

ROUNDING SQUARE HOLES FOR ROUND PEGS: BETTER ACCOMMODATING FRANCHISING WITHIN THE CURRENT REGULATORY FRAMEWORK

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I. INTRODUCTION

Franchise law reform in New Zealand is dead in the water. A review of the sector by the previous Government resulted in the release by the Ministry of Economic Development (MED) of a Discussion Document in August 2008.¹ However in June 2009, the current Government announced that, as there was not strong evidence that franchise contracts are unique from other forms of doing business or of widespread problems in the franchising sector, the current regulatory framework of generic business law and self regulation is sufficient to address any issues that have arisen and that there is therefore no case for franchise-specific regulation.²

This article examines the extent to which key elements of the current regulatory framework sufficiently address issues relating to franchising. It also suggests modifications that can be made without undue violence to the existing generic business law framework in order to make it work more effectively to encompass franchising. We do not argue for a franchise-specific paradigm. Instead, we demonstrate that many of the problems that exist in franchise arrangements could be resolved if the existing network of consumer and fair trading legislation were strengthened. In doing so, we draw attention to where the existing wording and ambit of these provisions presently render them largely ineffective in dealing with these problems.

The discussion we undertake is timely. Although franchise law reform is off the agenda, consumer and fair trading law reform is currently under review. The Minister for Consumer Affairs has recently put forward the idea of 'one law, one door' for consumer protection, suggesting that there be some rationalisation between the parallel regimes operating under the *Fair Trading Act 1986* (FTA) and *Consumer Guarantees Act 1993* (CGA).³ Two aspects of the Minister's proposals merit mention: first, there is the suggestion that

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1 For a discussion of the options put forward in the Discussion Document and an assessment of their merits see Maree Chetwin, 'The Seven Secret Herbs and Spices of Franchise Regulation: Some Suggested Options?' (2009) 15 *New Zealand Business Law Quarterly* 151.

2 Cabinet Paper: *Outcomes of the Review of Franchising Regulation*, <http://www.med.govt.nz/templates/MultipageDocumentPage_____40956.aspx>, [81].

3 Hon Heather Roy, "One law – One door" for consumer transactions' speech to the Combined Ministry of Consumer Affairs Stakeholders meeting; Ministry of Economic Development, Bowen St, Wellington, <<http://www.roy.org.nz/speeches/one-law-one-door-consumer-transactions>>.

businesses are in many respects consumers as well and secondly, it has been suggested that any regime that replaces the FTA and CGA be one based on principles rather than narrower rules.⁴

These two aspects traverse many of the arguments we canvas in this article. In the first place, we put forward the case that small businesses including franchises are just as vulnerable in their business dealings as are consumers. Furthermore, any principle-based regime must be one constructed on the premise that similar concerns be dealt with in a similar manner. In particular, we argue that standard form contracts where there is no opportunity for negotiation are treated in the same way whether they occur in a consumer or business environment.

The modifications we propose are relatively minor and work within the existing architecture of contract and consumer law in New Zealand. They do not adopt the approach taken in Australia where, in addition to a franchise-specific Code⁵, there is a broad-ranging prohibition against unconscionable conduct in certain business dealings.⁶ Nor are our suggestions as wide-ranging as those relating to legislative measures proposed or adopted elsewhere in relation to unfair terms in contracts.⁷ Nevertheless, the refinements we suggest would achieve many, if not most, of the objectives of these overseas examples.

II. THE ADEQUACY OF THE CURRENT REGULATORY FRAMEWORK

It is often argued that franchise-specific regulation is not needed due to the protection conferred on those who buy businesses, including franchises, by existing legislation, notably the FTA and the *Contractual Remedies Act 1979* (CRA) which, inter alia, proscribes the making of false or misleading statements to prospective purchasers by those who sell businesses.⁸ The CGA might also be seen as part of this package although currently claims brought under it are restricted to ones by consumers.

However, the protections conferred by these statutes are largely illusory as the safeguards they contain can in most cases be contracted out of where the contracting parties are businesses. In this section, we examine the degree to which parties to a franchise agreement are covered by the protections in the CRA, FTA and CGA and the degree to which those protections may be excluded by the terms of the franchise agreements.

4 Ibid.

5 See *Trade Practices (Industry Codes – Franchising) Regulations 1998* (the ‘Franchising Code of Conduct’).

6 *Trade Practices Act 1974* (Cth), s 51 AC.

7 See, for example, Part 2 B of the *Fair Trading Act 1999* (Vict) ‘Prescribed Unfair Terms in Standard Form Contracts’; *Unfair Contract Terms Bill* (UK).

8 ‘[T]he current arrangement of generic business law – including contract, intellectual property, fair trading and competition laws ... is the most appropriate for the New Zealand environment’, Hon Simon Power, Minister of Commerce, ‘Where Franchising Fits in New Zealand’s Regulatory Framework’, Speech to Franchise Law Symposium, Auckland University, 25 June 2009, <<http://www.scoop.co.nz/stories/print.html?path=PA0906/S00354.htm>>.

The Contractual Remedies Act 1979

The CRA contains rules applying to all contracts in New Zealand, including franchise agreements. These rules provide for a duty to refrain from making misrepresentations and for remedies for breach of contract and repudiation. However, the CRA allows the rights it confers to be excluded where the parties themselves make provision for the rights and remedies arising from breach of the contract, repudiation or misrepresentations.⁹ The position is different if there are contractual provisions purporting to preclude a court from determining whether statements were made which led a party to enter a contract and whether the statements were relied on. Such clauses are commonly called Disclaimers or Merger and Acknowledgment clauses: they essentially seek to assert that the terms of the written agreement constitute the entire agreement between the parties and that no statements preceded the written agreement or, even if they were made, that they were not relied on. Section 4 of the CRA nevertheless allows the court to disregard such a clause unless the court considers that it is fair and reasonable that the provision should be conclusive between the parties, having regard to all the circumstances. The court must have regard to three matters in particular: the subject matter and value of the transaction, the respective bargaining strengths of the parties and whether the parties had legal advice.

However, in some cases, rather than exercising the discretion conferred by s 4,¹⁰ the courts have in fact used various devices to circumvent the clauses altogether: the techniques employed being either to reason that the written document was not intended to form the entire agreement between the parties (the one contract theory) or that the oral representation, when it is acted upon by the person to whom it was made entering into the written contract, becomes a separate or collateral contract on which liability was founded (the two contract theory).¹¹

Experience to date has been that only occasionally has an exclusion clause prevented the bringing of an action for misrepresentation inducing the purchase of a franchised business. In *Dillon Holdings v Stirling Sports Franchise Ltd*,¹² the court found there was no actionable misrepresentation in any event but stated, obiter, that even had there been the exclusion clause would prevent recovery against the franchisor. It was a material fact that the franchisee had, despite the franchisor's advice to do so, failed to obtain independent legal advice. Another factor influencing the judge's reasoning was the cause of action being one founded in negligence, as an effectively worded disclaimer generally precludes an action in tort.

