

Surgical Intervention – Defining Limits for Regulatory Protection

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A. INTRODUCTION

Metaphors often assist us to step back and see an issue from a fresh perspective. The lead title I have chosen for my presentation is “Surgical Intervention”. In modern medicine, precision and focused attention on the specific ailment often means minimum impact on the patient, a faster rate of recovery and an improved quality of life. That should be our approach to law reform which is intended to be franchise specific. My concern is that some proposals for franchise specific law reform are too invasive and could damage the special characteristics of franchises.

Franchising continues to play a significant role in the growth of the economy and in job creation. It has revolutionised the distribution of goods and services and has added real value to organisational efficiencies of business. Its valuable contribution should not be underestimated or undermined by law reform. The concept of franchising is absolutely fine and well proven over many years. Yes there is risk. But franchising is part of business and business involves risk.

Sometimes my sense is that the value of franchising is overlooked as we over-focus on problems and lose perspective on how a problem has arisen. The focus is often driven by the media accentuating negativity and then flows into the political arena. The case of Green Acres is an example; a fraudster “rips off” many people, not just one, and the loss factor multiplies along with widespread ripple effects. If the problem is associated with franchising, it does not mean that the franchise concept is the problem and needs constraining. In my experience the problem, if there is one, is usually related either to the application or management of the franchise concept rather than the concept itself. In some cases, the real issue when a franchise is in difficulty is a fundamental problem with the business and/or its structure rather than the franchise concept or relationship. The challenge is to establish whether there is a problem, and if so, what is its nature and what precise action is required, if any, to deal with that problem.

Franchising is a method of business practice. It is commonly referred to as a marketing concept but it can be more broadly characterised in various ways including that of a business organisational form¹ or arrangement. It is not an industry but traverses industry lines. It involves the sector players of franchisor and franchisees each committing to the franchise relationship. A successful franchise system combines the needs of each along with ancillary participants such as suppliers and customers. It is the combination of the methodology with the interrelated parties that I regard as the *franchising patient*. It must be valued and safe guarded. I do not see the patient as one party alone despite the fact that it is common to view the franchisee as the patient or the victim. I also do not believe we should wrap the patient in cotton wool and attempt to remove all risk.

Franchisees must have confidence in the franchise sector if they are going to take the capital commitment risk that is required. Franchisors for their part must be confident that their important intellectual property and franchise system can be protected and controlled when

¹ James A Brickley and Frederick H Dark *The Choice of Organisational Form: The case of Franchising*. Journal of Financial Economics 1987 Vol 18. This article analyses agency problems relative to the organisational form options of owned versus franchised units.

used by the franchisee. The franchisor must also be confident that having chosen the franchise organisational form, they have the cost effective ability to control agency problems and develop as well as adapt their system as the market develops and changes in the future. It should not be overlooked that franchising is designed to be dynamic and progressive in a competitive market environment. These are all significant factors which combine to make it so successful. They should not be undermined by law reform that creates uncertainty.

The value of franchising to the economic well being of the country needs to be enhanced as a result of any legislative reform. The Ministry of Economic Development's (MED) Review of Franchising Regulation Discussion Document² (2008) has raised the issue of franchise specific law reform. It posed a number of questions for consideration including whether there are problems in the sector and if so, how they should be addressed. It is in that context that this paper, at the time of compilation, puts forward several considerations (these are by no means exhaustive) which need to be kept in focus, to ensure we do not indulge in an overreaction to the challenges presented. If we overreact and do not properly understand what we are dealing with, then to take my metaphor a step further, the patient's health will be endangered and perhaps even worse consequences may arise. Franchising in New Zealand is still maturing and may not sustain too heavy a dose of legislative reform, particularly in these current economic times.

It should also be remembered that a minority claim against a franchisor (even if unsuccessful) may jeopardise a whole network. The ripple effect through a network is a distinct advantage when positive. However, when there is a negative impact between the franchisor and even one franchisee, it can travel fast and affect many others in the network due to the common brand. That is a distinctive characteristic danger of a franchise arrangement.

That said, this paper presents a case for limited franchise specific legislative reform. It should primarily address the information imbalance that often exists at the pre-contract phase of a franchise arrangement. In particular: I support mandatory initial disclosure, similar to the FANZ Code of Practice disclosure requirements,³ which is sufficient to enable prospective franchisees to make well informed decisions whether to enter a franchise arrangement. I further support a post contract 'cooling off' period for franchisees and an opportunity for franchisees to obtain independent legal advice at the time of contracting, similar once again to obligations currently placed upon FANZ franchisor members.⁴

The one further area of law reform I support relates more to the ongoing relationship phase and the issue of power imbalance that can also exist in a franchise arrangement. I propose all parties have access to an alternative dispute resolution procedure in the nature of mediation similar to the FANZ Code.⁵ Mediation is not perfect, but it does present one of the best options for preserving relationships when conflict arises. I do not consider any further legislative intervention impacting the franchise sector is currently justified.

B. THE NEW ZEALAND FRANCHISE LAW REFORM DEBATE IN CONTEXT

In New Zealand the first and only formal and public government focus specifically on franchising has been in 2008 with the publication of the MED's Franchising Discussion Document.⁶ This can be contrasted with Australia's history of political and legislative involvement in the franchise sector over a number of years by both State and Federal

² Refer www.med.govt.nz.

³ FANZ Code of Practice s.14 and Appendix A.

⁴ FANZ Code of Practice ss.8 and 11.2.

⁵ FANZ Code of Practice s.9.

⁶ Refer n 2.

government.⁷ I suggest this is due in part to New Zealand not experiencing the dramatic instances of franchise failures or exploitation that Australia has experienced. It possibly also reflects a generally more measured interventionist approach by the New Zealand government and politicians. I further suggest that the New Zealand franchise sector has learnt and continues to learn a great deal about franchising by observing the successes and failures of its cousins across the ditch.

The Green Acres catalyst

The Green Acres' situation in 2008 provided a catalyst in New Zealand for law reform debate related to franchising. This is due in part to the high media profile of the case, the number of franchisee casualties, many of whom were quite vulnerable (some were immigrants with poor English) and the overall substantial collective loss involved.⁸ It was primarily a case of alleged fraud by a master franchisee who is now subject to quite adequate legal processes for dealing with appalling conduct. The process of dealing with fraud may not of course compensate people who have lost money, but that is often the way with fraud in many areas, quite apart from franchising.

It should also be noted that any civil claims arising from the Green Acres case have not as yet been subject to judicial scrutiny. It could be that through the application of existing law, other parties may be held accountable. This ultimately depends upon whether claims are pursued, the proven facts and the applicability of established legal principles such as contractual agency law and vicarious liability.⁹ Whatever happens, it is my view that it is entirely premature to use the Green Acres case as a basis for arguing that we now require franchise specific law in New Zealand.

