

**IBA/IFA 35<sup>th</sup> ANNUAL JOINT CONFERENCE**

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**New Challenges for International Franchising**

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**NEWS FROM AROUND THE WORLD**

**FRANCHISING IN NEW ZEALAND**

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## **1. Franchising in New Zealand**

Franchising is developing in New Zealand at a very fast rate. The sector is mature and expanding as shown by the 2017 survey of franchising which confirmed that the number of business format franchise systems operating in New Zealand has increased with 631 business format franchise systems operating in New Zealand, compared with 446 in 2012.

## **2. Legal Position**

Although there are no specific franchising laws in New Zealand, there are existing laws which protect franchisees such as the Fair Trading Act 1986, the Commerce Act 1986 and the Contract and Commercial Law Act 2017. Those Acts focus in particular on misrepresentations and restrictive trade practices which include anti-competitive behaviour.

The Franchise Association of New Zealand (FANZ) was formed in 1996 and publishes the Code of Practice and the Code of Ethics (the Codes) which all members must comply with. Many franchisors belong to the FANZ but some have chosen not to join yet still comply with the Codes.

## **3. Code of Practice**

The Code of Practice has four main aims which are as follows:

1. To encourage best practice throughout franchising.
2. To provide reassurance to those entering franchising that any member displaying the logo of the FANZ is serious and has undertaken to practise in a fair and reasonable manner.
3. To provide the basis of self-regulation for franchising.
4. To demonstrate to everyone the positive will within franchising to regulate itself.

The Code applies to all members including franchisors, franchisees or affiliates such as accountants, lawyers and consultants and all prospective new members of the FANZ must agree to be bound by the Code before they can be considered for membership.

Prospective franchisees will usually be given a disclosure document and franchise agreement by a franchisor. The Code states that franchisors must provide the disclosure document to prospective franchisees at least fourteen days prior to the signing of the franchise agreement. The disclosure document must provide certain information including the following:

- Details of the franchisor and its directors including experience and a viability statement with key financial information of the franchisor;
- Details of any bankruptcies, receiverships, liquidations or materially relevant debt recovery;
- Criminal, civil or administrative proceedings within the past five years;
- A summary of the main particulars and features of the franchise;
- A list of components making up the franchise purchase;

- Details of any financial requirements by the franchisor of the franchisee; and
- Other information as listed in the Code.

Franchising in New Zealand covers goods and services in many areas including general retail, leisure and education, business and commercial, food and beverage, health and fitness, computer and technology, home and building services.

#### **4. Structure**

If a foreign franchisor wishes to establish a New Zealand company, it must comply with the Companies Act 1993 and the Financial Reporting Act 2013. In relation to the formation of a company, this can be done online and the costs are minimal. All companies incorporated in New Zealand must have a director who lives in New Zealand or who lives in Australia and, in the case of a director living in Australia, is also a director of an Australian incorporated company. All directors must provide their place of birth and date of birth.

If a foreign business entity holds 25% or more of the shareholding in a company, the company must be audited and must file financial statements pursuant to the Financial Reporting Act 2013.

In relation to foreign investment, there are no barriers for funds coming into New Zealand. However, any proposed investment by a foreign entity (termed “overseas persons”) in significant business assets, certain types of sensitive land, residential land and fishing quota is subject to consent under the Overseas Investment Act 2005 and the Overseas Investment Regulations 2005. Overseas persons include companies incorporated outside New Zealand or a company or other entity that is at least 25% owned or controlled by an overseas person or persons. If an overseas person wishes to invest in these areas, an application must be made to the Overseas Investment Office for consent to the purchase before it can proceed.

#### **5. Intellectual Property Protection**

The term Intellectual Property encompasses trade marks, registered designs, copyright and patents. The protection of the rights to intellectual property is fundamental to any franchised business.

##### **5.1 Trade Marks**

It is imperative for a franchisor to obtain formal trade mark or service mark protection as a basis for any trading operation. There are forty-two classes of goods and services in which trade mark protection can be obtained in New Zealand and of those classes thirty-four relate to goods and eight to services. For example, there are three food classes and two classes covering products such as beer, alcoholic beverages, fruit juices and mineral water.

