The Franchise Law Review

Tenth Edition

Editor
Alan H Silberman

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PREFACE

The term franchise, used without contextual reference or an accompanying definition, is extraordinarily plastic and uncertain. As Humpty Dumpty explained to Alice in *Through the Looking Glass*: 'When I use a word, it means just what I choose it to mean – neither more nor less.' One hundred-plus years ago, you would expect it was part of a discussion about stringing electrical lines or laying streetcar tracks along urban streets, or later, the sale of equipment or machinery with a manufacturer's brand name and possibly some territorial exclusivity. If a non-business question was involved, the franchise topic was a women's ability to vote or the age a person had to attain to have a right to vote. Reduced to its lowest common denominator, franchise referenced a right involving a business or a transaction whose terms (and government-imposed limitations, if any) were typically a matter of freedom of contract.

By the middle of the 20th century, franchising took on a different, more complex meaning and grew exponentially. Commonly used terms such as partnership, dealer, distributor and agent did not capture the full scope of the intended relationship and were often inapplicable. In addition, most entrepreneurial innovators in franchise concepts were focused principally on brand, broader elements of brand identity, uniformity and the means of achieving those results. These goals, often reflected in restrictions, controls and allocation of function between franchisor and franchisee, were used to frame provisions in franchise contracts and associated documents. They were accepted by prospective franchisees as part of the pathway to success. Less evident was the fact that many franchisees needed support on an ongoing basis and that the franchisor – as the 'creator and keeper of the flame' – was the expected and essential source of that guidance and direction, which may not have been supplied.

A franchise, on the franchisor's side, did not simply mean contract, fees, royalties, expansion and certain profit; it involved much more, including compliance, authority to impose system changes and broad reservations of rights to engage in future conduct. On the franchisee's side, the belief in mutually aligned objectives and financial success was sometimes difficult to maintain. The franchise contract, which often grew in complexity to address each new problem, was, and is, essential, but it is not sufficient. The keyword for successful franchising is no longer only rights; at its core is an ongoing relationship.

Of course, success usually breeds imitation with less qualified and responsible players on both sides. While the number and variety of franchise offers and locations continues to grow, the promise of franchising as an engine of economic growth and benefit is often questioned by franchisees, their lawyers, legislators, regulatory agencies and others. A variety of statutory and administrative solutions to actual, perceived and sometimes created problems abound. Some are useful. However, in some jurisdictions, the result is a crazy quilt of requirements,

exemptions and efforts at insufficient or uncritical probing of the nature and extent of any significant issue, the source or sources of complaint, and the long-term impact of legislative or regulatory solutions.

That said, there are responsible individuals who seek reconsideration of the premise that structured disclosure of franchise agreement terms and related information (as in the grandfather of regulatory effort, the 1978 US Federal Trade Commission Franchise Disclosure Rule), without mandating specific contract provisions, provides a sufficient basis for an informed decision, while others point to the enactment of added relationship laws (such as California's 1981 Franchise Relations Act and its subsequent amendment) to argue that it demonstrates benefits without adverse effects on franchising and that the approach should be adopted and enlarged.

What seems to be without question is that just as departures from basic contract law principles to fashion franchise-specific rules raise serious questions, existing legal rules of general applicability in a jurisdiction should also usually apply to franchise agreements (unless pre-empted by law).

It is also essential to recognise that laws and regulations often have unintended effects. When Schwinn determined that effective marketing of its bicycles by franchised dealers required out-of-the-box personalised set-up as a brand-defining element, it became an issue in US antitrust litigation that went to the US Supreme Court. Surprisingly, the Court applied the ancient rule against restraints on alienation, and held that independent dealers could not be restricted in the sale of items they had purchased – but consignees could be fully controlled. Did the decision strike a blow for franchisee freedom? The result: independent dealers who valued the Schwinn product became consignees, with attendant cost and status changes.

Many business transactions have asymmetric features, franchises among them. Legislation or regulation that aim to create a level playing field do not change the facts. If consumer demand for a franchise is created by the franchisor, the potential franchisee may accept the terms even if he or she preferred a modification. If the franchisee negotiates and walks away from the offer, is it always a sound choice? If the franchisor adopts the change and it increases the franchisor's costs, who pays? The franchisees (including those who did not care) in higher fees? The franchisor's shareholders? Deductions from managements' salaries?

Asking, and answering, these questions in a careful and forthright manner is the challenge for today and tomorrow. But it must be placed in context. Notwithstanding legislation and regulation and the risk of new or enhanced requirements, new franchise offerings are ubiquitous in almost every jurisdiction; the pool of potential franchisees has not diminished; and the number of newly opened franchised locations reflects continual net growth. In sum, it is reasonable to conclude that the foundational elements of modern franchising are – and will continue to be – sound.

Remember, this review is intended as a broad, first-level survey of principles and practices in a substantial number of jurisdictions. It will, we hope, be useful in helping to identify issues and shape further enquiry. Its scope will also help to underscore the fact that effective franchise law compliance programmes are an essential element of risk management and client education (as well as having potential salutary effects in affecting the sanctions imposed when companies and individuals find themselves under scrutiny). The review is not a compendium of answers to actual problems that arise in the course of business activity. Answers require detailed review and evaluation. Franchise laws are not only complex as

written and interpreted; they often call for fact-intensive enquiry and analysis by experienced counsel. Those caveats notwithstanding, it is a body of information of value to anyone concerned with franchise questions that arise on a regular basis.