9 *Contractual Remedies Act 1979*, s 5.

10 In *Bartrum v The Sweet Factory Ltd* (1997) 6 NZBLC 102,047, the parties had failed to execute that part of the contract containing the exclusion clause but the judge stated he would have exercised the statutory discretion to disregard the clause conferred by s 4 of the CRA, should this have been necessary; in *Honeybone v Alpha Lighting Franchise Ltd*, 20/7/99, HC Christchurch CP71/99, the court stated that the discretion under s 4 was one that had to be exercised at trial, and not during interlocutory proceedings.

11 See, for instance, *Picture Perfect Ltd v Camera House Ltd* [1996] 1 NZLR 310.

12 28/5/02, HC Invercargill CP10/00.

We would conclude that the CRA does provide sufficient protection to franchisees where there have been misrepresentations. The ability of the courts to override exclusion clauses, and the criteria the courts take into account whilst doing so, provide some reassurance to franchisees and goes some way in redressing the power imbalance between them and franchisors. Furthermore, these criteria, in s 4, provide a model which we believe could be replicated in the context of the FTA, CGA or any successor regime.

Although the CRA has stood the test of time, it is certainly arguable that it is now somewhat in need of an overhaul especially as far as it is capable of application to modern relationship contracts¹³ and standard form commercial agreements. This is particularly relevant for franchising agreements which are of necessity incomplete¹⁴ whilst typically being non-negotiated. Uniformity is a central tenet of franchising and a necessary aspect as is the ability of the franchisor to make changes to its business system over a period of time. However these aspects of the successful franchise model can have pernicious effects.¹⁵

For example, in *Maranatha Ltd v Tourism Transport Ltd*¹⁶ (the Super Shuttle case) the franchisor decided that the cost of the Auckland Airport licence fee (which the franchisor had previously carried) should in future be passed on to franchisees and ultimately to customers through a user pays surcharge. The franchise operating manual was altered to require not only that the franchisees display and use the franchisor's current maximum fare schedule but also that the users pay⁷ surcharge set by the franchisor would apply. This evidences the unilateral ability of one party (the franchisor) to impose changes to the agreement on the other party (the franchisee). In turn this enables the stronger party to pass risk to the weaker party on an ongoing basis. Franchise agreements are usually a package of contracts and operating manuals are only one device that franchisors have at their disposal, but the ability to make unilateral changes through one or other of these devices is almost always available.

Existing contract law, as enshrined in the CRA, arguably fails to deal with these shortcomings. Although provisions of the CRA include the requirement that a party to a contract may cancel it on the grounds of repudiation by the other party, misrepresentation or breach,¹⁷ the ability of one party to change its own or the other parties obligations under the contract is not, at present, a basis for cancellation of the contract. Furthermore, under the

13 See C Goetz and R Scott, 'Principles of Relational Contracts' (1981) 67 *Virginia Law Review* 1089; I Macneil 'Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neo-classical and Relational Contract Law' (1978) 72 *Northwestern University Law Review* 854.

14 Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927.

15 For a discussion as to the relational aspects of franchising agreements see A Terry, 'Franchising, Relational Contracts and the *Vibe*' (2005) 33 *Australian Business Law Review* 289.

16 (Unreported) High Court Auckland, Rodney Hansen J, 3 April 2007, CIV 6006-404-6431; see G Gunasekara, 'Standard Form Commercial Contracts, Unilateral Variation and the Legal Response: the Case of Franchising' (2007) 13 *New Zealand Business Law Quarterly* 263.

17 *Contractual Remedies Act 1979*, s 7.

existing rules in the CRA, cancellation is only permitted where the effect of the misrepresentation or breach will be substantially to reduce the benefit of the contract to the cancelling party or substantially to increase the burden of the cancelling party under the contract or, in relation to the cancelling party, to make the benefit or burden of the contract substantially different from that represented or contracted for.¹⁸ These tests have stood the test of time but, we would argue, ought now to be extended to when one party is empowered to make unilateral variations especially where the contract is of a non-negotiated nature.

We have not examined the nature and extent of remedies that are currently available under the CRA. It suffices to say that the range of existing remedies, particularly those following cancellation, are wide-ranging and afford adequate redress when applicable.¹⁹

The Fair Trading Act 1986

Any consideration as to whether the generic business law regime is capable of addressing difficulties experienced by those who buy franchises must include the FTA. This statute, despite being primarily a consumer protection measure, has long been recognized as more generally serving the interests of commerce through its prohibition of misleading and deceptive conduct in trade.²⁰

Trotman and Wilson have observed that both Australian and New Zealand courts have relied heavily on common law principles in determining what amounts to misleading and deceptive conduct, particularly where non-disclosure is concerned, and that the general rule at common law is that a party to a contract is under no obligation to disclose material facts to the other party.²¹ Exceptions include where what was expressly said amounts to a half truth, where a true statement is rendered false by changed circumstances, where there is a deliberate and knowing failure to correct an incorrect statement made by the other party, where there has been active concealment or fraudulent conduct or where the relationship between the parties is one requiring utmost good faith.²²

Trotman and Wilson also point to the development, in New Zealand, of the doctrine that there is a 'reasonable expectation of disclosure' in some instances.²³ However, if such a doctrine exists, it is embryonic at best and, as the authors state, suffers from lack of certainty.²⁴ In *Guthrie v Taylor Parris Group Cassey Ltd*, the Court stated:²⁵

18 *Contractual Remedies Act 1979*, s 7(4).

19 *Contractual Remedies Act 1979*, s 9.

20 *Fair Trading Act 1986*, s 9; the Act has been used for example by traders as an alternative to the remedy for passing off, see *Taylor Bros Ltd v Taylors Textile Services Auckland Ltd* (1987) 2 TCLR 397.

21 L Trotman and D Wilson, *Fair Trading: Misleading or Deceptive Conduct* (2006) 81-82.

22 *Ibid* 83.

23 *Ibid* 89, and see *Hieber v Barfoot & Thompson Ltd* (1996) 5 NZBLC 99,384.

24 Trotman, above n 21, 90.

25 (2002) 10 TCLR 367, [21].

The duty of disclosure is not readily found in the context of *commercial transactions*. The real issue to be determined is whether there is something about the circumstances of the transaction which gives rise to a reasonable expectation that one party would volunteer information as to matters of importance to the other ... (our emphasis)

This, however, begs the question whether franchise agreements can in reality be categorised as commercial transactions or whether they should rather be treated as akin to consumer transactions. The rationale for much of the established jurisprudence does not apply to franchising. For example, it is not considered misleading or deceptive to withhold information from the other party during negotiation: this is viewed as a legitimate negotiating tactic.²⁶ However, there is usually no possibility of negotiation as far as franchise agreements are concerned: they are invariably standard form agreements offered to franchisees on a take it or leave it basis. It must be remembered that standard form contracts reduce transaction costs for the franchisor. Further, by avoiding conflicts between franchisees with different terms in the agreements, they maintain fairness and uniformity throughout the franchise.²⁷ Uniformity is, of course, a central pillar of business format franchising. On the other hand, such contracts place franchisees in a position not dissimilar to that of consumers.