Australia an example but not a model

Achieving greater harmonisation between the economic markets of Australia and New Zealand is also a recognised issue in this law reform debate. There has been, and I understand continues to be, consideration of steps to facilitate greater coordination between the two countries in relation to the core components of the competition and consumer protection regimes of each country. This is illustrated by the Australian Productivity Commission's Research Report in 2004¹⁰ commissioned by the governments of both countries. Following that study, the two governments signed a Memorandum of Understanding¹¹ on coordination of business law. It recognised that coordination is multi-faceted and does not necessarily mean the adoption of identical laws but rather finding a way to deal with differences so they do not create barriers to trade and investment.

⁷ Refer to history outline, Giles, Redfern and Terry, *Franchising Law and Practice*: chp 2. Refer also to chronology of regulatory proposals, *Franchising Down Under in the Lands of Oz and the Long White Cloud*. Franchise Council of Australia (FCA) publication in 2003, pp 193-195.

⁸ NZ Herald (26 Feb 2008) reported an estimated 30 franchisees each suffered loss of their \$20,000 initial franchisee fee and others suffered loss of revenue. There were an estimated 150 to 200 franchisees in the network.

⁹ Case law, particularly in Australia, has found master franchisors in certain circumstances liable to third parties arising out of the conduct of their master franchisee. *Donut King Australia Pty Ltd v Barber & ors* (1999) SASC 241 (1999) LSJS 162. Refer also unpublished paper presented at 2001 National Conference of Franchise Council of Australia by Leo Walsh *Master franchise or Agency: What Do You Really Have?*

¹⁰ *Australian and New Zealand Competition and Consumer Protection Regimes* Report 16 December 2004 Recommended "transitional integration" only. (Overview part p.xxiv) The Productivity Commission, an independent agency, is the Australian Governments principal review and advisory body on microeconomic policy and regulation. www.pc.gov.au.

¹¹ Refer http://www.med.govt.nz/templates/MultipageDocumentTOC____25652.aspx.

The many and varied official reports that have focused on the franchise sector in Australia have identified issues for legislative consideration.¹² However, it does not follow that because there is intensive activity in Australia in the franchise sector, New Zealand need hastily follow the example of Australia and introduce franchise specific law or consumer law reform generally. Indeed, MED has to date taken a very measured and considered approach to the issue of franchise specific law reform.

As Australia has developed its franchise specific law over recent years, some aspects of the law have been criticised at times by eminent commentators and some of the world's leading international franchise lawyers.¹³ Not least of these is Professor Warren Pengilley who is well respected in competition and consumer law protection matters in both Australia and New Zealand over many years.¹⁴ He seriously criticised the ill considered speed and politically high handed attitude with which Australia introduced its mandatory Code of Practice and its "overkill" definition of what constitutes a franchise agreement.¹⁵ Despite the never ending attention and changes by Australian authorities to franchising, I suggest that some of their *overkill* approach and lack of practicality to some disclosure requirements do not necessarily make them an example to follow. In addition, the significant impact on commercial law through Australia's use of executive fiat rather than the process of parliamentary enactment, is also seriously questionable in this context. Overall I submit, the Australian invasive approach, if naively followed, has the potential to damage the New Zealand economy and particularly the franchise sector.

UNIDROIT a model to learn from

On the international stage, UNIDROIT, the Rome based International Institute for the Unification of Private Law, developed such a concern (greatly influenced by its perception of how the adoption of franchise legislation in some countries, including Australia, would possibly impact on franchise growth) that it developed its own model initial disclosure document.¹⁶ The model is very much pro business (not franchisor) and was drafted by some of the most eminent international franchise professionals, to guide governments around the world contemplating a franchise disclosure regime and to provide international uniformity. It would be remiss to ignore the value of this Model and its Explanatory Report.

¹² Recent reports include: *Review of the Disclosure provisions of the franchising Code of Conduct*, October 2006 (The Mathews Report); *Inquiry Into the Operation of the Franchise Businesses in Western Australia*, April 2008 (The Western Australia Report); *Franchises*, May 2008 (The South Australia Report); *Opportunity Not Opportunism: Improving Conduct in Australia Franchising*, December 2008 (The Federal Report). Note further the latest (2009) powerful (some call it an "exocet") challenge for franchising, ie Proposed "unfair contracts" Federal legislation appears to render void any term in a "standard form contract" that is "unfair". This will include most franchise agreements.

¹³ Alexander Konigsburg QC (Canada), a member of the UNIDROIT model disclosure law Drafting Committee, in his text *International Franchising* (2nd ed) critically comments on pp iv.x.63 (definition criticism), and iv.x.72 (relationship law issues criticism) : Martin Mendelsohn has made a serious criticism of the Australian law, *Franchise Regulation - Has the World Gone Mad Franchise*, Franchise New Zealand Magazine 3(2) 1990.

¹⁴ Professor W Pengilley, Professor Emeritus of law at the University of Newcastle (Australia) and a former Commissioner of the Australian Trade Practices Commission (as it then was). He also lectures periodically at Canterbury University (Christchurch).

¹⁵ *The Franchising Code of Conduct : Does its Coverage Address the Need?* Newcastle Law Review 3(2) 1999 p1-48. This is a valuable analysis of the good and bad of franchise law reform in Australia.

¹⁶ www.unidroit.org *Model disclosure Law and Explanatory Report* (September 2002). The focus is on pre-contract disclosure rather than relationship issues but reservations were expressed regarding regulating relationship issues. The UNIDROIT publication *Guide to International Master Franchise Arrangements* is also of helpful value in understanding the distinctive characteristics and complexities of franchise arrangements. Refer to review by Philip F Zeidman, www.Unidroit.org/English/publications/review/articles/1998-4.htm

Wise guidelines for law reform

Against this background of cautionary comment, I believe the insightful comments of Professor Warren Pengilley are wise objectives when considering franchise specific law reform. He states that the objectives should be:¹⁷

- “1. that no franchising law should inhibit or stultify the growth of franchising as a method of marketing. Neither should franchising law inhibit or stultify the growth of other forms of business. This can happen, for example, if a method of conducting business is unreasonably classified as a ‘franchise’ and subjected to regulation as such;
2. that any franchising law should be aimed only at making franchising fairer or at redressing possible power imbalances. A franchising law should be confined to this object;
3. that any franchising law should operate only where unfairness or power imbalances is found, and not otherwise;
4. that if there is a perceived deficiency in a particular industry but not in others, legislative control should not be ‘broad brush’ but should aim at resolution of the problem on an industry specific basis;
5. that no franchising regulation should be greater than that required to remedy an identified problem. In other words, franchising should not be subjected to ‘overkill’ regulation; and
6. there is no need for further legislation if present legislation adequately deals with any perceived problem.”

These objectives establish the justification and limits for franchise law reform.