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July 2023

Chapter 7

NEW ZEALAND

Stewart Germann[1]

I INTRODUCTION

Franchising in New Zealand is developing at a very fast rate and is becoming more sophisticated. It is often said that New Zealand is one of the most deregulated countries in the world in which to conduct small to medium-sized businesses, and the fact that we have no franchise-specific legislation is also of great assistance.

The following international franchisors have a presence in New Zealand (although this list is not exhaustive): Anytime Fitness, Bakers Delight, Brumby's Bakeries, BurgerFuel, Cafe2U, Cartridge World, Cash Converters, Cheesecake Shop, Coffee Club, Domino's, Esquires, Gloria Jean's Coffees, Jamaica Blue, Jani-King, Jett's Fitness, Jim's Mowing, Just Cuts, Kip McGrath, Kwik Kerb, LJ Hooker, LJS Seafood Restaurants, Lone Star, McDonald's, Midas Car Care, Mini Tankers, Mr Rental, Muffin Break, Oporto, PappaRich, Pita Pit, Pizza Hut, Quest Serviced Apartments, RE/MAX, Snap Fitness 24/7, Snap-on Tools, Snap Printing, Specsavers, Speedy Signs, Subway, Taco Bell, The Athlete's Foot, Toni&Guy, VIP Home Services and Zambrero.

The following local franchisors operate in New Zealand (although this list is not exhaustive): AA Auto Centre, Active Plus, Armstrong, At Your Request, Baby on the Move, Bedpost, Business Buddy, Cleancorp, Clean Planet, Colourplus, Columbus Coffee, Cookie Time, Cookright, Corporate Cabs, CrestClean, Crewcut, Green Acres, Guthrie Bowron, Hardy's Health Stores, Hire A Hubby, Hollywood Bakery, Just Cabins, Kitchen Studio, Landmark Homes, Laser Electrical, Laser Plumbing, Liquorland, Mad Butcher, MathZwise, Meticulous Home Services, Mexicali Fresh, Mike Pero Mortgages, Mr Plumber, Mr Whippy, New Zealand Natural Ice Cream, Night 'n Day Foodstores, Palmers, Paper Plus, Para Rubber, Paramount Services, Pit Stop, Refresh Renovations, Robert Harris Coffee Roasters, Rodney Wayne, Shoe Clinic, Sierra Coffee, Signature Homes, Small Business Accounting, Stirling Sports, Streetwise Coffee, Super Liquor and Super Shuttle.

The Franchise Association of New Zealand (FANZ) was formed in 1996 and it has Rules, a Code of Practice and a Code of Ethics. The following are the three principal types of franchisors in New Zealand:

a those franchisors who belong to the FANZ, publish a disclosure document and have very high standards;

b those franchisors who do not belong to the FANZ, do not publish a disclosure document but have high standards; and

1 Stewart Germann is the principal of Stewart Germann Law Office.

c those franchisors who do not belong to the FANZ, do not publish a disclosure document and do not have high standards or a good reputation.

Category (c) is diminishing because of the growing interest in and effect of the FANZ, which as at October 2020 had 137 franchisor members, one individual and 59 affiliates, including attorneys, accountants and banks, with a total of 197 members.[2]

Survey of franchising 2021

Prospective franchisees who are looking at buying into a franchise must tread carefully and do their homework. New Zealand is an exciting and fast developing market, and the Franchising New Zealand 2021 Survey results released in December 2021 confirmed that there are 590 business format franchisors in New Zealand. The sales turnover for business format franchises was estimated at NZ$36.8 billion, and the sales turnover for the entire franchising sector was estimated at NZ$58.5 billion.

The Survey also confirmed that:

a there is an estimated total of 32,300 units operating in business format franchises;
b more than 156,000 people are employed directly in business format franchises;
c 70 per cent of franchise brands originated in New Zealand;
d more than 20 per cent of franchisors have entered international markets; and
e 90 per cent of franchise brands returned profits back into the community.

It also confirmed that the business areas involved in franchising include retail trade, other services, accommodation and food services, administrative and support services, construction and education and training.

II MARKET ENTRY

i Restrictions

Foreign franchisors who wish to enter New Zealand must be aware of a range of legislation, including, but not limited to, the Commerce Act 1986, the Companies Act 1993, the Fair Trading Act 1986, the Financial Reporting Act 2013 and the Overseas Investment Act 2005, plus any amendments. In relation to the formation of a company in New Zealand, the following will apply:

a 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
b all directors must provide their place and date of birth.

This is a departure from the previous position whereby a director resident anywhere in the world could be appointed as a director of a New Zealand company.

If a large foreign business entity holds 25 per cent or more of the shareholding in a company and, at the balance date for the two preceding accounting periods the total assets for the company and its subsidiaries exceed NZ$60 million, or the total revenue was more than NZ$30 million, the company must be audited and must file group financial statements

2 See www.franchiseassociation.org.nz.

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, an application must be made to the Overseas Investment Office for consent to the purchase before it can proceed. There are no restrictions on a foreign entity granting a master franchise or development rights to a local entity, and there are no restrictions on foreign franchisors owning equity in a local business.