Moreover, the very test in New Zealand for determining if there has been misleading or deceptive conduct is weighted against franchisees. This is the three step approach adopted in *AMP Finance New Zealand Ltd v Heaven*:²⁸ whether the conduct is capable of being misleading; (2) whether the plaintiff was in fact misled; and (3) whether it was in all the circumstances reasonable for the plaintiff to have been misled.

Trotman and Wilson note that steps one and three constitute an objective assessment: it is not enough for the plaintiffs to show they were misled if reasonable people in their shoes would not have been misled, although the application of this third criterion has been problematic in New Zealand.²⁹

The circumstances of franchising are a case in point. They raise the question of what would be misleading to a 'reasonable franchisee' and whether the courts in New Zealand consider there to be a distinction between someone purchasing a business generally and someone purchasing a franchise. The recent decision of the Court of Appeal in *David v TFAC Ltd*³⁰ suggests not.

In that case, the plaintiffs bought a regional master franchise, from the national master franchisee, for a home services franchise operation (JHS) which had its origins in Australia.³¹ The franchise agreement provided that the plaintiffs would have access to the JHS system, manuals, advice, training and similar support. However, a significant ingredient in the viability of

26 Trotman, above n 21, 91 and see *Eastern Garden v Stone* [2005] SASC 157, [34].

27 Stewart Germann, Anthony Grant, and Maurice Walker, *Franchising* (New Zealand Law Society, Continuing legal education, Wellington, 2007).

28 (1997) 8 TCLR 144.

29 Trotman, above n 21, 75.

30 2/3/09, CA26/2008, Arnold, Potter and Harrison JJ; [2009] NZCA 44.

31 James Home Services (JHS) which offered services such as exterior and interior house cleaning, lawn and garden care, car cleaning, pet grooming, carpet cleaning and pest control.

the regional master franchise hinged on the plaintiffs' ability to recruit sub-franchisees (which would necessitate 'hard selling' and a certain degree of self-confidence on the part of the plaintiffs). The disclosure document given to the plaintiffs advised them to obtain independent advice in the following terms:³²

You are required to have the Regional Master Franchise Agreement and associated Sub-Franchisee Agreement explained to you by a Solicitor experienced in franchising. You should also get independent accounting and business advice from an Accountant and a Business Advisor experienced in franchising before signing the Regional Master Franchise Agreement.

The plaintiffs also signed a disclaimer or acknowledgment clause that they had made their own judgment as to the commercial viability of the Regional Master Franchise and acknowledging 'the National Master Franchisee is not qualified in this regard'.³³ The effect of these provisions is examined below.

Shortly after entering into the agreement, the plaintiffs decided they had made a serious mistake in acquiring the JHS franchise and sought to cancel the agreement. The nub of the complaints were the amount of time it would take to recruit sub-franchisees and doubt as to the viability of the JHS system in the New Zealand context. A related allegation was the concealment of the fact that the only existing New Zealand regional master franchisee had made no sales at all over a protracted time-frame. A secondary complaint was about the quality of the training that was offered.

At first instance Baragwanath J found there had been misleading and deceptive conduct on the basis that it had been represented that the Australian success of the operation was readily transferable to the New Zealand market (this had in part been conveyed by the plaintiffs being flown to Brisbane to observe the JHS operation in Australia thereby implying that the New Zealand operation was similar to the one in Australia) and that statements as to the existence of a 'proven formula for success' implied the existence of adequate support systems. His Honour stated:³⁴

Such assertions required, if they were not to mislead, that there be evidence to support them. They also required disclosure of other facts known to the [appellants] that gave an inconsistent picture ... there is simply no evidence of the 'more work than people available'. Rather the truth is of virtually unrelieved failure of the New Zealand operation. Yet Mrs David encouraged Mr Grisdale to base his decision on Australian examples when she knew that there was no basis for representing that it formed any basis for an assertion that the [Grisdales] could base their plans for a New Zealand operation upon it.

While the results of the psychological tests indicated that Mr. Grisdale did not relish hard selling, those results were well known to the [appellants] who persisted with their sales pitch that the [Grisdales] had the capacity to succeed.

In the light of these factors, Baragwanath J reasoned it would be unreasonable to allow the various disclaimers and acknowledgments to nullify the effect of the 'the pitch'.³⁵

32 2/3/09, CA26/2008, Arnold, Potter and Harrison JJ; [2009] NZCA 44 at [14].

33 Ibid [23].

34 *David v TEAC Ltd* (2008) 8 NZBLC 102,179, [74] and [75].

35 Ibid [101].

[I]t cannot be said that the Grisdales or their lawyer or accountant can be regarded as acting quite unreasonably so as to insulate UAR from misleading and deceptive conduct.

The Court of Appeal, in a judgment given by Arnold J, on the other hand viewed the facts from an entirely different perspective and adopted a more orthodox approach. In the first place the statements preceding the contract were regarded as statements of opinion, rather than predictions as to the future, which can only found a claim on relatively narrow grounds:³⁶

[T]he expression of an opinion that subsequently turns out to be incorrect does not, of itself, give rise to liability for misleading or deceptive conduct under s 9. However, the expression of an opinion involves at least one and perhaps two representations of fact. The first is that the person expressing the opinion honestly holds it and the second is (in some cases at least) that he or she has a reasonable basis for the opinion

Applying these criteria to the facts the Court held that hindsight had no relevance in making an assessment as to whether there was a reasonable basis for the opinion (it might be relevant where subsequent events give rise to an inference that a person did not genuinely hold an opinion at the time it was made although there was no such allegation in this instance).³⁷ Furthermore and crucially, the plaintiffs ‘knew JHS was a greenfields operation as far as New Zealand was concerned’.³⁸ This allowed the Court to conclude that:³⁹

Mrs David [the defendant] had a reasonable basis for the view that the JHS system was capable of succeeding in New Zealand. There was no obvious reason to indicate that it would not.

However, the Court ignored the apparent lack of success on the part of the only existing regional master franchisee and the plaintiff’s failure in personality tests. In particular, the tests revealed that the franchise system involved ‘hard selling’ which was incompatible with the plaintiff’s personal values. Despite this, the Court stated that ‘Mr James was not under any obligation to disclose to Mr Grisdale what he already knew’.⁴⁰

While the issue of the disclaimer or acknowledgment clause is discussed below, the Court’s dictum as to the effect of the independent legal and accounting advice given to the plaintiff is also worth noting:⁴¹

In other words, it was unreasonable for them simply to rely on any assurances that they thought they had been given on this aspect, rather than on independent advice from someone experienced in franchising from a business perspective.

Although this appears to be an application of the third *Heaven* requirement, referred to above, that requirement is misconstrued. In considering whether it was in all the circumstances reasonable for the plaintiff to have been misled, several factors are undoubtedly relevant including the effect of independent advice and the nature of the statements that were made (statements as to existing facts, opinions or future predictions). Although statements as to the

36 *David v TFAC*, above, n 32, [43].