C. THE SPECIAL CHARACTERISTICS OF THE FRANCHISE ARRANGEMENT

When contemplating franchise specific law reform, I suggest we need to first carefully identify some of the more significant characteristics of a franchise arrangement and get our definitions right, as they set the parameters for any discussion. We also need to clearly understand the nature of the franchise arrangement, what it seeks to achieve, how it achieves it and what are its strengths and weaknesses. If we do not grasp a proper and indeed fundamental understanding of this very particular commercial method of business practice applying across many industry sectors, then we significantly risk placing the franchise *patient* in jeopardy as a result of law reform.

The traditional understanding of a franchise includes at least three categories of franchise, namely: product,¹⁸ manufacturing,¹⁹ and business format. However this paper is concerned with *business format* franchising. This tends to be the predominant and most familiar form of franchising although each can have attributes of the others. It typically involves a comprehensive operations system controlled by the franchisor. The franchisee must comply with the franchisor’s requirements in operating the system, or risk losing the franchise. There are many variations, including sole units, area development agreements and master agreements. This diversity combined with ongoing variation and sophisticated development, can complicate defining the characteristics of a business format franchise when applying any franchise specific regulatory control.²⁰

¹⁷ n.15 p6.

¹⁸ Where a distributor simply supplies the product of a manufacturer within an exclusive market.

¹⁹ Where an essential ingredient or technical information is supplied. It may be independent of any requirement to follow a particular business format.

²⁰ Professor Warren Pengilley, *What is a Franchise Agreement* NZLJ September 2008, p341.

Inexperience combines with Experience under a common brand

The typical franchisee for their part is often an inexperienced business person and takes on the franchise opportunity to enable them to enter a market without assuming the full level of risk usually associated with a stand alone start up enterprise. The franchisee usually gains a package of corporate services and support, and a product or service with a proven record and reputation. Most of all, the business is associated with a brand.

The franchisor for their part is usually an experienced business person who knows considerably more than the franchisee, at least as far as their particular business and system is concerned. The grant of the franchise opportunity allows the business to expand with minimal capital investment from the franchisor. (Sometimes however, there is considerable cost to a franchisor arising from the wayward conduct of a franchisee.) The franchisor also harnesses the franchisee's incentive derived from risking their own capital and facilitates more rapid market expansion. Business format franchising as a market concept also enables more effective penetration of the market. It leverages off the franchisees' local market knowledge and focus with potentially more beneficial results. The overall three key drivers are access to capital, incentives based on franchisee's investment risk and access to local market knowledge.²¹

An interdependent relationship between unequals and retained discretionary power

These interrelated key factors mean the relationship is essentially an interdependent relationship of reliance between unequal parties. The franchisee is dependent upon the franchisor's superior business knowledge and must follow the franchisor's directions if they are to enjoy success. The franchisor sets out the obligations and standards for operating the system under its brand and makes numerous detailed decisions about the business. There is usually a certain amount of discretion vested in the franchisor with regard to future decisions as it needs considerable flexibility to enable it to deal with the unpredictability of the future, especially when the contract is long term. One way this is addressed is through the ability to change the operations manual which forms part of the agreement.²² This flexibility and discretionary decision making power of the franchisor is fundamental to keep the brand and the associated value proposition, business model and franchise format relevant to an ever changing environment and market. This is vital and important for the survival and benefit of both the franchisor and the franchisee. The franchisee has to trust the franchisor with regard to future decisions. Trust, built upon integrity and commitment between parties, is the hallmark of a healthy franchise relationship.

A further characteristic I observe as relevant, is that a franchisee contracts to accept responsibility for operating their own independent business. This is not the franchisor's responsibility. It can be said, the franchisee focuses on their business while the franchisor focuses on the franchise system which the franchisee licenses to use in its business. The franchisor is not contracting to accept responsibility for the success of the franchisee's business and is usually wary of accepting any obligation in the franchise agreement that may lead it down that pathway of potential liability. It is therefore common to preserve a degree of discretion to the franchisor to decide what is appropriate action in certain circumstances and how far the franchisor should become directly involved in the franchisee's business, if at all. Preserving that discretionary factor in a franchise is important in order to retain the demarcation lines of responsibility for each parties' business and to manage liability risk.

²¹ Refer study of primary reasons for franchising by Rajiv P Dant, *Motivation for Franchising : Rhetoric versus Reality*, International Small Business Journal Vol 14 1992. Four further reasons are revealed in the study namely, access to managerial talent, and the three economies of production, promotion and co-ordination.

²² The law recognises this right. Refer to article by Gehan Gunasekara, *Standard Form Commercial Contracts, Unilateral Variation and Legal response: The Case of Franchising NZBLQ* vol 13 December 2007 p263. Refer *Maranatha Limited v Tourism Transport Ltd* 3 April 2007, HC Auckland, Hansen J, CIV-6006-404-6431.

Franchise contracts are necessarily “incomplete”

Professor Gillian Hadfield, in her award winning article (Stanford Law School) entitled *Problematic Relations; Franchising and the Law of Incomplete Contracts*,²³ states:

“Few contracts are called upon, as is the franchise contract, to accomplish so complex a task as to structure an entire ten to twenty year productivity relationship, especially under the conditions of significant uncertainty displayed in retail markets. To write a complete contract for this purpose would be to attempt to reduce to a written form a complete listing of all the different business decisions that the franchisor could undertake under all possible future circumstances, and also to specify the range of compliance responses available to the franchisee in each case..... ”

“Because this is an essentially impossible task, the franchise contract that we see in use is necessarily an incomplete one. Rather than spelling out every decision ex ante, it designs a decision making structure and assigns to the franchisor responsibility for responding to market conditions as they arise and to the franchisee responsibility for compliance.”

These special characteristics arising in a franchise arrangement have been recognised by The Privy Council in the *Dymocks* case²⁴ which has further characterised franchise contracts as:

“not ordinary contracts but contracts giving rise to long term mutual obligations in pursuance of what amounted in substance to a joint venture and therefore dependant upon coordinated action and co-operation”.

A New Zealand appellate judge of the Court of Appeal,²⁵ Thomas J, in a dissenting but very enlightening judgment, has also described franchise agreements as “relational contracts” which reflect similar flexible characteristics to those outlined above and the incomplete nature of such contracts in order to deal with future contingencies. The dissenting judge also commented on the relationship between the contracting parties *“requiring a deliberate measure of communication, co-operation and predictable performance based on mutual trust and confidence”.*

Tension between ownership and control of assets

Unlike many other commercial relationships, the interdependent nature of the franchise relationship has a highly distinctive structure which is for the benefit of both parties. Franchisees own the bulk of the capital assets put at risk while the franchisor retains the right to determine how those assets will be used. In addition the franchisor owns and controls the intellectual property and the important brand which the franchisee utilises in their own independent business. The terms of the franchise contract are also critical for enabling the franchisor to cost effectively control with a degree of certainty, the agency problems associated with this particular organisational form.²⁶

²³ (1990) 42 No 4 Stanford Law Review 927-992, pp947and 948.

²⁴ *Dymocks Franchise Systems (NSW) Pty Ltd v Biogola Enterprises Ltd* (1999) 8 TCLR 612; (2002) UKPC50(PC).