However, if a foreign franchisor who is deemed to be an overseas person, or an associate of an overseas person, wishes to acquire sensitive land or an interest in sensitive land (for example, by buying shares in a company that owns sensitive land) or business assets worth more than NZ$100 million, or a fishing quota or an interest in a fishing quota, an application must be made to the Overseas Investment Office for consent to such an acquisition before it can proceed. Land will be sensitive if it comes within the types of land and area thresholds detailed in Part 1 of Schedule 1 of the Overseas Investment Act 2005 (OIA) (as amended by the Overseas Investment Amendment Act 2018, which came into force on 22 October 2018). Generally, consent under the OIA must be obtained in the two scenarios set out below:

a Where there is an overseas investment in significant business assets. This includes:
- the acquisition of rights or interests in securities of a person (A) where, as a result of the acquisition, the overseas person has a 25 per cent or more ownership or control interest in A or an increase in an existing 25 per cent or more ownership or control interest in A and where, in each case, the value of the securities or the consideration provided, or the value of the assets of A, or A and its subsidiaries, where A has a 25 per cent or more ownership or control interest, exceeds NZ$100 million;
- the establishment of a business in New Zealand where the business is carried on for more than 90 days in any one year (whether consecutively or in aggregate) and the total expenditure expected to be incurred in setting up the business exceeds NZ$100 million; or
- the acquisition of property (including goodwill and other intangible assets) in New Zealand used in carrying on business in New Zealand where the total consideration paid or payable for the assets exceeds NZ$100 million.

b Where an overseas person (or an associate of an overseas person) wishes to acquire sensitive land or an interest in sensitive land, the definition of which is set out in Schedule 1 to the OIA and includes several types of land, including non-urban land of an area over five hectares, and any foreshore and seabed land, irrespective of the size of the area.

ii Foreign exchange and tax

Non-resident withholding tax (NRWT) is payable in respect of any income such as interest, dividends and royalties paid to non-residents in New Zealand when the income is repatriated overseas. NRWT is deductible from gross income and no expenses can be deducted. New Zealand has a double-taxation treaty with a number of countries, and it is important to check the relevant double-taxation treaty for any specific rates that might apply.[3]

3 Further information can be obtained from www.ird.govt.nz.

III INTELLECTUAL PROPERTY

i Brand search

If a foreign franchisor owns any trademarks and wishes to register them in New Zealand, a search must be made of the trademark register, which is administered by the Intellectual Property Office of New Zealand (IPONZ). The Trade Marks Act 2002 governs registration of all marks capable of registration, including trademarks or service marks. A search can be made at www.iponz.govt.nz, but it is wise to instruct a trademark and patent attorney in New Zealand to undertake a thorough search at IPONZ to ensure that the way is clear for registration of a foreign franchisor's trademark.

ii Brand protection

Assuming that the trademark is available, protection for it is afforded by filing an application and paying the requisite fee. IPONZ issues an application number, which is the unique trademark registration number for New Zealand. In relation to manuals and other intellectual property owned by a foreign franchisor, except for patents that are restricted, there is copyright protection under the Copyright Act 1994, and copyright exists at law with no registration required.

iii Enforcement

If trademarks have been registered, registration prevents any competitor from lawfully using the same or similar mark on any goods or services in New Zealand. Trademark registration would also prevent a subsequent registration of an identical or confusingly similar mark. If a third party breaches a registered trademark, action would be taken pursuant to the Trade Marks Act 2002 and the Fair Trading Act 1986. There are also remedies for breaches of the intellectual property of a franchisor that are not governed by the Trade Marks Act 2002 but are found in common law.

iv Data protection, cybercrime, social media and e-commerce

With the increasing use of e-commerce and social media in franchise businesses, franchisors must ensure that they observe the privacy principles contained in separate codes and in the Privacy Act 2020, which outlines how businesses should collect, use, store and disclose information about clients and customers. Other relevant law includes the Crimes Act 1961, which deals with crimes involving computer systems, and the Unsolicited Electronic Messages Act 2007.

IV FRANCHISE LAW

i Legislation

As stated earlier, there is no franchise-specific legislation in New Zealand. There are a number of statutes and laws that affect franchising, including (but not limited to) the Building Act 2004, Commerce Act 1986, Commerce (Cartels and Other Matters) Amendment Act 2017, Commerce (Criminalisation of Cartels) Amendment Act 2019, Companies Act 1993, Contract and Commercial Law Act 2017, Copyright Act 1994, Fair Trading Act 1986, Employment Relations Act 2000, Financial Reporting Act 2013, Health and Safety at Work Act 2015, Income Tax Act 2007, Overseas Investment Amendment Act 2021, Privacy Act 2020, Resource Management Act 1991 and the Trade Marks Act 2002. Any franchise or

master franchise agreement is a contract and there are robust legal principles affecting the law of contract and its enforceability. In addition, a recent amendment to the Commerce Act 1986, under Part 2: Restrictive Trade Practices (known as the cartel provisions), should be considered carefully in relation to franchise agreements (see Section VI.v).

ii Pre-contractual disclosure

There are no mandatory pre-contractual disclosure requirements in New Zealand. However, if a franchisor or a master franchisee is a member of the FANZ, a disclosure document that complies with the FANZ Code of Practice must be given to any prospective franchisee at least 14 days before the franchise agreement or master franchise agreement, as the case may be, is executed. If a disclosure document contains misrepresentations, the franchisor or master franchisee will most likely be liable to action under the Fair Trading Act 1986. The key elements to prove a claim of misrepresentation include that the facts are false or misleading, the potential franchisee relied upon those facts and the potential franchisee has suffered a loss.