37 *Ibid* [46] and [47].

38 *Ibid* [48].

39 *Ibid* [50].

40 *Ibid* [56].

41 *Ibid* [67].

past or current state of a business may not amount to statements concerning its future performance,⁴² Trotman and Wilson note that the Australian courts have tended to examine the statements from the standpoint of their effect on the person hearing them.⁴³

In the franchising context, such an approach would therefore require consideration of the relative disparity in the negotiating strengths and business experience between the parties. The franchisor is essentially selling a business model and it ought to be incumbent on the franchisor to point out any risks associated with it. There is a much higher degree of reliance on a franchisor than in most other business relationships and perhaps more so where a greenfields operation is concerned.

Where predictions as to future prospects are concerned, Baragwanath J's reasoning is more consistent with that of the full Federal Court in *Wheeler, Grace & Pierucci Pty Ltd v Wright*⁴⁴ that:

A positive unqualified prediction by a corporation may be misleading conduct in trade or commerce if relevant circumstances show the need for some qualification to be attached to that statement or the possibility of its non-fulfilment to be disclosed as a requirement of fair trading ... The misleading or deceptive conduct may be found in the failure to qualify the statement or disclose the risk of non-fulfilment and the event of non-fulfilment of a prediction or promise may be evidence that raises an inference that such a risk of non-performance existed or that qualification of the positive statement, prediction or promise was required.

Although Trotman and Wilson note that Australian jurisprudence should be treated with some caution in this sphere,⁴⁵ the requirement to attach a caveat to predictions has much to commend it. The sympathy shown by the Court of Appeal in *David* to the franchisor's attempt to shift responsibility on to independent legal and business advisors is simply not warranted. Indeed, the position taken by the Court of Appeal, as opposed to that adopted by Baragwanath J, significantly weakens the argument that existing generic law is adequate in the context of franchising.

Finally, in dealing with the plaintiff's claim that the defendant had provided insufficient training and support subsequent to the plaintiffs acquiring the regional master franchise, the Court stated that:⁴⁶

[T]hat again involves an assessment at the time TFAC entered into the contract. If subsequently there was a failure to provide promised training or support, that is not a FTA issue. Under the RMF agreement UAR undertook obligations in relation to training and support. If it breached those obligations, the remedy lay in contract, not in the FTA.

Once again, the limitations of the FTA in addressing what is a common area of complaint for franchisees are obvious. The response that the answer lies in contract demonstrates a certain naivety on the Court's part since

42 *ME Torbett Ltd v Keirlor Motels Ltd* (1984) 1 NZBLC 102,079.

43 Trotman, above n 21, 121.

44 (1989) ATPR 40-940, 50,250.

45 Trotman, above n 21, 126; for a comparative analysis see D Wilson and L Trotman, 'Non-Disclosure and Misrepresentation Under the Fair Trading Act (NZ) and the Trade Practices Act (Cth)' (2008) 14 *New Zealand Business Law Quarterly* 3.

46 *David v TFAC*, above n 32, [51].

agreements such as these are inevitably drawn up by the franchisor and tend to be written in such terms that the franchisor's obligations such as support and training are left to the franchisor's discretion while the franchisee's obligations (subject to modification through operating manuals and the like) are listed in considerable detail.

It is precisely in this area that it can be argued that protection for franchisees is warranted. One way in which this can be accomplished is through a broadening out of the definition of consumer and through a more generous application of existing consumer protection laws to require minimum standards in the services provided by franchisors to franchisees, or indeed services provided to all small businesses. This is examined next.

The Consumer Guarantees Act 1993

The *Consumer Guarantees Act* protects consumers by imposing certain minimum standards on suppliers that must be followed when supplying goods and services. Were it not for the definition of consumer in s 2 of the Act,⁴⁷ which states that a consumer acquires goods and services for personal, household or domestic use, and not for the purpose of resupplying them in trade, it is quite possible the Act could apply to franchisees. Section 43⁴⁸ permits contracting out from the Act for business dealings. If it were not for these provisions, franchisees would be covered by the protections conferred by the CGA.

Should franchisees be designated as consumers? When purchasing a franchise, the buyer has no real control over the bargain, and has merely a take it or leave it opportunity as franchise agreements are almost always standard form contracts. This puts franchisees at a disadvantage.⁴⁹ From prospective franchisees' point of view it could therefore be said that they consume the whole package of a franchise, including the goodwill and intellectual property, which they inevitably do not retain once the agreement is terminated, so in this sense franchise agreements are more analogous to leases or hire agreements, which are covered by the CGA.⁵⁰

Franchisees are usually dependant on franchisors in a variety of areas. These include both goods and services provided to them by the franchisor or from third parties (usually those nominated by the franchisor only). Furthermore, franchise agreements are inevitably highly prescriptive with little discretion being given to franchisees as to their choice in acquiring goods and services. In this regard they are even more vulnerable than consumers generally as the latter can vote with their feet but franchisees are rarely free to choose their sources for goods and services. Services received by franchisees include crucial matters such as advertising, product development, support and training.

47 'A person who ... does not acquire the goods or services ... for the purpose of – resupplying them in trade', *Consumer Guarantees Act 1993*, s 2(1).

48 'No contracting out except for business transactions', *Consumer Guarantees Act 1993*, s 43.

49 Germann, above n 27.

50 *Consumer Guarantees Act 1993*, s 2, meaning of supply.

The quality of ongoing training and support is a grey area that has generated disputes.⁵¹ The franchisor may be providing this support, but not to an acceptable standard. Where training and support is defective, there is often no recourse for a franchisee. This is where the CGA could prove very useful to a franchisee, as it stipulates that there is a guarantee as to reasonable care and skill being taken in the supply of services.⁵² This guarantee holds suppliers to a standard expected of a reasonable service provider in the circumstances,⁵³ which means the courts can take into account all the surrounding actions of the parties to come to an equitable conclusion. If the training and support is defective in the sense that it is not of a quality to be expected, then a franchisee can get a remedy that this be rectified by the franchisor.⁵⁴

It is possible for the courts to imply a term of reasonable care and skill into a contract, but this must then meet the stringent test set out in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*.⁵⁵ This is often a difficult hurdle for franchisees to surmount,⁵⁶ as franchisors usually word their contracts in such detail that they give themselves discretion as to how they perform their own obligations. For example, the operating system or manual is usually part and parcel of the contract and franchisors retain the right to modify it at their discretion. In addition, the nature of franchised businesses is such that each franchise will argue that its *modus operandi* is unique. These factors make it very difficult for a court to find an implied term such as the obligation to use reasonable care and skill on the part of franchisors to their franchisees.

Furthermore, it has been seen that at present business consumers regardless of size are permitted to contract out of the CGA. The position is different however in Australia where small businesses can bring claims under the provisions of the *Trade Practices Act 1974* that equate to the CGA.⁵⁷ The approach there is to confer consumer-type protection based on an arbitrary monetary threshold. The protection remains quite narrow, however, since it only covers goods of a household nature and not those acquired for re-supply or manufacture. It is noteworthy also to mention that the recently enacted *Consumer Protection Act* in South Africa treats franchise contracts in the same manner as consumer contracts.⁵⁸

51 *David v TFAC*, above n 32, and see *Preston v International Direct Ltd (in liquidation)* 4/7/05, HC Wellington CIV-2001-404-1762.