²⁵ *Bobux Marketing Ltd v Raynor Marketing Ltd* [2002]1 NZLR 506, p516.

²⁶ Refer n.1 Choices of Organisation Form p.408.

Professor Hadfield states that the distinctive separation between the ownership of the franchise assets and the control over those assets has enormous consequences for the nature of the exchange in franchising. It structures the central commitment dilemma of franchising:

“On the one hand, the franchisor has a strong interest in exercising control over product quality, decisions, and over the design of the overall system; on the other hand the franchisee has a strong interest in ensuring that the franchisor’s exercise of control is not opportunistic. Understanding the economic dynamics of the relationship identifies this basic commitment problem and provides some insight into the types of disputes that arise between franchisor and franchisee.”²⁷

The critical issue of definition

In his critique of the Australian definition of a “franchise agreement”, Professor Pengilly points out that the definitional issue is critical to all other issues. It should only capture franchises where the *overall business of a franchisee* is substantially related to the trademark of the franchisor.²⁸ He argues that the issue of power imbalance is more of an issue when the “*overall business*” of the franchisee is dependant on the franchisor’s prescribed system and the brand, rather than only a fractional part. The Australian Code definition of a franchise agreement fails to achieve that distinction. This *overall business* factor is the real factor that makes business format franchise arrangements different to all other commercial arrangements.

Conclusion – Three distinct characteristics

It is deduced from the above considerations, that there are at least three distinct characteristics of business format franchise arrangements. These are:

- 1) the existence of an information imbalance in advance of contractual commitments. This is particularly relevant when a business system requires a long term commitment of the franchisee’s capital;
- 2) the existence of a power imbalance between franchisor and franchisee. The overall business of the franchisee depends upon the franchisor’s business system and brand; and
- 3) the desirability of resolving conflict, which will inevitably arise in such a close interdependent relationship, in such a way that the relationship may still survive.

These characteristics present particular challenges for franchise arrangements. However, it should not be assumed that the imbalance factors are wrong and should therefore be removed. They are inherently part of the nature of a franchise arrangement. Careful consideration, without haste, should therefore be given to the characteristics. Appropriate solutions, if required, should only then be formulated which do not undermine the *incomplete* nature of the franchise arrangement. Justified solutions should enhance the value of the franchise concept for use in business and benefit all parties. We should avoid ill conceived remedies that may damage or impede use of the concept.

D. INFORMATION IMBALANCE – INITIAL DISCLOSURE

Better informed decision making and increased uniformity

In addressing the issue of information imbalance, the FANZ model of pre-contract initial disclosure combined with existing law rights has generally worked well enough to date for FANZ members and for franchisees of FANZ members, although it is under review. Initial

²⁷ n. 23 p.991.

²⁸ n. 20. Although commercial and legal uncertainty exists, to date, decisions of the Courts have been cautious. *ACCC v Kyloe Pty Ltd* [2007] FCA 1522.

disclosure tends to level the playing field more for both franchisor and franchisee and enables the franchisee to make far more informed decisions prior to contracting. It also provides less scope for future misunderstandings. Similar disclosure requirements can also lead to better comparative judgements between systems. In fact, this not only assist franchisees but provides a pool of better informed prospective franchisees for franchisors to draw from and can ultimately add value to a system. That is healthy.

Initial disclosure, as a means of addressing information imbalance, is also consistent with most western countries' approach to this issue. It is also consistent with the approach of the UNIDROIT Model disclosure law put forward for consideration by governments considering this area²⁹ of activity and the search for uniformity. It is seen as encouraging the development of franchising while at the same time it ensures prospective franchisees who intend to invest in franchising, receive material information about the franchise offerings which permit them to make an informed investment decision. The quality and amount of information to be supplied needs to enable informed judgments to be made. However it is not the intention of this paper to explore further the degree or adequacy of disclosure detail except to raise two caveats namely the danger of too much information and compliance costs.

Information overload

The first caveat is the real danger that too much information in a disclosure document can actually be counter productive especially for smaller investors who are already overwhelmed by the size and nature of the franchise agreement. This is particularly relevant if there is a matrix of several contracts involved. If it does not have the desired effect of informing the prospective franchisee because it is neither understood nor read, then it is of no value. The disclosure version promulgated by the FANZ, with some minor adjustments, has proven to be acceptable and therefore a very good position for any law reform. In contrast the Australian prescriptive disclosure requirements now appear so extensive as to have become burdensome and the resulting documents less comprehensible to the most vulnerable franchisees.

Disclosure requirements must be balanced against compliance costs

The second caveat relates to compliance costs associated with franchisors meeting disclosure requirements. Some will argue, the more information the better. However the more information provided, the greater the cost of gathering and providing information. Conversely one can expect with less information provided, the greater the disputation related costs. In early 2000, a review of the Australian experience following introduction of its mandatory disclosure, indicated that over 63% of franchisors surveyed and who responded either incurred no cost or relatively small compliance costs.³⁰ However compliance costs can vary with different systems. They are a serious issue and have apparently soared with increased disclosure requirements. Achieving the right balance between degree of disclosure and cost will always be a challenging issue for consideration but it should not be an excuse for not engaging the issue of disclosure.

Why not deal only with a FANZ member?

It is argued by some that it is not necessary to legislate for initial disclosure when prospective franchisees can choose to deal only with a FANZ member who is required to

²⁹ n 16 It can be argued that careful law reform requiring initial disclosure can be viewed as potentially enhancing the value of franchise activity quite apart from whether there is an identified problem to respond to. Refer also Frank Zumbo, *Franchise Disclosure and UNIDROIT :The Search for International Uniformity*, Australian Business Law Review, vol30, August 2002.

³⁰ 1999/2000 National Survey of Perceptions of the Franchising Code of Conduct prepared for the Federal Office of Small Business. Refer also Frank Zumbo, *Australia's Mandatory Franchising Code of Conduct: Successes, Challenges and Lessons*. Trade Practices Law Journal vol 9 December 2001.

provide that information. However, while FANZ appears to represent over 40% of all systems in New Zealand,³¹ it still leaves a significant proportion of systems not covered. It is appreciated that of those, a number will still comply with best practice principles and adopt initial disclosure procedures in franchising.³² However there still remain others who choose not to provide adequate pre-contract information. It is in this area in particular that the ignorant, reckless and unscrupulous franchisors will flourish and where prospective franchisees they encounter, are in most danger.