Being an English common law country, the law of torts, including equitable estoppel, is applicable in addition to promissory estoppel and unconscionability. However, while every case will be dealt with on its own facts, the Court of Appeal has commented that it would be unreasonable for parties to claim misrepresentation on pre-contractual disclosure where they were independently advised, and that independent advice ought to have explained the meaning of the contract (*David v. TFAC Limited*;[4] see also *PAE (New Zealand) Limited v. Brosnahan & Ors*).[5] Remedies may include damages for loss and general damages, and cancellation of the agreement; it is thus imperative that franchise agreements are properly drafted to mitigate any losses against the success of any misrepresentation claims.

iii Registration

There are no registration requirements for franchises. All franchise systems must comply with New Zealand laws, so if a particular franchise is in a special industry, such as the medical industry, for example, or uses controlled products such as drugs, those franchises would need to comply with the relevant statutes and regulations. Great care should be taken rather than assuming that there are no restrictions in New Zealand.

iv Mandatory clauses

If a franchisor belongs to the FANZ, mandatory clauses include:

a a seven-day cooling-off period whereby a prospective franchisee can 'cool off' or change its mind after signing the franchise agreement;

b a clause saying that the FANZ Rules, the Franchising Code of Practice and Code of Ethics must be adhered to and followed by both franchisor and franchisee; and

c that the franchise agreement must contain a dispute resolution clause, with the recommended mode of resolving a dispute being mediation or arbitration.

If a franchisor does not belong to the FANZ, no mandatory clauses apply.

4 *David v. TFAC Limited* [2009] NZCA 44.

5 *PAE (New Zealand) Limited v. Brosnahan & Ors* [2009] NZCA 611.

v Guarantees and protection

The law of contract governs guarantees and it includes both statute and case law. It is common for a franchisor to require personal guarantees of all shareholders and directors of the franchisee company. Guarantees executed by individuals and companies are enforceable by the franchisor. Where there is more than one guarantor, liability should be joint and several in all cases. It is prudent for franchisors to require that all personal guarantors obtain independent legal advice evidenced by a solicitor's certificate to mitigate against possible future claims that the guarantors misunderstood the effect of the guarantee that they executed or that they suffered any duress.

V TAX

i Franchisor tax liabilities

Tax is governed by the Income Tax Act 2007, and the corporate tax rate for both resident and non-resident companies is 28 per cent. New Zealand has tax treaties with many countries, and NRWT must be deducted from all interest and royalty income before funds are repatriated. The NRWT rate in relation to the United Kingdom, China, Taiwan and Canada is 10 per cent; for Fiji, Indonesia, Malaysia and the Philippines the rate is 15 per cent; and for Singapore, Japan, Australia and the United States the rate is 5 per cent. The overseas entity should be able to claim a tax deduction in the relevant country because an NRWT certificate will be provided. If dividends are repatriated, NRWT at 15 per cent must be deducted.

ii Franchisee tax liabilities

Franchisees and master franchisees will be required to deduct NRWT before remitting any royalties, dividends or interest income to a foreign franchisor. The liability to deduct NRWT is on the franchisee, who must obtain an NRWT certificate from the Inland Revenue and provide it to the franchisor or master franchisee. Failure to deduct NRWT will render a franchisee liable to a late payment penalty of 1 per cent after the due date plus a further 4 per cent penalty after seven days. Franchisees also have the requirement to deduct pay-as-you-earn tax from all employees and to pay goods and services tax at a rate of 15 per cent to the Inland Revenue.

iii Tax-efficient structures

The most common business structure used for franchise businesses in New Zealand is an incorporated company. A company can be formed by filing relevant documentation to the Companies Office.[6] The Companies Act 1993 applies and Part 18 applies for overseas companies. It is wise to have a separate constitution governing a company's operation.

There are other structures used to conduct franchise businesses such as sole traders, limited partnerships, traditional partnerships and trusts. All trusts must comply with the Trusts Act 2019. It is essential to obtain expert legal advice and accounting advice from an experienced tax accountant prior to entering the market.

Foreign franchisors typically use one of three methods: direct franchising between the foreign franchisor and local franchisees; forming a subsidiary company that acts as the franchisor; or appointing a local master franchisee. The latter two are the most common.

6 www.companiesoffice.govt.nz/companies.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

New Zealand courts have been reluctant to recognise that there is a general duty of good faith implied in all commercial agreements. Courts have been more willing to accept that there is an implied duty of good faith in contracts of a relational character or that when there is a clear lacuna in contracts it is necessary to imply a duty of good faith to achieve the purpose of the contract. In *Bobux Marketing Ltd v. Raynor Marketing Ltd*,[7] Thomas J explained that good faith is 'closely associated with notions of fairness, honesty and reasonableness which are already well recognised in the law'. Thomas J emphasised that the notion of good faith as loyalty to a promise and the duty to act in good faith is most often asserted in relational contracts, such as agency relationships, distributorships, partnerships, franchise arrangements and joint ventures, which require communication, cooperation and predictable performance based on mutual trust and confidence.

While some overseas courts have classified franchise agreements as relational, the Court of Appeal in New Zealand has ruled that a franchise agreement is indistinguishable from a commercial transaction in which a full disclosure is made and parties are independently advised.[8] Franchisees are considered to be experienced business persons, and the courts generally respect the sanctity of a contract entered into by informed parties.[9]

Unlike New Zealand, Australia has franchising regulation that explicitly includes an obligation to act in good faith.[10] The Code of Practice prepared by the FANZ, and revised in April 2018,[11] does not explicitly impose any good-faith obligations on the parties, but the Code of Ethics published by the FANZ does stipulate that each member must act in an honourable and fair manner.[12]

It remains to be seen how New Zealand law will develop in this area, but in our opinion good faith will keep developing and may be recognised by the courts soon. It is noted that there are similar trends in the United Kingdom.

ii Agency distributor model

The general rules of agency law apply. Notwithstanding the fact that franchisees are separate legal entities, it remains possible for a franchisor to be pursued in claims for damages or otherwise by a person claiming reliance through agency.

The consequences of a franchisor or a master franchisee being found to be a principal for the actions of its franchisee that have caused loss to another person may result in a claim for those losses and possibly exemplary damages.