52 *Consumer Guarantees Act 1993*, s 28.

53 NZ Business Law Guide, 'Supplier Guarantees to Use Care and Skill', CCH New Zealand, 50-810 <[http://intelliconnect.wkasiapacific.com.ezproxy.auckland.ac.nz/scion/secure/index.jsp#page\[6\]](http://intelliconnect.wkasiapacific.com.ezproxy.auckland.ac.nz/scion/secure/index.jsp#page[6])>.

54 *Consumer Guarantees Act 1993*, s 32(a)(i).

55 52 ALJR 20; 16 ALR 363; 180 CLR 266 (CAPCC).

56 *Rappongi Excursions Ltd v Denny's Inc* (Unreported, 2001, High Court, CP 20/01).

57 Section 4B of the *Trade Practices Act 1974* (Cth) states that a person will be a consumer for the purposes of the Act if the goods did not exceed \$40,000, the goods were of a kind ordinarily acquired for personal, domestic or household use or consumption or the goods consisted of a commercial road vehicle, and the person did not acquire the goods, or hold himself or herself out as acquiring the goods, for the purpose of re-supply or for the purpose of using them up or transforming them, in trade or commerce, in the course of a process of production or manufacture or of repairing or treating other goods or fixtures on land.

58 Above n 1, 155.

We examine below the changes that would be needed to the CGA – such as to the definition of consumer and to the right to contract out in relation to franchise agreements – in order to encompass franchising. It has been seen that at present, franchise agreements are easily excluded from its ambit. If these changes are made, as we suggest, much of the content of the CGA would be directly applicable to franchise agreements and greatly redress the power imbalance that currently exists between franchisors and franchisees. More importantly, such an application would improve both the relationship between franchisor and franchisee and the quality of franchise systems generally. We next explain in more detail why this would be the case.

Guarantee as to Title

This existing guarantee would be potentially useful to franchisees who are essentially consumers, for the duration of the franchise, of the franchisor's intellectual property. The franchisees' rights are in this respect only as good as the title possessed by the franchisor. It is certainly arguable that intellectual property rights are classified as goods under the CGA.⁵⁹ Indeed, computer software is specifically included.⁶⁰

Despite the guarantee of title not being applicable where goods are hired or leased⁶¹ – this will be the case with intellectual property rights which are usually licensed to the franchisee – in the latter instance the CGA confers a right to undisturbed possession for the period of the hire or lease.⁶² This would confer an important right on franchisees which is currently lacking as instances have arisen of franchisors re-branding the franchise and requiring major changes to the nature of the franchise itself during the tenure of a franchisee's licence.⁶³ In these instances franchisees, due to their significant sunk costs, have little choice but to comply and have no recourse against the franchisor or other way of recouping the additional expenses incurred.

The right to quiet enjoyment would also be applicable in the case of leases, where if a franchisor does not have the correct term for a sub-lease or no power to sublease at all then the franchisee ought to have a remedy under the Act. Franchisor insolvency is also another risk factor for franchisees but this is a complex area beyond the scope of the present article.⁶⁴

Guarantees as to Acceptable Quality and Fitness for Particular Purpose

The guarantee as to acceptable quality,⁶⁵ amongst other things, requires that goods be fit for the purposes for which goods of the type in question are commonly supplied, are as safe and durable as a reasonable consumer with full knowledge of their true nature would regard as acceptable having regard to such matters as the nature of the goods and the price paid for them.

59 *Consumer Guarantees Act 1993*, s 2, 'goods means personal property of every kind (whether tangible or intangible), other than money and choses in action'.

60 *Consumer Guarantees Act 1993*, s 2(1)(b)(vi).

61 *Consumer Guarantees Act 1993*, s 5(4).

62 *Consumer Guarantees Act 1993*, s 5(5).

63 *Halligan v Liberty Tax Service Inc* (2003) 36 BLR (3d) 75 (Man.Q.B).

64 See Jenny Buchan, 'Challenges that Franchisees of Insolvent Franchisors Pose for Liquidators' (2008) 16 *Insolvency Law Journal* 26.

65 *Consumer Guarantees Act 1993*, s 7.

In the franchising context, there is no reason why a franchisee should not expect acceptable quality in regard to items supplied by the franchisor. Alternatively, these might be encompassed by guarantees as to reasonable care and skill or as to fitness for particular purpose in relation to the supply of services. In either instance critical aspects of a franchise include such matters as the intellectual property rights licensed by the franchisor, store fit out plans, designs and computer software. Should the CGA be extended to franchisees, it would be incumbent on a franchisor to specifically draw any defects (for example, claims the franchisor is facing regarding ownership of its trade marks) to a franchisee's attention.⁶⁶ Likewise any assessment as to durability⁶⁷ would depend on how reliable is the computer software supplied by the franchisor, as well as how resilient the franchisor's trade marks prove to be.⁶⁸

The suitability of the CGA in this respect is further reinforced by the existing criteria that representations made about the goods are a factor that is taken into account in determining what a reasonable consumer would regard as acceptable.⁶⁹ In the franchising context, this would militate greater disclosure by franchisors to franchisees in order for franchisors to ensure they are compliant. Disclosure in this sense can be seen as potential shield, rather than the rather blunt sword of uniform mandatory disclosure under the Australian model. The attractiveness of the CGA scheme is that franchisors would be able to tailor their disclosure according to their particular circumstances.

Similar advantages are conferred by the guarantee as to fitness for particular purpose.⁷⁰ This guarantee, of course, overlaps with the similar provision in the *Sale of Goods Act 1908* although this Act has always allowed contracting out from its protections.⁷¹

Repairs and Spare Parts

Section 12 of the CGA contains a guarantee as to the availability of repairs and spare parts. As currently worded this section would exclude any form of business dealings if the Act has been contracted out of, which means even independent sole traders may not have access to this provision because they are not technically consumers. This is a shortfall in the drafting of the Act, and should be revised to include certain business dealings such as franchising. As now written, the provision is solely aimed at goods for personal use, which is too narrowly drawn. There is no reason why a business consumer should not have access to spare parts or repairs when required within a reasonable time frame, as this is only fair.

66 *Consumer Guarantees Act 1993*, s 7(2).

67 *Consumer Guarantees Act 1993*, s 7(1)(e) – goods will be of acceptable quality if they are as durable as a reasonable consumer fully acquainted with the state and condition of the goods, including any hidden defects, would regard as acceptable having regard to a number of listed factors.

68 Support and training provided by the franchisor might also be a consideration when assessing durability but these might be better addressed under the guarantee as to reasonable care and skill taken in the supply of services by the franchisor which is discussed below.

69 *Consumer Guarantees Act 1993*, s 7(1)(i).