Respect for common law traditions

A further argument when addressing the information imbalance factor is to simply let the common law traditions apply. For example, that *the law will not come between a fool and his bargain* or that ordinarily parties to a commercial bargain ought to be able to allocate the risk between themselves and that the courts should not interfere with that allocation. The traditional legal approach is that such principles should not be lightly departed from. However, the focus returns again to appreciating the significance of the information imbalance in a franchise arrangement and the need to identify what deficiency may exist that is not already addressed by the law. We also now have enough examples in our law where statutory remedies overlay the common law and are applied to further protect parties from being misled or deceived.³³

A pro-competition economy must be balanced with consumer protection

In a pro competition economy, which New Zealand has vigorously pursued by statutory enactment particularly since the early 1980s, a responsibility rests upon Government to be alert to the dangers that such a deregulated economic environment can present to the vulnerable, the uninformed and in some cases the foolish. At the same time as New Zealand introduced its pro-competition regime, it also introduced the regime of consumer protection as evidenced by statutes such as the Fair Trading Act 1986 and the Consumer Guarantees Act 1993. Encouraging competition and protecting consumers go hand in hand. Wider public interest factors dictate a need to avoid the unrestrained pursuit of wealth in a free market economy and the need to impose regulatory restraints to protect consumer interests and prevent anti competitive behaviour.³⁴ The recent developments and conduct in the financial sector should provide cause for warning when franchisees are considering their investment.

The *James Home Service* case

I respectfully submit that prospective franchisees are like consumers, despite the unfortunate obiter comments recently expressed by the Court of Appeal³⁵ in the *James Home Services* case. When discussing the “consumer” protection justification for the Fair Trading Act in consumer transactions, the court stated; “*While that justification has force in relation to consumer transactions, it has less force in the context of commercial transactions involving substantial independently advised parties negotiating from positions of equality*”. The court appeared to see little difficulty in a franchisee’s ability to allocate risk through contractual negotiation. In my experience that is not the case. Such parties are usually not in positions of equality. Furthermore, negotiating the allocation of risk in a franchise arrangement is extremely challenging, especially when the contracts are intended to be *incomplete* and usually non-negotiable. Prospective franchisees are very like *consumers* with a significant

³¹ FANZ reports at March 2009, a current membership of 218 with over 60% franchisor members. It estimates about 350 franchise systems in NZ.

³² McDonalds Restaurants (NZ) Ltd, a non-member, in its submission on the MED Franchising Discussion paper acknowledges (p3) the value and effectiveness of the FANZ self regulatory regime but also refers to their own system and procedure for communicating information.

³³ Fair Trading Act 1986, Contractual Remedies Act 1979.

³⁴ See Douglas White QC “*Facilitating and Regulating Commerce*” (2002) VUWL Rev 35.

³⁵ *David and UAR Ltd v TFAC & ors* (2009) NZCA 44.

reliance factor present. In this context it must be remembered that the overall business of the franchisee remains dependent on the franchisor and its brand.

Start up operations increase the risk for franchisees

The fundamental characteristics and long term relational nature of the franchise arrangement already discussed mean that there is justification for pre-contract information disclosure combined with independent advice to assist in due diligence and management of risk. The risk increases when the franchise opportunity is a *start-up* and there is not necessarily any existing business to evaluate in a new locality. The franchisee's task is to establish the business and they are vulnerable. At the very least, all prospective franchisees and not just those buying from a FANZ member, should be made aware of what they are acquiring and who they are entering into relationship with. Initial disclosure and independent advice assist with this process. The risk factor increases further still when the franchisor's system is an unproven business. In one reported case where the Commerce Commission did prosecute the franchisor for misleading conduct, it was found that in fact the franchise was fundamentally flawed and was nothing more than a "*cerebral exercise in marketing*".³⁶

Disclosure is a valuable risk management tool for the franchisor

Finally on the issue of initial disclosure, it can be of immense value to a franchisor as a constructive risk management tool to lower the unrealistic expectations of prospective franchisees.³⁷ They often perceive the franchisor as the knowledgeable *guru*. Communication of representations and the base upon which information is supplied, is a highly vulnerable phase in a franchise sale transaction, both for the franchisee and the franchisor. Well prepared disclosure documents can assist to carefully manage communication at the time of acquisition and lower franchisee reliance on the franchisor.

E. INDEPENDENT LEGAL ADVICE

Both the power and information imbalance can be managed by introducing independent legal and (possibly) financial advice requirements, if a franchisee will heed it. Such requirements also have direct relevance to issues of contractual incapacity and the equitable doctrine of unconscionability. They further provide an opportunity for franchisees to increase their understanding, of both the documentation and the nature of the transaction they enter, especially when assisted by advisors experienced in franchising. Substandard advice achieves little. It greatly facilitates the potential for comprehensive and focused due diligence to be carried out with regard to the fundamentals of the business and the market it operates in as well as the franchise arrangement itself. There is a great deal of present and future uncertainty attached to a business acquisition and more so when it is a *greenfields* franchise opportunity.

Independent advice also adds to the effectiveness of holding a franchisor accountable for the information supplied and influential representations made when negotiating the sale of a franchise. The flip side is that it enables the franchisor to manage their own pre-contractual liability risk and challenges prospective franchisees to make their own judgment calls. As mentioned above, franchisors are often perceived by franchisees as the expert, especially at the stage of negotiating a franchise purchase. In many respects they are and can be held accountable for that. Both parties need to carefully manage the risks associated with a franchise sale and purchase for the benefit of everyone.³⁸

³⁶ *Commerce Commission v Chalmers* (1990) 3 TCLR 522.

³⁷ Refer Greg Nathan E Factor *Profitable Partnerships*. 6th Ed (*The Franchise E factor*, chp 8). *Infra* n.38.

³⁸ *Miba Pty Ltd v Nescor Industries Group Pty Ltd* (1996) 141 ALR 525, The director and controller of the franchisor (Muffin Break franchise in Australia) held himself out as "*having developed a special expertise in respect of food outlets*" and the franchisor and director were held accountable for misleading conduct. Refer also *Poulet Frais Pty Ltd v The Silver Fox Company Pty Ltd* [2005] FCAFC 131.

Independent advice can also, indirectly, facilitate better processes for the flow of education to those in need of it. The FANZ³⁹ diligently focuses on the value of franchise education and best practice for both franchisors and franchisees. It provides enormous support and information in this area. Experienced advisors will indirectly draw this to their client's attention even if the prospective franchisee has no prior exposure to the sector.

F. COOLING OFF PERIOD

I advocate the incorporation of a mandatory *cooling off* period following execution of a contract. A right of cancellation for a limited period should be recognised even if experience has shown that it is not exercised much in practice. It makes little sense to force an unwilling party into such a long term relationship. Pressure selling of franchises can be reduced by such an approach. It is also an area where franchisees are easily exploited with regard to forfeiture of monies arising from such exit arrangements and there is a case for legislation to control this.

G. ALTERNATIVE DISPUTE RESOLUTION (ADR)

Owing to the incomplete nature of franchise agreements, the power imbalance factor and the highly relational component of a franchise agreement, conflict and disputes will undoubtedly arise. The relationship in many cases needs to survive the conflict and the capital investment made by the franchisee needs to be preserved as much as the franchisor's intellectual property. The brand in particular must be protected for the benefit of all parties.