It is imperative for a franchisor to have appropriate contractual considerations within its franchise agreement prohibiting a franchisee from holding itself out as the franchisor

7 *Bobux Marketing Ltd v. Raynor Marketing Ltd* [2002] 1 NZLR 506 (Court of Appeal).

8 *David Anor v. TFAC Limited* [2009] NZCA 44 at 23 and 61.

9 Maree Chetwin, 'The Seven Secret Herbs and Spices of Franchise Regulation: Some Suggested Options?' (2009), 15 *NZBLQ* 151 at 156.

10 Trade Practices (Industry Codes – Franchising) Regulations 1998 (AU), 23A.

11 Code of Practice of the FANZ: 'The purpose of the Code is to promote high standards of Franchising conduct and procedure in accordance with the objects of the Association.'

12 Code of Ethics of the FANZ: 'Each Member of the Association will . . . Act in an honourable and fair manner in all its business dealings and in such a way so as to uphold and bring credit to the good name of the Franchise Association of New Zealand Inc.'

or an agent, and acknowledging that the franchisee is not an agent, partner or otherwise legally connected to the franchisor; and to ensure that its manuals and initial and continuing education materials set out specific requirements to be followed by the franchisee so that the public is aware that the franchisee is a separate legal entity.

In addition, there may be circumstances where franchisors find themselves liable for breaches of the workplace health and safety regime, and the current statute is the Health and Safety at Work Act 2015, which contains extensive changes to the prior legislation and increased penalties for breaches of the Act.

iii Employment law

Franchisees conduct their own independent businesses, and franchisors are not liable in any way for the actions of franchisees and their employees except for vicarious liability in some cases. As the law stands at present, franchisees cannot be treated as employees by the courts and all employment law is governed by the Employment Relations Act 2000. Franchisors must, however, ensure that they are not acting as employers in respect of a franchisee's employees.

iv Consumer protection

New Zealand's current consumer law may cover business-to-business relationships and accordingly, franchisors must contract out of consumer protection legislation such as the Consumer Guarantees Act 1993 and the Fair Trading Act 1986 to the fullest extent possible.

Consumer Guarantees Act

The Consumer Guarantees Act 1993 (CGA), which was amended by the Consumer Guarantees Amendment Act 2013, includes new guarantees relating to the delivery and supply of electricity and gas. It also has new obligations and restrictions relating to contracting out of the CGA, collateral credit agreements, and indemnification of gas and electricity retailers.

Unfair contract terms

The Fair Trading Act 1986 (FTA) which was amended by the Fair Trading Amendment Act 2021, came into force on 16 August 2022. The FTA has new obligations and restrictions relating to unfair contract terms, unsubstantiated representations, extended warranties, shill bidding, unsolicited goods and services, uninvited direct sales and lay-by sales, consumer information standards, product safety and product recalls, internet sales and auctions and auctioneers.

The existing prohibition on unfair contract terms has been extended in consumer contracts to small trade contracts worth under NZ$250,000, so this will affect franchising.

A contract is a standard form small trade contract if each party is engaged in trade (i.e., two businesses); it is not a contract between a business and a consumer, and the relationship between the two parties in trade in relation to the goods, services or interest in land provided does not exceed the annual threshold. Any contract signed prior to 16 August 2022 will not be subject to the new amendments.

The Commerce Commission can apply to a court for a declaration that a term in a contract is unfair. If it is found to be unfair by a court, then that business must not include a term (or it can be amended with the court's approval) or attempt to enforce or rely on the term. A business may also face:

a in the case of an individual, fines not exceeding NZ$200,000, and in the case of a company, a fine not exceeding NZ$600,000; or

b court orders stopping that business from applying or enforcing that term and or orders directing a refund or payment of damages.

Unconscionable conduct

The same Amendment Act has introduced unconscionable conduct in trade provisions that are much broader, and they apply to all conduct and not just contractual terms.

The unconscionable conduct in trade provisions are much broader as they apply to all conduct, not just contractual terms. The term unconscionable conduct is not defined, but the Amendment Act states that a court can take the following into consideration:

a the relative bargaining power of the parties;
b the extent to which the parties acted in good faith;
c whether the affected person was reasonably able to protect his or her interests; and
d whether unfair pressure or tactics were used.

It may be that New Zealand will take guidance from Australian cases, but at this stage no guidance or comment have been provided by the Commerce Commission.

The Commerce Commission can seek penalties and fines as above. The Commerce Commission could also could bring civil proceedings, for example, seeking a declaration from the court in relation to unfair contract terms. The remedies include damages, injunctions and other court orders.

Whether the new amendments apply to any contract will depend on whether it falls within the definition of a standard form small trade contract. When looking at the annual value threshold, this is assessed when the relationship first arises.

No definition is provided in the Act. However, the prohibition is intended to address similar conduct as in Australia, where the courts have found conduct unconscionable that is 'against conscience by reference to the norms of society'. The intention is that New Zealand courts will be able to draw on existing Australian case law.

v Competition law

The Commerce Act 1986 provides the regulatory framework relating to anticompetitive conduct and the Commerce Commission is charged with policing that framework. The Commerce (Cartels and Other Matters) Amendment Act 2017 made significant changes and replaced the previous prohibition on price-fixing between competitors with an expanded prohibition on cartel provisions, which extends to market allocations and output restrictions, as well as to price-fixing, by competitors. The New Zealand cartel prohibition is very wide and will have quite an impact on franchise networks. Some additional clauses must be inserted into franchise agreements, and there should be explanations as to why certain clauses are necessary. Consideration must be given to cartel clauses in franchise agreements; for example, clauses that set or influence prices, restrict output or allocate markets will be caught. The possibility that alternative arrangements might achieve the same or a similar commercial outcome as a cartel clause should also be considered. Another consideration is whether the collaborative activity exemption or the vertical activity exemption would apply. Expert legal advice should be obtained in relation to this Act.