70 *Consumer Guarantees Act 1993*, s 8; see especially s 8(1)(b) which implies a guarantee that the goods are reasonably fit for any particular purpose for which the supplier represents that they are or will be fit.

71 *Sale of Goods Act 1908*, ss 16 and 56 respectively.

Franchisees are particularly vulnerable, in this respect, as they are commonly required to purchase only the goods and equipment specified in the franchisor's business model. Currently, there is little protection for franchisees who invest heavily in equipment that is either purchased from the franchisor directly or from a third party nominated by the franchisor – if the equipment breaks down there is no guarantee that spare parts and repairs will be available for a reasonable period. Under the new category we put forward below, of business consumer, this guarantee would be enforceable against both franchisors and manufacturers.

Guarantees in Relation to the Supply of Services

Part 4 of the CGA implies a number of guarantees in relation to the supply of services. These include guarantees that services will be carried out with reasonable care and skill,⁷² that services will be fit for their purpose or will reasonably achieve any particular result,⁷³ that services will be completed within a reasonable time⁷⁴ and, where it has not been decided by the contract, that no more than a reasonable price will be charged for the services.⁷⁵

Most, if not all, of these guarantees should extend to business consumers such as franchisees. Many of the reasons for this have already been articulated in the discussion above relating to goods. As we have seen, franchisors provide a great many services to franchisees. These include not just the operating manual but everything from staff training, computer upgrades and 0800 telephone numbers to property management and leasing. Training is particularly contentious being a frequent area of complaint by franchisees. For example, in the recent case of *David v TFAC*⁷⁶ a major source of complaint by the plaintiff was that the training provided by the national master franchisee was completely inadequate for the purposes of the regional master franchisee. In addition, the guarantee as to time of completion would assist franchisees who are often promised support and training but not within a fixed time-frame.

III. REFORM OF THE *CONTRACTUAL REMEDIES ACT*

We have argued above that the CRA remains a valuable part of the architecture of contract law in New Zealand. It already contains core principles such as the principle that parties should not be substantially deprived of the benefit of their bargain or have the burden of their obligations under the contract substantially increased. Although the role of good faith in contract law is a contentious issue that we have not traversed, we would venture to point out that Lord Steyn has stated that there is a large area of overlap between the concepts of good faith and that of significant imbalance in contract.⁷⁷

72 *Consumer Guarantees Act 1993*, s 28.

73 *Consumer Guarantees Act 1993*, s 29.

74 *Consumer Guarantees Act 1993*, s 30.

75 *Consumer Guarantees Act 1993*, s 31.

76 *David v TFAC*, above n 32.

77 *Director General of Fair Trading v First National Bank plc* [2002] 1 AC 481, at [37].

As we have seen, an issue associated with franchising and indeed, with most relational contracts, is the need for flexibility in order to deal with changing market conditions. However, the ability of one party to unilaterally vary the terms of the agreement is contentious. The capacity of the franchisor to make changes through the operating manual and the like leads to the possibility of opportunistic conduct. Conduct would be opportunistic where, for instance, a franchisor seeks to impose additional burdens on a franchisee that are not justified by the circumstances prevailing in the economic environment or market in which the parties operate. At present the CRA insufficiently addresses these concerns.⁷⁸

We therefore suggest the addition to the grounds for cancellation, in s 7, of a new criterion for cancellation where one party to a contract materially varies its terms in an unreasonable manner, where the variation is not required to protect the legitimate interests of the party making the variation and where the variation is one that would not have been anticipated at the outset. Such a ground for cancellation would arise even where the discretion to vary is one that is expressly conferred by the contract and would be in addition to the existing grounds for cancellation of repudiation, misrepresentation, breach and anticipatory breach. A new paragraph (d) in subsection (3) would permit cancellation if 'a party to a contract unreasonably varies in a material way the terms of the contract or the obligations contained in it, under a power reserved to it in the contract'.⁷⁹

In addition, a definition of what constitutes 'unreasonable variation' would be needed. For example, this could state that: 'a variation is unreasonable when it was not in the contemplation of the parties at the time the contract was entered into and is not reasonably necessary in order to protect the legitimate interests of the party making the variation'.⁸⁰ Importantly, this additional ground for cancellation would also be subject to the existing benefit/burden test which ensures that a remedy can only be awarded where the effect of the variation is sufficiently serious.⁸¹

The amended CRA would not, of course, apply where a stronger party, through commercial strong-arm or bullying tactics, induced a weaker party to agree to accept a variation in the contract. Franchisees due to their sunken costs are especially susceptible in this regard. Such conduct may need to be proscribed by a provision such as the wider prohibition against unconscionable

78 By contrast the *Trade Practices Act 1974* (Cth), s 51 AC(3)(ja) permits a court to take into account in determining if conduct is unconscionable 'the extent to which the supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the business consumer'.

79 This could be immediately after the existing s 7(3)(c).

80 See for instance *Trade Practices Act 1974* (Cth), s 51 AC(3)(b) 'whether ... the business consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier' and *Trade Practices Amendment (Australian Consumer Law) Bill 2009*, schedule 1, cl 3 which partly defines a term as unfair if 'it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term'.

81 *Contractual Remedies Act 1979*, s 7(4); the words 'unreasonable variation' would also need to be added to s 7(4)(b) and s 7(5) and (6) would also need to be amended.

conduct which applies in Australia.⁸² However, this provision only governs dealings involving the supply of goods or services below a defined monetary threshold whereas the reforms to the CRA we have put forward would address all incomplete or relational contracts, an issue that is conceptually distinct from the issue of unequal bargaining power or unfair bargaining tactics.

Another area where reform is needed is the current ability to contract out of the CRA, by providing remedies in the contract itself.⁸³ A cogent argument may be made that this provision ought not to extend in circumstances where no opportunity existed for a party to a contract to negotiate its terms. We do not articulate, in this article, how such a revised provision might be worded. However, cognizance ought to be taken of provisions in other jurisdictions regulating unfair terms in contracts that have the same or similar effect.⁸⁴

These simple additions to the existing legal framework will be of immediate benefit to many small businesses such as franchisees. They will also address in one fell swoop much of the mischief that legislation and proposed legislation overseas governing unfair terms in contracts is designed to prevent. For example, under the agreed model in the proposed Australian Consumer Law a term will be considered ‘unfair’ when it causes a ‘significant imbalance in the parties’ rights and obligations but is not reasonably necessary to protect the legitimate interests of the supplier’.⁸⁵ It has been suggested that this is aimed at when businesses use contractual terms to remove all risks by passing these on to consumers, there being rarely any legitimate business reasons for such contractual terms.⁸⁶ The suggestions we have made in this article are essentially aimed at addressing the same issue.

IV. REFORM OF THE *FAIR TRADING ACT*

The Ability to Contract Out

By contrast to the position under the CRA, as seen above, the approach to contracting out under the FTA was until recently more clear-cut. As the Court of Appeal pointed out in the *David* case:⁸⁷

The courts have long held that it is not possible to contract out of the FTA ... The justification given for this is that as the FTA is consumer protection legislation, it would be contrary to its protective policy to allow contracting out – see *Smythe v Bayleys Real Estate Ltd* (1993) 5 TCLR 454 at 472 (HC).

