THE FRANCHISE LAW REVIEW

Eighth Edition

Editor
Mark Abell

THE LAWREVIEWS

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PREFACE

Since the publication of the seventh edition of *The Franchise Law Review*, the major economic and geopolitical developments that we would expect to have a significant impact on world trade have been dwarfed by the impact of the coronavirus pandemic. Covid-19 has had a devastating effect on the global economy and despite the advent of vaccines and the roll-out of national vaccination programmes, it is likely to continue to do so for some time to come. Through all this, however, the apparently inexorable march towards the globalisation of commerce has continued unabated. While there have been some economic bright spots, the global economy continues to underperform and concerns persist about the stability of the US economy.

As a consequence, businesses are often presented with little choice but to look to more vibrant markets in Asia, the Middle East and Africa for their future growth. At the same time, South–South trade is on the increase, perhaps at the expense of its North–South counterpart. All of this, coupled with the unstable wider geopolitical landscape, presents business with only one near certainty: there will be continued deleveraging of businesses in the coming years and, thus, growing barriers to international growth for many of them. All but the most substantial and well-structured of such businesses may find themselves facing not only significant difficulties through reduced access to funding for investment in their foreign ventures, but also challenges arising from their lack of managerial experience and bandwidth.

Franchising, in its various forms, continues to present businesses with one way of achieving profitable and successful international growth without the need for either substantial capital investment or a broad managerial infrastructure. In sectors as diverse as food and beverages, retail, hospitality, education, healthcare and financial services, franchising continues to be a popular catalyst for international commerce and makes a strong and effective contribution to world trade. We are even seeing governments turning to it as an effective strategy for the future of the welfare state as social franchising gains still more traction as a way of achieving key social objectives.

Given the positive role that franchising can play in the world economy, it is important that legal practitioners have an appropriate understanding of how it is regulated around the globe. This book provides an introduction to the basic elements of international franchising and an overview of the way that it is regulated in 29 jurisdictions.

As will be apparent from the chapters of this book, there continues to be no homogenous approach to the regulation of franchising around the world. Some countries specifically regulate particular aspects of the franchising relationship. Of these, a number try to ensure an appropriate level of pre-contractual hygiene, while others focus instead on imposing mandatory terms upon the franchise relationship. Some do both. In certain countries, there is a requirement to register certain documents in a public register. Others restrict the manner

in which third parties can be involved in helping franchisors meet potential franchisees. No two countries regulate franchising in the same way. Even those countries that have a well-developed regulatory environment seem unable to resist the temptation to continually develop and change their approaches – as was well illustrated by changes to the Australian regulations in the recent past. The unstoppable march towards franchise regulation continues, with countries such as Argentina, which previously had not specifically regulated franchising, adopting franchise-specific laws in the past year or so.

Many countries do not have franchise-specific legislation but nevertheless strictly regulate certain aspects of the franchise relationship through the complex interplay of more general legal concepts such as antitrust law, intellectual property rights and the doctrine of good faith. This heterogeneous approach to the regulation of franchising presents yet another barrier to the use of franchising as a catalyst for international growth.

While this book certainly does not present readers with the complete answer to all the questions they may have about franchising in all the countries covered – that would require far more pages than it is possible to include in this one volume – it does seek to provide the reader with a high-level understanding of the challenges involved in international franchising in the first section, and then, in the second section, explains how these basic themes are reflected in the regulatory environment within each of the countries covered. I should extend my thanks to all of those who have helped with the preparation of this book, in particular Caroline Flambard and Nick Green, who have invested a great deal of time and effort in making it a work of which all those involved can be proud. It is hoped that this publication will prove to be a useful and often-consulted guide to all those involved in international franchising, but needless to say it is not a substitute for taking expert advice from practitioners qualified in the relevant jurisdiction.

Mark Abell
Bird & Bird LLP
London
January 2021

Chapter 33

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, Number Nurses, 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 nor 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, for a total of 197 members (see www.franchiseassociation.org.nz).

Because the pandemic disease known as covid-19 hit New Zealand in March 2020, it has been a most difficult year and this should be noted and recorded. New Zealand was locked down completely for 33 days from 25 March 2020 and our borders were closed and still remain closed, so no one from overseas except New Zealand citizens can enter the country at present. Franchising has been difficult, but with New Zealand now back to Level 1 it is business as usual; however, great care must be taken.

Survey of franchising

The latest survey of franchising in New Zealand, in 2017, showed the following key results:

a 631 business format franchisors in New Zealand in 2017, compared with 446 in 2012, which leads the world on a per-system-per-head-of-population basis;
b the number of units operating with business format franchise systems has also increased: with an estimated 37,000 units compared with 22,400 in 2012;
c franchised businesses are estimated to contribute around NZ$27.6 billion to the New Zealand economy;
d 124,200 people are employed in New Zealand franchises;
e dominant sectors include retail trade (23 per cent), 'other services' (20 per cent), accommodation and food retail (18 per cent) and administration and support services (8 per cent);
f 72 per cent of franchises are New Zealand-founded;
g the median initial franchise fee is NZ$35,000 for retail and NZ$28,750 for non-retail;
h the median total start-up cost is NZ$308,500 for retail and NZ$87,550 for non-retail;
i 50 per cent have been franchising since before 2000; and
j the median time before franchising is 4.5 years and 36 per cent are franchised within the first year.

There will be another survey of franchising in New Zealand undertaken in 2021 and the results should be available by June. There are also other reliable franchise-specific reports available, and Statistics New Zealand has a number of statistics relevant to commerce and population in general.

