments?

There are no restrictions on the amount of interest that can be charged on overdue payments. However, any ridiculous or oppressive amount is likely to be challenged by a franchisee or a franchisee's lawyer. If a franchisor wants to charge such a high rate of interest that it would be in the nature of an unjust penalty, then that rate of interest may be unenforceable by the court.

34 Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Laws and regulations exist restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic country. As discussed in question 5, in all cases non-resident withholding tax would have to be deducted. New Zealand has double taxation treaties in relation to many countries, so any tax paid in New Zealand by an overseas franchisor in relation to the repatriation of income should be able to be claimed as a tax credit in the franchisor's foreign country.

35 Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are enforceable.

36 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

There is a general legal obligation for parties to deal with each other in good faith, and a good faith clause should always be included in franchise agreements. The courts in New Zealand are moving towards implying a duty of good faith into franchise agreements if no such duty is expressly stated, but this has not happened yet. Both parties should act loyally and in good faith towards each other at all times, as that is the essence of any franchise relationship.

37 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

Consumer laws do not apply to a franchisee who purchases products from a franchisor because both parties are in business. See, however, question 26.

38 Must disclosure documents and franchise agreements be in the language of your country?

There is no legal requirement for disclosure documents and franchise agreements to be written in English, but since the major language of New Zealand is English, all parties would insist that English is used.

39 What restrictions are there on provisions in franchise contracts?

All franchise contracts must comply with the Commerce Act 1986, as amended by the Commerce (Cartels and other Matters) Amendment Act 2017. Key changes include the following.

Cartel conduct restrictions

New cartel conduct restrictions are as follows:

- the previous restriction on competitors fixing prices; and
- new restrictions on competitors jointly restricting output and market allocating.

These new restrictions will have the most far-reaching impact on business.

Collaborative activity exemptions

This is a new cartels exemption for permitted collaborative activities. Competitors will be able to seek clearance for proposed collaborative activities, providing certainty that the proposed activities will not breach the Commerce Act.

Vertical supply contract exemption

This is a new exemption for cartel provisions that are included in vertical supply contracts where certain requirements are met.

International liner shipping exemption

This is a new exemption for international liner shipping from the prohibitions against anti-competitive agreements and cartels.

Because the new cartels legislation impacts upon key areas contained in franchise agreements, it is very important to explain the basis of a number of clauses that are commonly inserted in franchise agreements. Such clauses include approved products, approved services, restraint area, restraint period and location of a franchised operation.

40 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

See question 39. The Commerce Commission enforces the Commerce Act 1986; its wide powers include declaring a transaction void, together with monetary penalties, and there is a current trend for the courts to award higher penalties if the gravity of the offence demands that the public should be protected. At present, it has no power to imprison a guilty party.

41 Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The lowest level court in New Zealand is the district court, which can determine claims involving up to NZ\$350,000. For claims exceeding NZ\$350,000, the High Court of New Zealand is the relevant body. Appeals from the High Court of New Zealand go to the Court of Appeal of New Zealand, which sits in Wellington. Appeals from the Court of Appeal go to the Supreme Court of New Zealand, which also sits in Wellington.

If a franchisor belongs to FANZ, the franchise agreement must contain a dispute resolution clause. The Code of Practice prescribes that mediation is mandatory, and it has a high chance of success. There is also the Arbitration Act 1996. A domestic franchisor who is not a member of FANZ can resort to court action, but the courts usually require an attempt to resolve the dispute by way of mediation. A foreign franchisor could issue proceedings in New Zealand and sue a particular franchisee, but again, the courts may require an attempt to settle any dispute by way of mediation. The governing law in any franchise agreement is important and most foreign franchisors require the governing law to be that of their home country. At the same time, it is recommended that foreign franchisors should stipulate that the governing law should be the law of New Zealand, as it is far easier to take swift action in relation to a defaulting master franchisee or franchisee through the New Zealand courts and to apply New Zealand law.

There is also the Disputes Tribunal, whereby disputes between parties can go to a hearing before a referee with no lawyer representation allowed. The maximum amount of any claim is NZ\$15,000, or NZ\$20,000 if both parties agree.

42 Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

The principal advantages of arbitration include the fact that a hearing date would usually be much earlier than a court hearing date, the costs should be lower than the costs of litigation, any arbitration is confidential between parties, so the result will not appear in the press or elsewhere, and it should be more informal than litigation in the High Court. Disadvantages include the fact that one party may want publicity but will not get it, and enforcement of the arbitral award that may have to go down the path of litigation.

43 In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

Foreign franchisors still need to comply with the laws of New Zealand insofar as they affect them. The only way they would be treated differently from domestic franchisors may be in the area of taxation, where income of any sort that is to be repatriated from New Zealand to an overseas jurisdiction will be subject to non-resident withholding tax.

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Private Equity
Private M&A
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Product Recall
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Risk & Compliance Management
Securities Finance
Securities Litigation
Shareholder Activism & Engagement
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