There will not be a cartel arrangement in place where parties are not in competition with each other. In most franchise systems the franchisor will not be in competition with its own franchisees, but that is not always the case. For example, a franchisor that owns its own outlet might be found to be in competition with franchisees. Similarly, where a

franchisor sells online direct to the end consumer, yet at the same time has franchisees who sell to those consumers, it may also be in competition with its franchisees. There may also be instances where the franchisees are in competition with each other. Where a franchisor is in competition with a franchisee or where franchisees are found to be in competition with each other, there will be a competitive relationship, so the franchisor needs to be cognisant that there may be provisions in its franchise agreements that amount to cartel provisions.

There is no prohibition or law around third-line forcing or full-line forcing in relation to franchising.

The Commerce (Criminalisation of Cartels) Amendment Act 2019 has introduced a new criminal offence for cartel conduct, and the criminal sanctions reflect the covert nature of cartels and the harm they cause to consumers and the economy. For an individual who commits an offence, the penalty on conviction could be imprisonment for a term not exceeding seven years or a fine not exceeding NZ$500,000, or both. For a company that commits an offence, the penalty could be up to NZ$10 million.

The Commerce Act 1986 provides a number of statutory exceptions that would not constitute a cartel arrangement and may be pro-competitive. These exceptions relate to collaborative activities (for example, joint ventures or franchise arrangements), joint buying, vertical supply contracts and specified liner shipping arrangements as stated earlier in this chapter. There are no defences for mistakes of fact relating to the elements of joint buying and promotion and vertical supply contracts. Therefore, it would be possible in the future for a director of a franchisor company to be criminally liable under the Act for a cartel offence. For an individual who commits an offence, the penalty on conviction could be imprisonment for a term not exceeding seven years or a fine not exceeding NZ$500,000, or both. For a company that commits an offence, the penalty could be up to NZ$10 million, so great care must be taken.

vi Restrictive covenants

The New Zealand courts have recognised that it is reasonable for a person in the position of a franchisor to impose a contractual restraint upon competitive conduct by a franchisee or an ex-franchisee, but such restraints must not exceed the boundaries of the court's notion of reasonableness. The first principle is that it is reasonable for a person to stipulate that if he or she is willing to disclose all secrets of how to establish a particular business enterprise, then the recipient of the information cannot immediately terminate the contract and set up a competitive business using the information received during the course of the relationship. If the courts did not provide protection to franchisors against conduct like this, there would be no incentive for the owners of established businesses to share their secrets with others and enhance their business skills. The second principle is that it is important for the wellbeing of the community that every individual should, in general, be free to advance his or her skills and earning capacity.

The Contract and Commercial Law Act 2017 in New Zealand gives the courts authority to rewrite a restrictive covenant and to allow an excessive covenant to be enforced at a lesser level. Section 83 of the Act states as follows:

> *83 Restraints of trade*
>
> *(1) The court may, if a provision of a contract constitutes an unreasonable restraint of trade –*
>
> *(a) delete the provision and give effect to the contract as amended; or*

> *(b) so modify the provision so that, at the time the contract was entered into, the provision as modified would have been reasonable, and give effect to the contract as modified; or*
>
> *(c) decline to enforce the contract if the deletion or modification of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand.*
>
> *(2) The court may modify a provision even if the modification cannot be effected by deleting words from the provision.*

The ability of the courts to modify excessive restraints is constrained by the principle that terms that could never have been considered reasonable will not be modified, as to do so would be contrary to the public interest. This is the doctrine of restraints that are *in terrorem*, which translates into 'contracts that terrorise a contracting party'. If a franchisor could only ever have reasonably sought a two-year restraint within a five-kilometre radius of the business in which the person established goodwill, then a nationwide restraint for 10 years could never be regarded as reasonable; and in that case the courts would refuse to rewrite the clause to determine that the period of 10 years should be two years and the area of the restraint should be five kilometres rather than the entire country. What then is a reasonable restraint? There are two factors: area and time. So the message is clear in New Zealand – for a restraint to be enforceable, it must be reasonable.

There have been a number of restraint-of-trade cases in the franchising sector in recent years. Some recent New Zealand restraint-of-trade franchising cases include the following: *M and L Holdings (2012) Limited v. Whenua Productions Limited and Wenyuan Kuang*;[13] *Water Babies International Limited v. Kelly Jane Williams and Ors*;[14] *Dorn Investments Ltd v. Hoover*;[15] *Mike Pero (New Zealand) Ltd v. Krishna and Mortgage Suite Ltd*;[16] *Mad Butcher Holdings Ltd v. Standard 730 Ltd and Wightman*;[17] and *Mainland Digital Marketing Ltd v. Willetts and Meyers*.[18]

The recent cases of *M and L Holdings* and *Water Babies* are interesting as they both involved renegade and non-complying franchisees who breached their respective restraint of trade clauses. I acted for the successful parties in these cases, and an injunction was granted by the High Court of New Zealand in both cases.

Non-compete and other restrictive covenants need to be included in the relevant franchise agreement to be enforced during the term of the agreement. The type of clause that I often include is as follows:

> *The franchisee covenants that it shall not during the term except with the prior written approval of the franchisor carry on or be directly or indirectly engaged or concerned or interested whether as principal, agent, partner, shareholder, investor, financier, lender, director, employee, consultant, independent contractor or otherwise howsoever in any business conducted in competition with the [particular franchise business], the franchisor or any of its other franchisees.*

13 *M and L Holdings Limited v. Whenua Productions Limited and Wenyuan Kuang* [2020] NZHC 2541.