Alternative dispute resolution (ADR) by way of mediation is growing in popularity and there is a case for encouraging the parties to a franchise arrangement to pursue ADR options and in particular mediation. From a franchisor's perspective, mediation can be utilised in a constructive way to manage conflict at an early stage before it develops into litigation. Litigation is obviously more costly and the franchisor's attention and indeed resources can be significantly diverted away from the franchise business. That can seriously affect a whole network. For some franchisors, mediation can also mean a smaller number of litigation disputes to be disclosed in subsequent disclosure documents. Furthermore, as the parties engage in the mediation process, they are usually exploring mutually acceptable options in a less combative way. This can improve the prospect of preserving the relationship.

From a franchisee's perspective, ADR can remove or minimise barriers of cost, location and duration which are inherent in litigation. It is also much more difficult to maintain a relationship once a franchisee has issued proceedings against their franchisor. Although mediation is not always the most appropriate dispute resolution mechanism, it is a positive and constructive step in seeking to counterbalance the power imbalance factors present in franchise arrangements. It enables franchisees in particular, to at least assert their legal rights and be heard without necessarily having to resort to litigation. A well prepared mediation case can be a sobering experience for a franchisor who may be confronted by a franchisee's justified grievance.

A certain level of success has been achieved by FANZ with its Code of Practice requirement that all member franchise agreements mandate ADR by way of mediation as an initial step if either party wishes to seek it. The Australian experience with mediation also appears relatively successful as reported by the Office of the Mediation Adviser (OMA) in Australia. I am informed by the OMA that since its establishment in 1998, the OMA has received 3,400 new inquiries and appointed mediators to 1093 disputes (not all appointments are made by

³⁹ Others also provide regular valuable information and guidance in New Zealand such as in particular, Franchise New Zealand Magazine and website.

the OMA) and of the mediations conducted approximately 75% have resulted in settlement. Almost 30% of mediations are started by franchisors. There are still weaknesses associated with franchise mediation in Australia as noted by some commentators.⁴⁰ However, the overall trend demonstrates the value of mediation. ADR and particularly mediation, has also proven its value in various areas of New Zealand law such as in employment and matrimonial/family matters.⁴¹

In the context of the challenges faced in franchise arrangements and particularly to soften the effects of power imbalance factors, as well as preserve the relationship between parties, I submit there is a good case for the legislature to introduce compulsory ADR into the franchise sector in the manner advocated by FANZ. There are of course cost implications with such an approach and particularly if the Australian approach of an Office of the Mediation Advisor is adopted. However, the cost to participants can be expected to be much less than the astronomical costs associated with litigation or social and wider commercial costs associated with franchisees simply not being able to pursue legal rights through litigation.

H. ADEQUACY OF EXISTING LAW

Some argue that we already have sufficient law to deal with the imbalance of information and the imbalance of power at both the pre-contract stage and the subsequent relational stage. In many ways that is true. The laws of particular relevance are of course the common law particularly as it relates to contract law but also statutory remedies provided by such statutes as the Contractual Remedies Act, the Fair Trading Act, the Commerce Act and the Illegal Contracts Act. However there is no legal requirement for pre-contract disclosure or independent advice which would address both information and power imbalance factors.

Pre-contract representations

The area of pre-contractual negotiation has over recent years provided numerous cases where franchisees have pursued their rights. These causes of action have largely arisen at the time the parties have contracted, either due to contractual misrepresentation or through misleading and deceptive conduct. It is recognised that franchise sale transactions tend to draw more attention in this area than perhaps non-franchised business sales. This is evidenced by the number of court decisions dealing with misleading and deceptive conduct associated with a franchise-based sale.⁴² It needs to be appreciated however, that this may be a natural consequence of a purchaser often buying only a franchise business opportunity (a greenfields situation) at the time of acquisition rather than an existing operating business. Purchasing only a franchise opportunity to start-up a business leaves the door wide open for franchisee expectations not to meet reality, partly due to limited due diligence or poor communication management. It is acknowledged however, that significant legal remedies are available for aggrieved parties to pursue under existing law.⁴³

A fence on top of the cliff is better than rights at the bottom

An important point to appreciate is that even with existing law providing available rights and remedies, these are of little value if one does not have the financial resources (or indeed the emotional energy) to exercise those legal rights. An analogy would be falling off a cliff. If

⁴⁰ John Levingston, *Franchise mediations: Experience, Problems and Solutions* (2008) 19 ADRJ 83.

⁴¹ Refer also to requirements for ADR in the Financial Services Provider (Registration and Dispute Resolution) Act 2008 and the Retirement Villages Act 2003.

⁴² Refer unpublished paper presented at Auckland University Business School (June 2009) by G.Gunasekara and N.Dabee, *Franchising and Misleading or Deceptive Conduct : An analysis of Litigation*.

⁴³ Refer NZLS seminar paper (August 2008) which discusses available remedies, *Deception in Commercial Dealings* by Hon Justice Arnold and David Goddard QC. See also Warren Pengilley article, *How Not To be Misleading or Deceptive in Pre-contract Negotiation*, NSW Law Society Journal 55, September 2005.

you are still alive but injured, how do you climb back up without the resources to do so? The losses have been sustained. Access to justice is, of course, a fundamental economic challenge. Legal aid for civil proceedings is of limited value in New Zealand and it generally does not fund court proceedings by companies, which is the structure many franchisees use.

Building a fence at the top of the cliff at least reduces the number of casualties. It does not have to be a fence that is so high that no one will ever fall (we should not expect to completely remove risk), but it can be a fence that presents at least some resistance. At the very least it provides adequate warning of the risk relating to the terrain and dangers ahead. If persons still wish to proceed further, then, in my view, they take the risk upon themselves but in an informed way. It is my contention that initial disclosure provides that fence. It is strengthened further when combined with a *cooling off* period, independent legal advice, an alternate dispute resolution process and education. Legislative reform of this limited nature and degree can address an existing need and danger in a reasonably effective way.

Reasonable notice of termination

While initial disclosure in particular is focused on the information imbalance and to a lesser degree on the power imbalance factor in franchising, the power imbalance may manifest itself more with conduct associated with the ongoing relationship. Australia has ventured into the relationship area as part of its Code of Practice dealing with issues such as unreasonably withholding consent to assignment and providing reasonable notice of termination and in some instances requiring reasons.⁴⁴ I submit that in New Zealand the case law is sufficient to address the issue of reasonable notice of termination. The law supports the proposition that if the terms of a contract do not expressly provide for a prescribed period of notice prior to termination, then reasonable notice is required to be given and the court will consider what is reasonable.⁴⁵

Consent to transfer

With regard to the issue of unreasonably withholding consent to an assignment, this may be challenged if the agreement expressly provides for consent not to be unreasonably withheld.⁴⁶ However if the agreement is effective in its express terms, then it appears unlikely that the court will imply a term of reasonableness unless the test of business efficacy is satisfied.⁴⁷ I suggest that in the context of consent to transfer of a franchise agreement, this can be argued as acceptable. This is because franchisee selection is critically important in a franchise both at the time of initial establishment but also at the time of any transfer and the law should be very cautious to intervene in and override a franchisor's discretion on such a matter.