82 See, for example, *Trade Practices Act 1974* (Cth), s 51 AC(3)(d) ‘whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer ...’.

83 *Contractual Remedies Act 1979*, s 5.

84 See, for example, Part 2B of the *Fair Trading Act 1999* (Vic) ‘whether the term was individually negotiated or is a prescribed unfair term’; *Unfair Contract Terms Bill* (UK), cl 9 ‘written standard terms in business contracts’.

85 *Trade Practices Amendment (Australian Consumer Law) Bill 2009*; see Hon Chris Bowen, ‘Australian Consumer Law – The Future’, Address to the Monash Centre for Regulatory Studies, Monash University Law Chambers, 17 Feb 2009, <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2009/001.htm&pageID=005&min=ceb&Year=&DocType=>>>.

86 *Ibid.*

87 *David v TFAC*, above n 32, [60]; the Court cites three earlier decisions, ironically two of these relate to claims brought by franchisees.

Thus far the Court's reasoning is unobjectionable. However, the Court then ventured the following dicta:⁸⁸

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. In the latter case, any resulting contract can be expected to reflect the parties' wishes as to the allocation of risk and it is difficult to see why they should not be permitted to allocate risks between them by contracting out of the FTA.

Although the wording of the FTA does not expressly sanction the ability to contract out of its provisions, the Court adverted to the mechanism through which this may be achieved⁸⁹ as stated by French J in *Kewside Pty Ltd v Warman International Ltd*:⁹⁰

A disclaimer or exclusion clause will affect liability for misleading or deceptive conduct only if it deprives the conduct of that quality or breaks the causal connection between conduct and loss. Whether it has that effect in a given case is a question of evidence and not a question of law.

In *David*, the Court of Appeal was clearly of the opinion that the exclusion clause did break the causal connection, whereas Baragwanath J had held otherwise. This would suggest that determining the issue on a case by case basis may not be a straightforward exercise. The causation argument is, in any event, misleading in the light of the Court's dicta, cited above, on the limited justification for the FTA to apply to commercial transactions. In effect, a presumption exists whenever an exclusion clause is used in such transactions that a causal connection does not exist.

Although the Court's statements are merely dicta (since it had already found there had been no misleading or deceptive conduct) the assumptions underpinning them are seriously flawed, especially as they relate to franchise agreements, and the dicta ought not to be followed in future. One commentator explains the shortcomings in the Court's reasoning as follows:⁹¹

This was not an existing business acquisition agreement where parties may well negotiate terms and warranties from positions of equality ... This was a typical non negotiable contract to purchase a franchise opportunity and the franchisee then had to establish the business ... The vendor franchisor already knew the system and indeed the market and the franchisee's independent advice was much more narrowly focused than the Court would suggest.

With respect, the Court appears to have failed to properly appreciate the nature of what is involved in buying a 'green fields' franchise. While it obviously is a commercial transaction it is very difficult not to see prospective franchisees as (to some extent) vulnerable consumers ... *Despite disclaimer clauses and independent advisers there is still a substantial dependence upon the franchisor as the ultimate 'guru' for its franchise which it is selling.* (Emphasis added)

It is suggested, with respect, that this description characterises the nature of the transaction involved in purchasing a franchise in more accurate terms than does the description adopted by the Court of Appeal. It was recognition

88 Ibid [61].

89 Ibid [63].

90 (1990) ATPR (Digest) 46-059, 53,222 (FCA).

91 David Munn, 'Second Opinion on Court of Appeal's Due Diligence Decision', Franchise New Zealand <<http://www.franchise.co.nz/article/view/816>>.

of the degree of reliance placed on the franchisor, as ultimate ‘guru’, rather than on the formalistic and technical nature of legal or accounting advice, that had led Baragwanath J to find in favour of the franchisee.

The Court of Appeal’s classification of franchise agreements as ‘commercial transactions’ is also at odds with the Privy Council’s view that they are:⁹²

... not ordinary commercial contracts but contracts giving rise to long-term mutual obligations in pursuance of what amounted in substance to a joint venture and therefore dependent upon coordinated action and cooperation.

One first instance judge has candidly gone as far as to describe an exclusion clause in a franchise contract in these terms:⁹³

It is perfectly obvious, and must have been obvious to SSFL, that the Dillons had relied on the representations made by SSFL as to the likely profitability of the new franchise. So clause 33, as drafted is, in effect, a lie. As well, because clause 33 is simply part of the boilerplate in what is quite a lengthy agreement, potential franchisees might be expected to read it with glazed eyes.

To allow parties to a franchise agreement to ‘allocate risks between them by contracting out of the FTA’ as the Court of Appeal suggests in *David* would invariably see franchisors adopting such exclusion clauses as a matter of course and the risk would invariably be passed on to franchisees.

Suggested Solution

We have seen that the protections conferred by the FTA on those who purchase businesses, such as franchises, have faltered somewhat as evidenced by the recent judicial pronouncements in the *David* case. In particular, there has been little understanding of the impact of standard form contracts when combined with exclusion clauses such as merger and acknowledgement provisions in such contracts.

In this regard we have argued that a consistent approach is needed and that the preferred solution is that which is already contained in the law and practice of the CRA.⁹⁴ A provision along these lines should be inserted into the FTA following the *David* ruling to correct any judicial misconceptions as to the nature of a franchise agreement. A minor amendment would suffice such as: ‘in assessing whether a party to a transaction was misled or deceived, the court shall have regard to ... the subject matter and value of the transaction, the respective bargaining strengths of the parties and whether they had independent legal advice’. Alternatively, the provision might be worded such that the court could have regard to whether a party to the contract ‘deals on the written standard terms of business of the other’.⁹⁵

At the very minimum, some corrective action is required by the legislature in response to the approach of the Court in *David*. This would of course assist not just franchisees but others who in the course of business encounter exclusion clauses as part of standard form contracts.

92 *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] 1 NZLR 289, 311.

93 *Dillon Holdings*, above n 12, [50].

94 *Contractual Remedies Act 1979*, s 4: ‘Statements During Negotiations For A Contract’.

95 See *Unfair Contract Terms Bill* (UK), cl 9.

Predictions, Income Projections and the Sale of Business Models

It has been shown that the courts struggle when applying the FTA to projections or forecasts made where a business model is purchased, as opposed to where a business is bought as a going concern. In the *David* case, the plaintiff was effectively denied a remedy due to existing jurisprudence as to what constitutes misleading or deceptive conduct in relation to such projections and forecasts.

