

Welcome to the late Autumn issue of *Commercial eSpeaking*. We hope you find the articles of interest. If you would like to talk further about any of the issues covered in this newsletter, please be in contact with us.

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Franchising

The Pros and Cons

Operating a franchise can be a very satisfying and profitable method of running a business. There are, however, some specific issues around franchising that are quite different from running a 'regular' business. This article looks at some of the positives and negatives of buying a franchise business.

What is franchising?

Franchising is the licensing of a brand and system from one person (a franchisor) to another (the franchisee). The franchisor/franchisee relationship is governed by a franchise agreement that sets out the rights which are obtained and the services that the franchisee will be entitled to receive subject to the paying of a fee (normally an initial fee and then ongoing royalty payments).

There can be a significant difference in the initial franchise investment depending on the type and scale of the business purchased; it could range from \$20,000 for a small cleaning business to \$250,000+ for a larger retail operation. The average length of a franchise contract is 10 years, with the average royalty paid by franchisees to the franchisor ranging from 3%–6% of monthly gross sales.

Why buy a franchise business?

There are estimated to be over 400 different franchise systems operating in New Zealand and more than 20,000 franchise businesses. In presenting the 2010 Survey of Franchising, Dr Susan Flint-Hartle of Massey University estimated that the franchising sector in New Zealand accounted for 5% of this country's small to medium-sized enterprises.

The popularity of the franchise business model is due to its proven track record of success and the ease in becoming a business owner. However, while the success rate for franchise-owned businesses is significantly higher than for independent businesses, no individual franchise is guaranteed to succeed.

We have listed below some of the issues you should consider before making the leap into franchising.

The positives

The biggest advantage of buying into a franchise is that you gain immediate access to an established brand and customer base. Other key advantages are likely to include:

- » Significant marketing and business support
- » Access to reputable suppliers and lower priced goods and/or services
- » Access to proprietary goods, methods and/or systems
- » Initial and ongoing training
- » Access to ongoing research and development and new products, and
- » You're the boss.

For all of these reasons and more, starting a franchise of an established brand can have less risk than starting a business from scratch.

And the negatives

- » Possibly large initial investment costs (franchise fee and start-up costs)
- » Ongoing royalty payments and ongoing marketing/advertising fees
- » Limited creativity/flexibility – you must follow the rules of the franchise system
- » Restricted suppliers
- » Potentially locked into a long term contract
- » Dependent on franchisor success, and
- » Risk: there's always risk in starting any new enterprise – even a franchise business.

Before finalising your decision about buying into a franchise operation talk to your family, to several different franchise system franchisors and franchisees, and most definitely consult with franchise experts.

We will help you understand all the ins and outs of the franchise contract before you sign it. And you'll also need an accountant to help you develop a business plan, both for yourself and for any financing you may need.

Finally, if you are a true entrepreneur, then owning a franchise may not be for you although you may be well suited to establishing your own franchise and becoming a franchisor. On the other hand, if you are willing to follow a system then joining a franchise can be a highly rewarding and successful option.

Anti-Competitive Behaviour

Avoid it at all costs

There are often benefits for competing businesses to discuss industry related practices and issues among themselves. However, when having discussions like this, you must ensure you are not engaging (inadvertently or otherwise) in anti-competitive behaviour that could breach the Commerce Act 1986.

The Commerce Act restricts anti-competitive behaviour, and also prohibits businesses entering into anti-competitive agreements, contracts or understandings. You should familiarise yourself with the restrictions and requirements in this legislation so you can recognise anti-competitive behaviour, and implement systems and policies to avoid you or your employees engaging in this type of conduct.

The Commerce Act 1986

The purpose of the Act is to promote competition in markets for the long-term benefit of New Zealand consumers. Anti-competitive behaviour can damage the economic welfare of New Zealand by raising prices, limiting choice, and compromising innovation and quality.

Business owners and their employees (and even consumers) should be familiar with two key provisions of the Act:

1. Section 27, which prohibits anti-competitive contracts, arrangements or understandings. Under the Act it is unlawful to enter into contracts or arrangements, or arrive at understandings, that would, or may, substantially lessen competition in the market.
2. Section 30, which prohibits competing businesses entering into contracts and arrangements, or arriving at understandings, that do, or may, fix, control or maintain prices or provide a mechanism for doing so.

When deciding whether competition has been, or may be, substantially lessened in the market, the court will consider the impact the contract, arrangement or understanding will or have on competition in the relevant market, whether other market participants can compete, and how difficult it is for new competitors to enter into that market.