There is also a service class to protect advertising and business services. The nature and extent of any trade mark protection needs to be considered for each particular case.

Trade marks may comprise any word, brand, label, symbol, device or logo which serves to distinguish the particular goods or services of one party from the goods or services of another party. The Trade Marks Act 2002 governs registration of all marks.

The principal function of a trade mark is to indicate the origin of goods and services. It is important to select a distinctive trade mark in order that the public will associate your goods and services with the unique brand.

Trade marks are protected by registration in the Intellectual Property Office of New Zealand. Once you have selected or designed your trade mark then as a precautionary move it is possible to obtain a search of the Trade Mark Register to ensure that it does not conflict with anyone else's mark.

Assuming that the trade mark is available, its protection is afforded by filing an application and paying the requisite fee. This obtains a filing date and application number from the Trade Mark Office.

The benefits of registration are as follows:

- (i) It can be used to prevent any competitor from using the same or similar mark on any goods or services in New Zealand.
- (ii) It serves as public notification of your rights in that trade or service mark.
- (iii) It can prevent registration of an identical or confusingly similar mark.
- (iv) Trade mark registration is a valuable business asset.

It is also possible to have common law rights in an unregistered mark which can be protected by the tortious action of passing off.

## 5.2 **Registered Designs**

Registered design protection pursuant to the Designs Act 1953 is available for a wide range of products. Protection may be obtained for novel features of shape, configuration, pattern or ornament applied to an article by an industrial process. The features protected by a registered design must appeal to and be judged by the eye such as design on china and cutlery.

It is possible to obtain a preliminary search in the designs section of the Intellectual Property Office and such a search can provide advice as to whether or not the proposed design is likely to infringe an existing registered design and/or whether it is in fact registrable.

## 5.3 **Copyright**

Under the Copyright Act 1994 the labour, skill and judgment which an author, artist or creator has expended in the creation of an original literary, artistic, musical or dramatic work is protected. Copyright arises automatically in the work. It is not the ideas that can be protected but the tangible form the ideas take such as the manual, the logo or the advertising jingle.

Protection is in the form of a right to prevent anyone else from copying or reproducing the work or a substantial part of the work without the author's permission.

## 5.4 **Patents**

The registration of patents is governed by the Patents Act 2013. In broad terms, patent protection may be obtained for inventions (ideas) which are new and are capable of manufacture. Patent rights are granted by statute and the system operates as a reward for technical innovation by granting exclusive monopoly rights for a defined period.

In order to obtain a valid patent, the invention must be new. An invention should not have been used, sold, published or otherwise known in New Zealand by the applicant or any third party prior to the date of application. Hence the importance of confidentiality.

It is essential to have expert advice in the areas of trade marks, registered designs, copyright and patents.

## **6. Cartels Legislation**

The Commerce (Cartels and Other Matters) Amendment Act 2017 became law in New Zealand in August 2017. This new Act amended the Commerce Act 1986 and key changes include the following:

### **6.1 Cartel Conduct Prohibitions**

Broadly speaking, there are three new "cartel conduct" prohibitions that are unlawful unless an exemption applies:

- (i) a prohibition on competitors fixing prices;
- (ii) a prohibition on competitors jointly restricting output; and
- (iii) a prohibition on competitors colluding to allocate markets.

These new prohibitions clarified the law in New Zealand and will have a far-reaching impact on business. However, some types of anti-competitive arrangements are exempt from the cartel prohibitions and are summarised below.

### **6.2 Collaborative Activity Exemptions**

This exemption applies to cartel conduct by competitors in a "*collaborative activity*" where the cartel provision is reasonably necessary for the purpose of the collaborative activity. The collaborative activity exemption may also apply to a restraint of trade provision post-termination of a franchise agreement in certain circumstances. Competitors can seek clearance for proposed collaborative activities that contain a cartel provision giving certainty that the proposed activities will not breach the Commerce Act.

The collaborative activities exemption is an important exemption for those involved in franchising in New Zealand. Some provisions of franchise agreements may be regarded as cartel provisions (such as territory allocation and restraint of trade) and so any franchisor entering New Zealand will want to obtain legal advice that this exemption applies to any cartel provisions in the proposed franchising activities.