Any legislative attention to this area needs to respect the fundamental principle of freedom of parties to contract and to achieve, as far as possible, certainty in contractual dealings. In my view, commercial dealings can significantly suffer when there is a tendency for the law to override what parties have agreed. It generates a climate of uncertainty with regard to the effects of agreed contractual terms. It does not assist confident business decision making.

Industry specific law for industry specific problems

In its submission on the MED Franchise Discussion Document, The Motor Trade Association raised some concerns regarding the dominating conduct of various players in the motor trade and cited examples. However, some examples given in the submission appear to

⁴⁴ Trade Practices (Industry Codes - Franchising) Regulations 1998, sections 20 to 23.

⁴⁵ *Paper Reclaim Ltd v Aotearoa International Ltd* [2007] NZSC 26 Supreme Court 1 May 2007.

⁴⁶ *KA Old and JD Maroney v Snack Systems Ltd* 10 August 1994, unreported, HC, Auckland CP 266/94, Master Towle.

⁴⁷ *Raponini Excursions Ltd v Dennys Inc*, unreported (April 2002) HC, Nelson CP 20/1 Master Venning. *Infra* n. 57.

arise in the context of express contractual terms which were agreed to at the outset and need to be considered in the context of their particular circumstances. If that is the case, it is questionable whether a statutory duty not to act *unconscionably* should be allowed to introduce terms which may override the bargain that the parties have agreed to.⁴⁸ ADR can be helpful if disputes arise but if there are specific industry concerns, then I submit they should be dealt with by specific laws applicable to that industry, rather than a *broad brush* approach of enacting general laws across many industries⁴⁹ where one size attempts to fit all. A good illustration is the enactment of the Oil Code as a mandatory Code in Australia which is designed to assist in resolving disputes in the petroleum retail industry.⁵⁰

I. UNCONSCIONABLE CONDUCT

With regard to the information imbalance and power imbalance factors that exist in franchise arrangements, some have advocated that further legislative intervention is required at both the contracting stage and the relationship stage to counter these factors. As already stated, I consider the information imbalance is adequately addressed through initial disclosure combined with independent legal advice. I have pointed out that the power imbalance factor found in franchising is an inevitable consequence of the very nature of the arrangement. It enables protection and control of the system for the benefit of all. It also provides flexibility to adapt in the future. Any regulation that attempts to adjust or neutralise that power imbalance in a way that creates negative consequences or uncertainty, will, in my view, undermine franchising and its growth. Accordingly, great care is required if all the objectives Professor Warren Pengilley set out,⁵¹ are to be achieved.

From my experience with representing large corporates operating franchise networks (including in the oil and motor trade industries), preserving the value of the brand and corporate reputation is very important. This *reputation* risk factor has the potential to be a moderator of so called *unconscionable* conduct and many corporates are inclined to lean heavily in favour of the franchisee. This is particularly the case with corporates that properly understand the franchise concept.

Australia introduced into its general commercial law at the same time as its mandatory franchise code, provisions making unlawful, "*unconscionable conduct*" in certain business transactions.⁵² The law of unconscionable conduct under the Australian Trade Practices Act 1974 is not franchise specific law but it does significantly affect franchising activity along with other commercial activity. I understand this particular law had a significant initial impact on franchise growth in Australia. Indeed I speculate that the fall off in franchise growth in Australia at the time the mandatory franchise Code was introduced, had as much to do with the serious uncertainty generated by the new unconscionability law as it did with the new mandatory Code. Since its inception the Australian Competition & Consumer Commission (ACCC), which oversees the operation of the Trade Practices Act, has had franchising firmly within its sight and my observation is that franchisors have been extremely wary of its meaning and application when dealing with franchisees. Nobody wanted to become a test

⁴⁸ The threshold to overcome under Australia's unconscionable conduct law has been narrowly interpreted as being of the nature of "serious misconduct", *Garry Rogers Motors(Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) 21 ATPR 41-703; *Hurley v McDonalds* (2000) 22 ATPR 41-741.

⁴⁹ Refer Professor W Pengilley's article n.15, p 41.

⁵⁰ The Trade Practices (Industry Codes-Oilcode) Regulations 2006, a regulation under the Trade Practices Act 1974. Refer also to history and chronology of development. n 7, FCA publication pp 169-180.

⁵¹ n 15.

⁵² Trade Practices Act 1974 s51AA relates to conduct generally and enshrines the equitable doctrine of unconscionable conduct; s51AB relates to the supply of goods or services to consumers; s51AC relates to small business. S51AC further sets out eleven factors that the court may take into account in its determination of whether conduct is unconscionable.

case for what the law means. I consider this had an inhibiting effect on the sector, particularly in the early stages.

A decade after Australia introduced its unconscionability law, the interpretation of the core concept of *unconscionability* is still unsettled in Australian law.⁵³ Only a limited number of cases have been decided to date in Australia under section 51AC in which unconscionable conduct has been proven. The considerable uncertainty associated with the interpretation of this law is hardly conducive to confident business decision making activity. The uncertainty could also deter businesses that significantly utilise the franchise model from entering or remaining in the market when New Zealand needs to encourage such business activity.⁵⁴ In my view, New Zealand should not follow Australia's example by introducing such uncertainty with a similar law and it definitely should not be franchise specific. I suggest the franchise sector in New Zealand, currently, can ill afford the impact of such uncertainty.

Unconscionable conduct also falls within the realm of *consumer protection*. I understand this area of law is currently under review by the Ministry of Consumer Affairs as part of a general review of the consumer protection regime in New Zealand. There are substantial commercial stakeholders beyond the franchise sector, both large and small, who will be seriously affected by such potential legislative change. I submit that it would be most unwise to pre-empt matters by incorporating unconscionable conduct type provisions into franchise specific law reform.

J. DUTY OF GOOD FAITH

The concept or duty of *good faith*, referred to by some as loyalty to the promise, tends to arise for consideration in the context of the power imbalance factor in a franchise arrangement. The challenge is to achieve the right balance between on the one hand, the right to contract freely and on the other hand, the need to protect franchisees in particular from opportunistic or predatory behaviour by franchisors, having regard to the *incomplete* nature of franchise agreements. As stated, New Zealand has a significant body of relevant law that already addresses conduct issues. It is my view, the existing rights and remedies when combined with the proposals outlined above, are quite adequate to address any power imbalance factor without the need to introduce a further overarching general duty of *good faith*. This takes account of the objective that we should not attempt through law reform to neutralise the power imbalance as some appear to advocate, for it is fundamental to franchising.

In New Zealand, a general implied overall obligation of *good faith* in franchise contracts has not been decided conclusively by the courts and the issue remains open and debatable as to whether it should apply.⁵⁵ However, a reasonably strong argument can be made that the common law already recognises a contractual implied duty of *good faith* in certain circumstances involving *relational contracts* where mutual ongoing contractual obligations require the parties to co-operate and work together. It is likely that New Zealand courts will,

⁵³ Refer to the Australian Senate Standing Committee on Economics, *The need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of The Trade Practices Act 1974* (December 2008). The report referred to difficulties with the definition of "unconscionability".