Contracts, arrangements and understandings between competitors don't have to be formally recorded in writing. They could simply be an informal, and possibly oral, understanding created by a hand shake or even a nod of the head.

Consequences of breaching the Commerce Act

The Commerce Commission investigates complaints or issues that are brought to its attention. If it believes the Act has been breached, it has a number of options including educating a business about how to comply with the Act, issuing a warning or prosecuting the business in the High Court. Penalties for a breach of the Commerce Act are severe. Individuals can face penalties of up to \$500,000 and organisations can be liable for the greater of \$10 million, or three times their commercial gain or 10% of turnover.

Reducing the risk of anti-competitive behaviour

Bearing in mind the penalties, what steps can you take to avoid breaching the Act? You should:

- » Ensure you and your relevant employees are familiar with the restrictions and requirements of the Act
- » Avoid exchanging private information with your competitors
- » If you are approached by a competitor business to discuss pricing, immediately raise an objection and leave the discussion
- » If you are approached by a competitor to discuss allocating customers, bids for contracts or restrictions on outputs, raise an objection immediately and leave the discussion, and
- » Review your internal documentation, policies and procedures to ensure they comply with the Act.

Competing businesses shouldn't be discouraged from discussing industry related practices and issues, but they must ensure they don't overstep the mark and inadvertently (or not) find themselves engaging in anti-competitive behaviour. Immediate steps should be taken to ensure compliance with the Act, as the penalties can be severe. Familiarise yourself with the legislation and ensure you have good systems and policies in place to avoid a breach.

Business Briefs

New copyright law

On 14 April 2011, the Copyright (Infringing File Sharing) Amendment Act was passed. The new regime comes into effect on 1 September 2011. The Act establishes a 'three strikes' regime in an effort to curb illegal file-sharing over the internet. It will not, however, apply to mobile phone networks until 1 August 2013.

From 1 September copyright owners (or an agent acting on their behalf) may notify an internet service provider (called an IPAP in the Act) that someone is illegally downloading material, such as films or music through 'file sharing', for example, via peer to peer. The IPAP then sends a notice to the internet account holder telling them that they or someone using their account may have infringed.

After three warnings (at least 28 days apart), the copyright owner can then take a claim to the Copyright Tribunal. The Tribunal (which will commonly hear cases 'on the papers' rather than at a hearing) can impose a penalty up to \$15,000 on the internet account holder.

Penalties can be imposed whether or not the account holder knows its account is being used to infringe, so they are still liable even if their wi-fi has been hacked, for example. This situation, and the fact that an Infringement Notice, by itself, creates a presumption of infringement, is an extension of the normal innocent until proven guilty rule. The presumption can be rebutted, however, by the account holder providing evidence to the contrary.

The Act includes provisions for the termination of internet accounts, but these have not been brought into force. They can, however, be brought into force at any time by an Order in Council.

PPSA – Australian style

The Australian version of New Zealand's Personal Property Securities Act is expected to come into effect across the Tasman in October this year. Whilst conceptually similar to New Zealand's PPSA, the Australian legislation differs in a number of significant respects.

However, as in New Zealand, registration of financing statements to perfect security interests is an important aspect of the new Australian legislation. If you own or have a security interest in any personal property in Australia, have moveable assets (or security over such assets) which may be transferred to that jurisdiction from time to time, or export goods to Australia, then the new Australian PPSA may impact on you.

Digital legacy

These days a significant amount of correspondence, interaction with others, storage of photos and other documents, and day-to-day transactions are increasingly carried out on-line. This can take place through various social networking sites, websites, email accounts and blogs.

A topical question in relation to the ever-increasing amounts of personal information stored online is – what happens to all that personal information when we die?

The New Zealand Law Society's Property Law Section has suggested that if you are making a Will or reviewing your current Will, you should consider what will happen to any digital assets you hold, including those that are password protected – the existence of which may be unknown to your family and friends. Any wishes you may have in relation to your digital assets should be included in your Will. You should specify where this account information can be found (if you wish to share it), who should be given access and any wishes regarding keeping or destroying of those digital assets.

The Law Society has published a *Digital Legacy checklist* which provides some useful suggestions to take into account in respect of your *digital legacy*. Many web services such as Facebook, Google, LinkedIn, Twitter and YouTube require a user to accept a standard form agreement on registration. This prescribes the procedures to take place when the user dies. The *Digital Legacy checklist* provides a useful summary of a number of these policies.