### **6.3 Vertical Supply Contract Exemption**

This exemption recognises that there may be circumstances where a supplier and a customer may be in competition with each other and as a result provisions in their supply agreement risk being cartel provisions. This exemption allows cartel provisions that are included in vertical supply contracts where certain requirements are met.

#### 6.4 **Joint Buying and Promotion Agreements Exemption**

This exemption may apply when competing buyers arrange to purchase goods or services together on terms that individually the competitors could not negotiate on their own. This exemption applies only to price fixing and not the other forms of cartel conduct.

The amendments to the Commerce Act affect New Zealand businesses including:

- (i) Many suppliers and resellers – for example distribution agreements with territorial allocation clauses; and
- (ii) Most franchisors and franchisees since most franchise agreements contain territorial allocation clauses and restraints of trade.

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

Examples of necessary clauses to be inserted into all Franchise Agreements in New Zealand include the following:

##### (i) ***Grant of franchise***

A clause along the following lines should be inserted in the grant of franchise clause:

*“The success of the franchisee and franchisor’s system generally is reliant on the collaborative relationship between the franchisee and other franchisees from time to time so as to ensure a uniform offering to customers and to instil customer confidence in the franchisor’s system, and to continue to allow the franchisee to provide quality products to customers at competitive pricing.”*

##### (ii) ***Marketing***

Normally a Franchise Agreement will contain clauses in relation to marketing and marketing advice. Within that heading the following clause should be inserted:

*“The parties expressly acknowledge that consultation by the franchisor and the franchisee in relation to marketing is no more than is reasonably necessary to continue the collaborative nature of the relationship between the franchisor, the franchisee and all other franchisees of the franchisor’s system in:*

- (a) *Being able to offer quality services to customers at competitive prices; and*
- (b) *Acting in uniformity so as to engender and maintain a positive customer perception of the franchisor’s system and the franchisor’s name.”*

##### (iii) ***Licensed products***

Licensed products are those products that the franchisor has agreed with external suppliers will be supplied exclusively to all franchisees. These agreements are generally time-bound and often require a minimum level of purchases by the group. The supplier will generally agree to this exclusive arrangement because it is primarily

for the purpose of growing distribution and sales of their products through the promotion of their products through the group and the suppliers are keen to assist the group and the franchisees at all times.

(iv) ***Approved suppliers***

Approved suppliers are those suppliers who have been assessed by the group and who are determined to be reputable suppliers of good financial standing and comply with New Zealand legislation and with the franchisor's best practice guidelines – for example, having regard to claims and warranties.

(v) ***Restraint area and period***

The restraint area is defined as within a franchise or company owned territory, for example within 25 kms of a franchise or company owned territory. The purpose of the restraint area is to provide some protection to each franchisee and to encourage investment by all franchisees within the franchisor's system, and also to provide some sort of protection to potential new members of the group. The restraint period may be defined as one or two years and its purpose is to encourage investment by current and potential franchisees to build and operate their businesses. If any franchisee chooses to leave the group in the future then the restraint period will provide some protection for the remaining franchisees.

(vi) ***Location***

The location is the geographic area defined for the purposes of the marketing and advertising of the franchisor's products and services. The location does not define where the franchisor's customers are allocated or serviced from, and customers are able to choose to purchase any products from any franchisee or company owned store, wherever it may be located.

7. **Commerce (Criminalisation of Cartels) Amendment Act 2019**

At the time of writing this paper the Act has not passed into law but that event is imminent. 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 paper. 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 7 years or a fine not exceeding \$500,000, or both. For a company which commits an offence the penalty could be up to \$10 million so great care must be taken.