14 *Water Babies International Limited v. Kelly Jane Williams, Silvana Tizzoni and Coral and Aquamarine Limited* [2020] NZHC 1289.

15 *Dorn Investments Limited v. Hoover* [2016] NZHC 1325.

16 *Mike Pero (New Zealand Limited v. Krishna and Mortgage Suite Ltd* [2016] NZHC 1255.

17 *Mad Butcher Holdings Limited v. Standard 730 Limited and Wightman* [2019] NZHC 589.

18 *Mainland Digital Marketing Limited v. Willetts and Meyers* [2019] NZHC 1201.

In other words, a franchisor and a franchisee have a relationship for the term of the franchise agreement. During that period the franchisee must not compete with the particular franchise system and must not divulge confidential information to any third party outside the system without the consent of the franchisor. A breach of these covenants will usually give rise to an event of termination allowing a franchisor to terminate the franchise agreement with the particular franchisee, plus it will allow the franchisor to enforce the personal covenants given by the directors and shareholders of the franchisee in relation to the restraint.

vii Termination

The courts have recognised that it is reasonable for a person in the position of a franchisor to impose a contractual restraint upon the competitive conduct of franchisees and that contractual restraints are known as restrictive covenants or agreements in restraint of trade. The case of *SKIDS v. McNeill*[19] reached our Court of Appeal, which determined that a 90-day restraint was reasonable under the circumstances. Such agreements must not exceed the boundaries of the courts' opinion of reasonableness, and there are two competing principles that govern the courts' decision-making process.

The first principle is that it is reasonable for a person to stipulate that if he or she is willing to disclose all secrets of how to establish a particular business enterprise, the recipient of the information cannot immediately terminate the contract and set up a competitive business using the information received during the course of the educational process. If the courts did not provide protection to franchisors against conduct like this, there would be no incentive for the owners of established businesses to share their secrets with others and to enhance their business skills.

The second principle is that it is important for the wellbeing of the community that every individual should be free to advance his or her skills and earning capacity. The way these two conflicting principles are resolved is to require that a restrictive covenant must be reasonable in its terms before it will be enforced.

The case of *Dorn Investments Limited v. Hoover*[20] is worthy of mention. Paul Hoover, who was 60 years old and had a background as a rigger and truck driver, was the defendant and Dorn Investments Limited was a franchisee of Green Acres Franchise Group Ltd (Green Acres), which had an exclusive licence to operate the Green Acres Lawnmowing and Garden Care Services in a mapped territory in the Waikato region. Paul Hoover had some medical issues and he entered into a sub-franchise agreement with Dorn Investments. The relationship between the parties was not good, and in the course of his work for the franchise Mr Hoover had been performing lawn mowing and gardening services for an entity called Spotless. In September 2015, Dorn Investments became dissatisfied with the way in which Mr Hoover was carrying out the Spotless work, so it took the contract from him and gave it to another franchisee. Following that, Mr Hoover made the decision to give up the franchise and to commence trading on his own account, and he did so by rebranding as the Lawn Ranger. He destroyed the Green Acres business cards and signage and never had a manual. When Dorn Investments found out, it terminated the sub-franchise agreement and sought an undertaking that Mr Hoover would not provide lawn and gardening services in competition with the Green Acres businesses in New Zealand. Mr Hoover provided no such undertaking, so injunction proceedings were served in late January 2016. Justice Asher dismissed the application for an

19 *Skids Programme Management Limited & Ors v. McNeill & Ors* [2013] 1 NZLR 1; (2012) 98 IPR 324.

20 *Dorn Investments Limited v. Hoover* [2016] NZHC 1325.

interim injunction and stated that, on the balance-of-convenience argument, the result of granting an injunction would be severe for Mr Hoover, as he would have to stop his business. The judge said that Dorn Investments acted too quickly in taking Spotless as a customer from Mr Hoover, and in issuing the proceedings. The judge said that damages would not be great in any event. What really swayed the judge to decline the injunction was, in my opinion, 'the peremptory removal of one-third of Mr Hoover's custom in September 2015 by Dorn Investments when it took the Spotless contract away from him'. This case goes to show that in restraint-of-trade cases there is no certainty that the court will grant an injunction.

The Contract and Commercial Law Act 2017 gives the courts authority to rewrite a restrictive covenant and to allow an excessive covenant to be enforced at a lesser level. For example, if an agreement provided for a three-year period of restraint when a two-year period was considered to be reasonable, the covenant would be enforced to the extent that it could be rewritten by the courts as being confined to a two-year term. The ability of the courts to modify excessive restraints is constrained by the principle that terms that could never have been considered reasonable will not be modified. The reason for this is that it is considered to be contrary to the public interest that a person should be able to intimidate a contracting party by stipulating for a wholly unreasonable constraint and then have the court come to its rescue and rewrite the agreement so that it falls within the boundaries of reasonableness. This is the doctrine of restraints that are *in terrorem* (see Section VI.vi). When would a restraint be reasonable? There are many factors to consider – time and area, nature of the rights to be protected and the public interest.

The courts view breaches of restrictive covenants very seriously. Whether or not the franchisor could take over the business of the franchisee who breaches a restrictive covenant depends on the circumstances and materiality of the breach. Well-drafted franchise agreements would always allow a franchisor to seek injunctive relief. In relation to the shareholders of a franchisee company, there is normally a restriction that shares cannot be transferred to any third party without the franchisor's knowledge and consent, and contravention of this will be deemed to be an illegal transfer. Similar provisions apply to leases where a franchisee has leased premises.