⁵⁴ Some of the largest international real estate (eg Century 21, Remax) and home cleaning (eg Jani King) chains, only function by operating a franchise model rather than company owned units.

⁵⁵ *Dymocks Franchise Systems (NSW) Pty Ltd v Biogola Enterprises Ltd* (1999) 8 TCLR 612. The Privy Council did not need to address the issue of an implied duty of good faith but stated that they "wish to reserve their opinion on the suggestion that the implication of an obligation of good faith in the relationship between franchisor and franchisee would be an undesirable development." In Australia, a general duty of good faith has been recognised but only at a State level, *Burger King Corporation v Hungry Jacks Pty Ltd* [2001] NSWCA 187.

as a matter of law, impose a duty of *good faith* in such contracts requiring the performance of specific contractual duties to be carried out in *good faith*.⁵⁶ I submit, that is sufficient. It does not follow that the duty will or should be extended to impose a general overarching, duty of *good faith* on parties, not just in their actual contract performance actions, but in relation to actions generally. That would introduce uncertainty as to what it means and potentially undermine the sanctity of the contract the parties have made.

The law does recognise that courts should not imply a duty of *good faith* which is inconsistent with an express term of the contract as that undermines the basic freedom of a commercial enterprise to pursue a commercial opportunity.⁵⁷ Following his analysis of New Zealand case law regarding an implied contractual *good faith* duty, Justice Asher (at the time a QC but now a High Court judge) in an ADLS seminar paper, made the observation :

*“It is understandable that the Courts should be cautious about implying duties of good faith across the board, and defining the terms of duties. Parties need to be able to rely on the specific words of contracts, and pursue their own commercial interests. It would be contrary to ordinary commercial expectations, for commercial parties to be saddled with a duty akin to a fiduciary duty to the opposite party in ongoing contractual relationships.”*⁵⁸

There are also additional common law contractual duties which can provide further support in particular circumstances such as the obligation of non derogation from grant.⁵⁹ This general principle of law basically provides that where a benefit is conferred on another, the person granting the benefit should not do anything which substantially deprives the other of that benefit. That has relevance in a franchise arrangement. The common law further requires that reasonable notice be given in the case of default or termination where there is no applicable express provision in the contract.⁶⁰

When considering a statutory duty of *good faith*, it must also be appreciated that defining the exact boundaries of a *good faith* duty has proved elusive for the courts and can expect to be even more so for the legislature. Professor Andrew Terry⁶¹ of Australia has stated, that insofar as the interpretation of the concept of unconscionability still remains unsettled in Australia after ten years, “a broad and general prohibition of the ethical command “good faith” raises even more complex and sensitive issues”.⁶² Professor Terry goes on to state that the introduction of an express obligation of *good faith*; “has the potential to propel the franchising sector into a new era of uncertainty, disputation and litigation with breaches of good faith being sought to be applied to an indeterminate range of real and imagined grievances”.⁶³

⁵⁶ Refer to ADLS paper presented by Raynor Asher QC. *Contract Law Update* 2003. p5. Cases cited in support include the case of *Bobux Marketing Ltd*, n 25 and *Stanley v Fuji Xerox New Zealand Ltd*, Elias J, HC Auckland CP 470/96 5 November 1997. The paper also refers to an article by Lord Steyn *Contract Law: Fulfilling the Reasonable Expectations of Honest Men* (1997) 113 LQR 433 and a helpful article by Sir Anthony Mason (former Chief Justice of Australia) *Contract, Good Faith and Equitable Standards and Fair Dealing* (2000) 116 LQR 66.

⁵⁷ *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1997) 180 CLR 266, 283. Refer also *Bobux Marketing Ltd v Raynor Marketing Ltd* [2002] 1 NZLR 506.

⁵⁸ n 56 p5.

⁵⁹ Refer to unpublished paper, 2009 (due to be published in the Melbourne University Law Review) of Professor Andrew Terry *Franchising and the Quest For the Holy Grail : Good Faith or Good Intentions*, p13. This paper is an excellent and comprehensive background analysis of the duty of good faith as developed in the common law and as relevant to the franchising sector in Australia.

⁶⁰ Refer n 45.

⁶¹ Professor and Head of School of Business Law and taxation, University of New South Wales.

⁶² n 59. p 36.

⁶³ n 59. p 38.

The ACCC in Australia has also said it would be difficult to independently define *good faith* or reduce it to a “*rigid rule*”.⁶⁴ The ACCC stated in its submission to the committee undertaking the recent Federal Government review of franchising; “*a good faith obligation may introduce confusion about rights and responsibilities of franchisors and franchisees, and potentially increase disputes and conflict among franchising participants*”.⁶⁵

If one considers Australian developments in this area, it is noted that although recent government reviews have recommended that the legislature introduce an overarching general duty of *good faith* into the franchise sector,⁶⁶ no such duty has yet been enacted. I suggest that New Zealand should therefore, at the very least, wait and watch developments in Australia before proceeding further down this particular pathway and introduce consequences of uncertainty. I submit the case is simply not currently made out to enact such a franchise specific general statutory duty of *good faith*.

K. CONCLUSION

No legislation is a substitute for exercising sound commercial judgment of the risks at the outset of any business opportunity. This is particularly relevant with the special characteristics of a franchise arrangement. However I submit there is a case for very carefully targeted but limited franchise specific law reform in New Zealand. Its particular focus should be limited to initial disclosure, a *cooling off* period, the opportunity for independent professional advice and an available dispute resolution process in the nature of mediation. I consider this is in the interest of all stakeholders including franchisors, franchisees, suppliers, customers, investors and the economy generally. Franchise specific law reform which is very carefully considered and focused with precision, can make the franchise concept attractive and enhance the health of everyone. It will also facilitate the growth of business through use of the franchise concept.

This paper started by referring to surgical intervention, being best and most effective when it is precise, targeted and of minimum impact necessary to achieve the required outcome. The suggestions put forward in this paper are submitted as a proposal that I believe would achieve that precision, with minimum impact, but provide the desired result.

D S Munn⁶⁷

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⁶⁴ n 12 Australian Federal Report paras 9, 8.10.

⁶⁵ n 12 Australian Federal Report para 8.59.

⁶⁶ n 12.

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David has represented numerous franchisors in various industries, nationally and internationally, including large corporates and small businesses as well as many prominent and leading brands.

Gaze Burt has been a member of the Franchise Association of New Zealand since its inception and David acts as its honorary solicitor. He is a member of the Franchise Council of Australia and is one of two New Zealand lawyers listed in the International Who’s Who of Franchise Lawyers. He has had articles on franchising published in the New Zealand Law Journal and the NZ Accountants Journal. He has also presented at franchise conferences in New Zealand and Australia and Auckland District Law Society seminars.