8. **Taxation**

Taxation is payable on all income earned in New Zealand. The current rates for companies is 28%. The goods and services (GST) tax rate is 15% and it is added on to all goods and services with no exceptions. Although there are no restrictions on the transfer and remittance of currency from New Zealand to an overseas jurisdiction, the tax laws of New Zealand must be complied with. In relation to the payment of royalties, dividends or interest, non-resident

withholding tax (NRWT) must be deducted by the payee before funds are remitted to the overseas entity. The tax deduction must be paid by the payer to the New Zealand Inland Revenue Department (IRD) but a tax credit would be available to the overseas company. The rate of tax varies on the country involved, and New Zealand has double taxation treaties with a large number of countries. For example, in relation to Australia, Japan, Singapore and the United States, the rate of NRWT is 5% in relation to royalties, and in relation to Canada, China, Taiwan and the UK, the rate is 10%. In relation to Fiji, Indonesia, Malaysia and the Philippines, the rate is 15%.

Royalties means *“payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematographic films, films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. The term ‘royalties’ also includes income or gain from alienation of any property or rights described in this paragraph to the extent that such income or gains are contingent on productivity, use or disposition of such property or rights.”*

It is common for franchise agreements and licence agreements to contain a “*gross up*” clause in relation to any withholding tax liability and the following clause should be considered:

*“All royalties and other sums payable under this agreement shall be paid free and clear of all deductions and withholding taxes unless the deduction or withholding tax is required by law. If any deduction or withholding is required by law, the franchisee shall pay to the franchisor any sum as will, after the deduction or withholding has been made, leave the franchisor with the same amount as it would have been entitled to receive in the absence of any such requirement to make a deduction or withholding.”*

The clause essentially means that the franchisor would receive royalty payments net of any overseas taxes.

## **9. Privacy Laws**

The right to privacy is a fundamental human right and the modern threat to this is the increased collection and use of personal information which is essential to the operation of all governments and other agencies. The Privacy Act 1993 is relevant and the Act endeavours to control privacy, accuracy, property and accessibility and overseas franchisors must be aware of the privacy laws.

## **10. Territories**

A key part of franchising is for a franchisor to be able to offer some sort of territory to their franchisees. Most franchise systems in New Zealand rely on specific territories and the number of territorial disputes has risen in New Zealand over recent years. A potential franchisee who has selected a franchise system and obtained a copy of the disclosure document and franchise agreement from the franchisor must look carefully at the territories available and what is being offered by the franchisor.

If the business will be conducted in a shop in a shopping mall then will the territory just be the surrounds of the shopping mall? Will it be a territory covering a reasonable area which will be defined on a map to be attached to the franchise agreement? Will there be a non-exclusive territory or no territory at all, and, in consequence, “a free for all” within which numerous franchisees will be conducting their own separate businesses with no demarcation line?

## 10.1 Concise Territory

In the majority of cases, a franchisor will have divided up New Zealand into concise and separate territories which will be allocated to each new franchisee. Territories should be carefully defined on maps and a typical clause in the franchise agreement may be as follows:

*“The franchisor grants to the franchisee a franchise to establish and carry on a business within the territory as set out in the schedule and delineated in red on the map attached and to carry on the business within the territory using the methods and techniques developed by the franchisor ...”*

This type of clause gives certainty to a franchisee by way of a map being attached to the franchise agreement with the boundaries of the territory clearly defined. There can be no doubt as to the boundaries of the territory which a franchisee is contracting by way of execution of the franchise agreement and payment of the initial franchise fee. In my opinion, some franchisors make the mistake in the early days of giving franchisees too big a territory which a particular franchisee does not service and exploit to its maximum potential.

Some franchisors may wish to cover their position by reserving in the franchise agreement the right to take back part of the territory in the future (perhaps when the system has become established) by re-demarcation of the boundaries during the term. This may be framed as an absolute right or in the franchisor’s discretion (reasonable or otherwise) that the territory is not being (or has become) and/or may not be capable of being serviced to its maximum potential. A franchisee should be aware of a blanket sole discretionary right which may be drafted as follows:

*“The franchisor shall have the right at any time during the term to reduce the territory if in the franchisor’s opinion the franchisee is not maximising or is unlikely to be able to maximise business exploitation of the territory.”*

A possible way out of the above is for the franchisee’s lawyer to suggest inclusion of an amendment along the following lines:

*“provided that the franchisor shall not be entitled to reduce the territory to an area within a [insert number] kilometres radius from the premises.”*