The ability of any franchisor to take over a franchisee's business post-termination must be a matter of contract. Usually, franchise agreements provide the right of a franchisor to purchase the assets of a franchisee at an agreed value or, failing agreement, to be determined by arbitration.

Franchisors are often empowered to take over the leases of franchisees by express provision in the franchise agreement, but this will always depend upon the exact wording of the clause.

viii Anti-corruption and anti-terrorism regulation

The Fair Trading Act 1986 applies to any misrepresentations (unsubstantiated or false or misleading representation) made by a party to a franchise agreement.[21] The Crimes Act 1961 and the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) apply to offences involving fraud and money laundering.[22] The Organised Crime and Anti-corruption Legislation Bill passed into law in November 2015 by way of 15 amendment acts with the aim of enhancing New Zealand's anti-corruption legislative

21 Sections 9–16.

22 Sections 243–245.

frameworks by implementing amendments to the AML/CFT Act, the Crimes Act 1961 and various other enactments. The AML/CFT Act, which places obligations on New Zealand's financial institutions and casinos to deter and detect money laundering and terrorism financing, is being implemented in phases. Phase one applied to banks, casinos and a range of financial service providers. Phase two, which was implemented on 1 July 2018, extended the AML/CFT regime to lawyers and conveyancers. Phase three came in on 1 October 2018 and extended the regime to accountants and, on 1 January 2019, phase four extended the regime to real estate agents.

ix Dispute resolution

Franchise agreements usually include a dispute resolution clause. Some clauses favour arbitration, but franchisors who belong to the FANZ normally include the dispute resolution clause from the Code of Practice, which favours mediation in the first instance; if this is the case, mediation will be mandatory.

A foreign judgment has no direct operation in New Zealand. However, some foreign judgments may provide the basis upon which a New Zealand court will grant a judgment that will then be enforced in the same way as any New Zealand judgment. At common law, a New Zealand court may grant judgment to enforce a money judgment given against a defendant by a foreign court whose jurisdiction over the defendant is recognised by New Zealand's Rules of Private International Law provided the judgment is for a debt or definite sum of money other than a sum payable in respect of taxes or other charges of that nature, or in respect of a fine or other penalty; and the foreign judgment is final and conclusive.

There are certain types of judgments given in foreign courts that, as a matter of public policy, a New Zealand court will decline to enforce. Examples are attempts to enforce foreign revenue and penal law; judgments obtained by fraud; and judgments given overseas in breach of the rules of natural justice as applied in New Zealand.[23]

As recently mentioned, mediation is the favoured mode of resolving disputes. Normally, the parties to a dispute must meet and are given 21 days to resolve it, failing which one party can issue a mediation notice to the other party. The parties have 10 days to agree on the appointment of a mediator and, failing agreement, a third party will determine who the mediator is. Once the mediator has been appointed the mediation must take place within 14 days, so the process is swift and time-effective.

If a franchise agreement has been terminated and the previous franchisee conducts a new business in breach of a non-compete provision or uses the franchisor's trademarks or other intellectual property rights, injunctive relief is available from the High Court of New Zealand. A plaintiff who succeeds in a claim for breach of contract is entitled to recover losses on an expectation basis (i.e., the loss is the sum that the person expected to make (profits) if the contract had been fulfilled). If a party is successful in court, costs are awarded pursuant to a court scale, and in special circumstances exemplary damages or costs are awarded.

A careful drafting of a dispute resolution clause is required in an international franchise agreement as it affects the franchisor's ability to enforce the agreement across other jurisdictions.

Parties to a franchise agreement should also note that some disputes may not be submitted to arbitration. It is crucial that any subject matter of a potential dispute is capable

23 *Connor v. Connor* [1974] 1 NZLR 632.

of being settled by arbitration under the law of the country where enforcement of the arbitral judgment and award are likely to be sought and that enforcement is not contrary to the public policy of that country.[24]

New Zealand is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958. An arbitration award rendered in another Convention country is generally enforceable in New Zealand unless there is a ground for non-enforcement that relates to grave procedural errors or conflicting public policy. International courts have taken a restrictive view of this exception,[25] and have required fraud or corruption in procuring a foreign arbitral award or a violation of international public policy, not domestic public policy.[26] New Zealand courts would be likely to apply a similar standard.

A franchising dispute involving a franchisor called Hire Intelligence International Limited resulted in proceedings being issued in the High Court, and the reported decision is *Cityside Asset Pty Limited & Ors v. 1 Solution Limited & Ors*.[27] The High Court proceeding involved discovery, the destruction of vital evidence and legal privilege. The dispute was subsequently resolved after a two-day mediation and the High Court proceedings were discontinued by consent.

VII CURRENT DEVELOPMENTS

The FANZ is currently reviewing its Code of Practice, and as part of that review it will be looking into marketing funds. It is highly likely that there will be a new separate section in the Code relating to marketing funds, and requiring all franchisors to have their marketing funds in a separate bank account and to provide annual accounts and explanations to all franchisees in relation to that marketing account.

24 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958, Article V(2) (a) and (b).

25 Kerry Bundy, Marco Hero and Pascal Hollander, 'Choice of Law, Venue and Jurisdiction, Arbitration v. Litigation' (2012) 10 *Int'l J Franchising L.* 3 at 6 and 10.

26 id., at 6.

27 *Cityside Asset Pty Limited & Ors v. 1 Solution Limited & Ors* [2012] NZHC 3075.