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 (1) the total assets for the company and its subsidiaries exceed NZ$60 million, or (2) the total revenue was more than NZ$30 million, the company must be audited and must file group 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, 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. 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 1993, 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. Note also that the new Privacy Act 2020 came into force on 1 December 2020, and the Privacy Act 1993 has been repealed.

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 2018, Privacy Act 1993, (new) Privacy Act 2020, Resource Management Act 1991 and the Trade Mark 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. Also, 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 a party 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*;[2] see also *PAE (New Zealand) Limited*

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

v. Brosnahan & Ors).[3] 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 seven-day cooling-off period whereby a prospective franchisee can 'cool off' or change its mind after signing the franchise agreement; 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 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.

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 a NRWT certificate will be provided. If dividends are repatriated, NRWT at 15 per cent must be deducted.

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

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 a 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 the 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 (www.companiesoffice.govt.nz/companies). 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. Note that the new Trusts Act 2019 comes into force on 30 January 2021 and great care must be taken with a number of new provisions. 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 and the latter two are the most common.

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*,[4] 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, co-operation 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 ruled that a franchise agreement is indistinguishable from

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

a commercial transaction in which a full disclosure is made and parties are independently advised.[5] Franchisees are considered to be experienced business persons and the courts generally respect the sanctity of a contract entered into by informed parties.[6]

Unlike New Zealand, Australia has franchising regulation that explicitly includes an obligation to act in good faith.[7] The Code of Practice prepared by the FANZ, and revised in April 2018,[8] 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.[9]

It remains to be seen how New Zealand law will develop in this area, but in my 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 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 to a franchisee's employees.

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

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

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

8 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.'

9 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.'

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.

The Fair Trading Act 1986 (FTA) was amended by the Fair Trading Amendment Act 2013. 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 FTA also has a new right to contract out of certain provisions of the FTA in business contracts. Penalties for contravening the FTA go up to NZ$200,000 for individuals and NZ$600,000 for companies.

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

a contracting out of the CGA;
b collateral credit agreements; and
c indemnification of gas and electricity retailers.

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.

Consideration must also be given to the Commerce (Criminalisation of Cartels) Amendment Act 2019, which comes into force on 8 April 2021. The Act introduces a new

criminal offence for cartel conduct and the proposed new criminal sanctions reflect the covert nature of cartels and the harm they cause to consumers and the economy. 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. The new Act does not apply until April 2021.

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 well-being 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 5-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 5 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*;[10] *Water Babies International Limited v. Kelly Jane Williams and Ors*;[11] *Dorn Investments Ltd v. Hoover*;[12] *Mike Pero (New Zealand) Ltd v. Krishna and Mortgage Suite Ltd*;[13] *Mad Butcher Holdings Ltd v. Standard 730 Ltd and Wightman*;[14] *and Mainland Digital Marketing Ltd v. Willetts and Meyers.*[15]

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.*

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.

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

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

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

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

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

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

The case of *SKIDS v. McNeill*[16] 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 well-being 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 recent case of *Dorn Investments Limited v. Hoover*[17] 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 off 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 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

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

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

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 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.[18] The Crimes Act 1961 and the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act) apply to offences involving fraud and money laundering.[19] 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 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.

18 Sections 9–16.

19 Sections 243–245.

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.[20]

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 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.[21]

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.

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

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

International courts have taken a restrictive view of this exception[22] and have required fraud or corruption in procuring a foreign arbitral award or a violation of international public policy, not domestic public policy.[23] 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*.[24] 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 Commerce (Criminalisation of Cartels) Amendment Act 2019 will come into force on 8 April 2021. Further, the Privacy Act 2020 became law on 1 December 2020 and the Trusts Act 2019 will come into force on 30 January 2021. All three Acts will have an impact on franchising in some way. Local expert legal advice should be obtained in relation to franchising in New Zealand to assess the implications of the new laws.

22 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.

23 id., at 6.

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

Appendix 1

ABOUT THE AUTHORS

STEWART GERMANN

Stewart Germann Law Office

Stewart Germann founded Stewart Germann Law Office (SGL) in 1993 as a boutique law firm at Auckland, New Zealand, specialising in franchising, licensing and business law.

Stewart Germann has over 35 years' experience in franchising law and acts for franchisors in New Zealand, Australia, the United States and the United Kingdom. SGL also acts for franchisees and provides legal advice. Stewart has spoken at franchising conferences in New Zealand, Australia, Italy, Seoul and the United States, and he was on the board of the Supplier Forum of the International Franchise Association (IFA) for six years until March 2007.

Stewart has extensive franchising contacts worldwide and locally. He is actively involved in international franchising and has written many articles that have been published overseas, including in the *International Journal of Franchising Law*. Stewart is included in *Who's Who Legal: Franchise 2020*.

Stewart is a past chairman of the Franchise Association of New Zealand (FANZ) and wrote the original Franchising Code of Practice for the FANZ. He has also written many published articles on franchising. In October 2018, Stewart received an award from the Franchise Council of Australia in recognition of his outstanding contribution to franchising for over 30 years. Stewart graduated as a Certified Franchise Executive (CFE) and was presented with his CFE certificate and pin at the FCA conference at Gold Coast in October 2019 and at the IFA convention at Orlando, Florida in February 2020, and he is the first person in New Zealand to gain CFE accreditation. Stewart is also an adjunct professor of law at Auckland University of Technology (AUT), lecturing in franchise law in 2020.

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