## 10.2 Exclusivity of Franchise

What a franchisee requires in entering into a franchise arrangement is certainty. There must be certainty as to the upfront franchise fee payable, certainty as to the ongoing service fees or royalties payable together with advertising levies and, most importantly, certainty in relation to the territory. A possible clause to consider is along the following lines:

*“If the franchisor or the franchisee identify the opportunity to establish a further franchise in the territory (‘the proposed franchise’) then the franchisee shall be considered prior to any third party as the proposed operator of the proposed franchise. The existing franchisee, subject to meeting all new franchisee criteria, shall be offered a 14 day first right of refusal.”*

### 10.3 Alternative Clause

Another way is to confirm that the franchisee has not been granted an exclusive territory but to combine that provision with a right of first refusal by a franchisee should a franchisor wish to establish another franchise outlet within the territory, and such a clause would read as follows:

*“The franchisee acknowledges that it has not been granted an exclusive franchise territory but that it has been granted the right to carry on a business at the premises. The franchisor agrees that it shall give the franchisee a first right of refusal (provided the franchisee is in full compliance with all of its obligations pursuant to this agreement) to purchase another franchise it may propose to offer in respect of the establishment of another [insert brand name] outlet at a site which is within the area as specified in the schedule (‘the territory’) on no less advantageous terms than the proposed franchise offer to any third party. The franchisee shall then have fourteen (14) days from the receipt of notice of such offer to notify the franchisor by notice in writing whether or not it wishes to accept the offer. If it wishes to accept the offer then it must agree to open the new [insert brand name] outlet within ninety (90) days of acceptance.”*

### 10.4 No Territory Franchises

Some franchise systems prescribe no territories whatsoever. There is a difficulty here for the initial franchisee who should be concerned about saturation of the area of the franchisee’s proposed operation i.e. how far is the franchisee going to travel to get business? This is especially relevant when in the case of a new system there are no actual (as opposed to hypothetical or anticipated) figures to justify a viable business. The logical reaction would be to request a limit on the number of franchisees to operate in the area although this can also be counterproductive because it may stultify the establishment of and/or the growing of brand awareness to the public.

Territories or the lack of specific territories is a fascinating topic in franchising. A franchisor must be fair to each particular franchisee but must also abide by the provisions of the franchise agreement and also what is stated in the disclosure document. Too often a franchisor in the early years has granted a franchise to a franchisee and has given too large a territory. It is true that it is easier to give a person a limited area and later to agree to enlarge it if the business is succeeding than to give a person a large area and later take it away or subdivide it if the territory is not being utilised to its maximum potential. The key aspect for potential franchisees is always – know what you are getting into in relation to all aspects of the franchise agreement but, in particular, in relation to the territory.

## 11. Restraint of Trade

During the term of the franchise agreement, a franchisee is normally prevented from carrying on any competing business and may also be prevented from carrying on any other business and their full time and attention is critical to the success of the franchise business.

The franchise agreement will also almost invariably contain a restraint of trade which will apply to the franchisee following the termination or expiration of the agreement or the sale of the franchise business to a third party. The length and area provisions of the restraint will normally be set out in a schedule and they will be subject to general legal principles governing restraints of trade.

The courts have recognised that it is reasonable for a person in the position of the franchisor to impose a contractual restraint upon any competitive conduct by a franchisee. Contractual restraints of this type are known as “restrictive covenants” or “agreements in restraint of trade”.

Such agreements must not exceed the boundaries of the courts’ notion of reasonableness. There are two competing principles which govern the courts’ decision-making process. The first principle is that it is reasonable for a person to stipulate that if he 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 which it has received during the course of the educational process. If the courts did not provide protection to franchisors in such situations, 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 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 current position in New Zealand is set out in Section 83 of the Contract and Commercial Law Act 2017. Section 83 states as follows:

- “(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) *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.”*

What this means in practice is that if a franchise agreement provides for a three year period of restraint when a two year period would be considered to be reasonable, the covenant would be enforced to the extent that it could be re-written by the court as being confined to a two year term. The ability of the courts to modify excessive restraints is constrained by the principle that terms which 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 re-write the contract so that it falls within the boundaries of reasonableness. This is the doctrine of restraints which are “*in terrorem*”, i.e. contracts which ‘terrorise’ a contracting party. If a franchisor could only ever have reasonably sought a two year restraint within a five kilometre radius of the business from which the person established a goodwill, a nationwide restraint for six years could never be regarded as reasonable and the courts will refuse to re-write the clause so as to determine that the period of six years should be two years and the area of restraint should be five kilometres rather than the entire country.

What then is a reasonable restraint? There are two factors: area and time. For a franchise which teaches the art of making coffee and running a café, an area of restraint would typically be

confined to the area in which the franchisee is likely to establish a goodwill. A person who establishes a café in Auckland city is likely to establish a goodwill which will extend perhaps 200 to 400 metres from the site. There are so many other competing cafés that the goodwill would not extend much further than that.

The duration of a restrictive covenant should be such as will enable a franchisor to interpose a new operator who will have a reasonable time to secure the retention of the customers. In the case of a café, it is unlikely that this will extend beyond two years.

### 11.1 Typical Clause

A typical restraint on competition clause which I include in franchise agreements is as follows:

- “1.1 The franchisee covenants that it shall not during the term (or any period in renewal or extension of it) 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 business, the franchisor and its other franchisees.*
- 1.2 *Both during the term and also following the termination of this agreement or its expiration by the effluxion of time the franchisee shall not:*
- (a) act in any way to adversely affect the persistency or retention of the customers of the business; or*
  - (b) indefinitely use or disclose in any way the intellectual property or confidential information as defined in this agreement.*
- 1.3 *The franchisee shall not during the term or any renewal period or at any time following the termination of this agreement or its expiration through the effluxion of time for any reason disparage or do anything calculated to damage the franchisor’s goodwill, reputation and intellectual property rights or the goodwill of any other franchisees.*
- 1.4 *The parties agree that the restraints and restrictions contained in this agreement shall each operate as a separate and independent obligation of the franchisee enforceable to the full extent permitted by law, and shall not be affected by any invalidity in any other restraint or restriction contained in this agreement.*
- 1.5 *The franchisee and the guarantor shall not during the term of this agreement directly or indirectly engage in any activity or own or operate any similar business to the business or become interested whether as principal, agent, partner, shareholder, investor, financier, lender, director, employee, consultant, independent contractor or otherwise in any such business without the written consent of the franchisor.*
- 1.6 *The franchisee and the guarantor shall not for a period of two (2) years after the termination of this agreement or its expiration through the effluxion of time either on their own account or with or for any other person, firm or company or by their servants or agents, solicit or endeavour to entice away from the franchisor or any other franchisee by any means whatsoever any business from*

*any person, firm or company who during the term of this agreement is or was a customer of the franchisee or of the franchisor or of any other franchisee in the franchise network.*

- 1.7 *This restraint on competition shall apply to both the franchisee and the guarantor for the period as set out in the schedule from the date of termination or expiration of this agreement both within the territory or within the distance as set out in the schedule from a franchised area.*
- 1.8 *For the purpose of this clause, acts done by the franchisee and the guarantor outside the territory shall nonetheless be deemed to be done within the territory where their primary purpose is the obtaining of any business carried on by the franchisor and/or its agents within the territory from any person, firm, company or other entity with business premises within the territory. This restraint of trade restriction shall also apply to any internet use of the business by the franchisee and by the guarantor.*
- 1.9 *The franchisee and the guarantor acknowledge that the restraints as stated in this clause are fair and reasonable and are necessary to protect the franchisor.”*

## 11.2 Some Relevant Cases

While each case is very fact specific, broadly speaking recent cases regarding the enforcement of restraint of trade provisions in New Zealand have tended to uphold the restraint contained in the franchise agreement.

In *Mike Pero (New Zealand) Limited v Heath and Others*<sup>1</sup>, Mike Pero (an established mortgage broker franchise in New Zealand) applied for interim injunction against Heath a former franchisee. Heath did not renew his franchise agreement and then incorporated a new company to continue to provide mortgage broking services despite the restraint of trade provision in the franchise agreement. Mike Pero filed for an interim injunction, which was granted by the court. Heath had filed proceedings in the High Court alleging that the restraint was unreasonable and that Mike Pero did not have any goodwill to protect. The court disagreed with Heath and noted that Heath acknowledged the restraint when he entered into the franchise agreement, he must have known what he was doing when he did not renew his franchise agreement and that he had been well informed of the restraint.

In *Supatreats Asia Pte Limited v Grace & Glory Limited and Others*<sup>2</sup>, the franchisor had a well-known ice cream parlour brand in New Zealand called Wendy's Supa Sundaes. There was a master franchisor agreement with Cone Enterprises Limited. The two parties disagreed over a proposed new ice cream supplier. Cone argued that the new supplier was more expensive, but inferior in quality and refused to comply, and did not force the other franchisees to comply. As the parties were attempting to resolve the dispute, the director of Cone opened a new ice cream parlour store called Shake Shed & Co and other former Wendy's franchisees cancelled their franchise agreement with Cone (and Supatreats) and rebranded to the new store. The director did not advise Supatreats of the re-branding and when Supatreats eventually found out it issued breach notices to Cone, Chang and other franchisees. Supatreats eventually terminated the master franchisor agreement and applied for interim injunctions against the defendants to stop the operation of the new stores under the restraint of trade

<sup>1</sup> [2015] NZHC 2040, Moore J.

<sup>2</sup> [2018] NZHC 1612, Wylie J.

provisions, alleging that the director induced other franchisees to enter into the new franchise agreement with Shake Shed. The defendants argued that the restraints were unreasonable and that Supatreats breached the franchise agreement. They also argued that since the roll out was complete the stores should remain open. The court disagreed and granted the interim injunctions. The judge commented that it was clear that the defendants knew of the restraint of trade provisions and continued to trade as Shake Shed in the face of express notice from Supatreats which was a significant factor in granting the injunctions.

By contrast, in *Dorn Investments Limited v Paul Hoover*<sup>3</sup>, Dorn was a master franchisee of Green Acres, a lawn mowing franchise in New Zealand. Dorn had become unsatisfied with Hoover, a franchisee, and removed a significant cleaning contract, which accounted for a large part of Hoover's earnings. Hoover then rebranded and continuing servicing the same area and clients. Dorn terminated the franchise agreement and sought an interim injunction to restrain Hoover. Hoover argued that the removal of the cleaning contract amounted to repudiation. The court acknowledged that there was a restraint and Hoover had breached it. However, the court also agreed with Hoover that taking the contract off him arguably resulted in repudiation of the franchise agreement. Dorn never gave Hoover the chance to rectify any issues with how he had been operating. Furthermore, an injunction would be severely detrimental to Hoover as the business was his only source of income, so the court did not grant an injunction.

There is a trend to enforce restraint of trade provisions by the New Zealand courts. However, each restraint of trade scenario needs to be examined on its merits and no-one can assume that because there is a franchise system involved the restraint will be upheld. The party attempting to enforce restraint must show that there is a proprietary or legitimate interest justifying the restraint, and that the restraint goes no wider than is reasonably necessary to protect that interest. The actions of the parties leading up to the breach of the restraint are also relevant and whilst franchisors who behave fairly may feel confident about the enforceability of their restraints, nothing is certain. The cases where the courts have been prepared to uphold restraints each involve successful and well-established systems with strong brands, systems and a strong network of franchisees. Therefore, in relation to interim injunction applications the courts will recognise the need for enforceable restraints of trade to protect a franchisor's goodwill. Where the case is a strong one, the courts are willing to enforce a restraint of trade even where there will be significant cost and difficulty for the restrained party; and the remedies can even include forcing a restrained party to re-join a franchise system that it is in dispute with, pending outcome of trial. Franchisees should consider the risks of the restraint being enforced before entering (or breaching) restraints of trade.

## 12. Conclusion

Franchising in New Zealand is continuing to expand annually. There are inbound and outbound franchise systems and there is always an attraction for international franchisors to enter New Zealand because it is a sophisticated market and there is no franchise-specific legislation so we are easy to enter. International franchisors must be aware of our Cartels legislation and should obtain independent legal advice from a franchising attorney with experience in franchising laws.

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<sup>3</sup> [2016] NZHC 1325, Asher J.

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