Undoubtedly, existing provisions in the FTA are capable of being used by franchisees. For example, there is a prohibition when advertising services that there must not be any misrepresentations as to their 'performance characteristics'.⁹⁶ At a stretch, this could encompass a franchisor's business model. Likewise, there is a prohibition on misleading representations concerning the 'need for any goods or services'.⁹⁷ However, the difficulty with such provisions, in light of the Court of Appeal's reasoning in the *David* case, is that their effectiveness is diluted by the inevitable defence that what was said was a mere prediction or statement of opinion. We would argue that the FTA should be strengthened by the addition of a provision in relation to claims made regarding a non-existing business. This would protect a franchisee who purchases a 'greenfields' territory where what is purchased is, essentially, a business model.

It should be made a requirement that where projections or forecasts are made in relation to a business model as opposed to the sale of a business as a going concern such projections and forecasts should include: the facts and assumptions on which they are based; the extent of enquiries and research undertaken by the vendor or others; the period to which the projection or forecast relates; an explanation of the choice of period covered; whether the projection or forecast includes depreciation; salary for the purchaser; the cost of servicing loans and assumptions about interest and tax.⁹⁸ Alternatively, these factors could be listed as ones a court may take into account in determining whether the forecasts or projections were misleading or deceptive.

It can be seen that requirements such as those above would almost certainly remove the sting of complaints made by franchisees such as those raised in the *David* case. They would also substantially remove the possibility for misleading or deceptive conduct to occur, particularly when it is sought to implement a successful overseas-based franchise model in New Zealand.

V. REFORM OF THE *CONSUMER GUARANTEES ACT*

We have highlighted in the discussion above several areas where franchisees are just as vulnerable, if not more so, than consumers in their dealings with franchisors. Several alternatives are possible in addressing this deficiency. One option would be to extend the definition of consumer to include transactions under a defined monetary threshold as is the case in

96 *Fair Trading Act 1986*, s 13(e).

97 *Fair Trading Act 1986*, s 13(h).

98 These requirements exist in Australia: see the Franchising Code of Conduct, cl 19.5.

Australia.⁹⁹ However, this only covers goods of a household nature and not those acquired for re-supply or manufacture which would make the extension of little value to franchisees.

Another option would be to categorise as a consumer anyone who is forced to transact business on a standard form basis or on the written standard terms of business of the other.¹⁰⁰ It is noteworthy that this was the approach, in relation to unfair contract terms, that was proposed at the federal level in Australia. However, the application of the draft provisions of the Australian Consumer Law to all businesses has been criticised.¹⁰¹ In the United Kingdom, on the other hand, the difficulty is surmounted by the draft legislation containing separate categories for non-consumer contracts: written standard terms in relation to business contracts and non-negotiated terms in relation to small business contracts.¹⁰²

Whatever the approach overseas, we suggest below a more modest reform aimed at franchisees. We do not however see this as the end of the debate but rather the beginning of a discourse which is yet to occur in New Zealand on who is a consumer and on the wider policy considerations underpinning the legislation.

The Definition of Consumer

As we have seen, the existing definition of consumer precludes application of the CGA to franchisees. This is because consumers are defined to be those who both acquire goods or services that are of the kind ordinarily acquired for personal, domestic or household consumption and who do not acquire them for the purpose of resupplying them in trade, consuming them in production or manufacture or in the case of goods repairing or treating in trade other goods or fixtures on land.¹⁰³

In the case of franchisees it is quite possible that both goods and services acquired by them will, despite these restrictions, fall within the definition of consumer.¹⁰⁴ Even where they do, however, the CGA currently permits contracting out where the goods or services are acquired for the purposes of a business.¹⁰⁵ This may be justified when businesses are able to negotiate, but less appropriate where, as is the case with a franchisee, it is imposed as a standard term, particularly also when the goods or services have to be taken as a package.

The solution we propose is a pragmatic one. We would retain the existing definition of consumer and the ability for businesses to contract out. At the same time we would add two new definitions, that of 'business consumer'

99 See *Trade Practices Act 1974* (Cth), s 4B.

100 See *Unfair Contract Terms Bill* (UK), cl 9.

101 Law Council of Australia, Submission on the *Trade Practices Amendment (Australian Consumer Law) Bill 2009*, August 2009, <<https://senate.aph.gov.au/submissions/comittees/viewdocument.aspx?id=8d7bbcac-c56b-4849-a6ed-3b028f5f045b>>.

102 *Unfair Contract Terms Bill* (UK), cls 9 and 11 respectively.

103 *Consumer Guarantees Act 1993*, s 2.

104 Consider for example cutlery and crockery purchased for a franchised restaurant: such items are clearly goods of a kind acquired for personal, domestic or household use and cannot really be said to be consumed in the course of manufacture.

105 *Consumer Guarantees Act 1993*, s 43(2): provided the agreement is in writing or otherwise clearly signposted by the supplier.

on the one hand and of 'written standard terms of business' on the other. Where a business consumer deals on the written standard terms of business of another party, no contracting out should be allowed. Such an approach would fall somewhere between the measures proposed to deal with unfair contract terms in the United Kingdom and in Australia which we have discussed earlier.

A further issue concerns how business consumer is defined. The draft United Kingdom legislation defines both non-negotiated terms and consumer and business contracts.¹⁰⁶ One possibility is the addition of a limiting criterion for business consumers as follows: 'where the business consumer is required to acquire the goods or services under a system or marketing plan substantially determined, controlled or suggested by the other party'.¹⁰⁷

Should such an approach be adopted, the new definition of business consumer would only prevent contracting out where a party (A) deals with another (B) on B's written standard terms of business and, in addition, is required to purchase the goods or services in accordance with the marketing plan or system stipulated by B. As we have argued, franchisees and perhaps others who are in a similar position in these circumstances are at least as vulnerable as are consumers and deserving of protection on a similar basis.

Enforceability of Guarantees

We have not canvassed which of the guarantees in the CGA should be available to the proposed new category of business consumer. We have however earlier hinted at areas where franchisees would derive an immediate benefit should guarantees such as those relating to acceptable quality, fitness for purpose and in relation to services be extended to them.

An area of potential difficulty is where goods or services are acquired from third parties. One manner of dealing with this may be to provide a remedy in these instances against the franchisor either in lieu of or in addition to a remedy against the supplier. This is broadly analogous to the existing provisions in the CGA conferring rights of redress against manufacturers.¹⁰⁸

VI. CONCLUSION

In this article, we have argued that many difficulties faced by franchisees are unlikely to be addressed under New Zealand's existing business law framework, but also that this is symptomatic of the existing generic business law being out of date and inadequate in several areas. This is particularly the case with regard to standard form business contracts, unfair contract terms and relational or incomplete agreements.

We have maintained that a consistent approach is needed by the courts and the legislature towards misrepresentations, misleading and deceptive conduct and the ability of parties to contract out or to agree to their own remedies. It has been seen that at present, a divergent approach has arisen under the CRA

106 *Unfair Contract Terms Bill* (UK), cls 11 and 26 respectively.

107 This wording is similar to that found in the Franchising Code of Conduct, above n 5, cl 4.

108 *Consumer Guarantees Act 1993*, Part 3.

and the FTA which is not justified by the factual circumstances as they relate to franchisees. Furthermore, the classification of contracts as being consumer or commercial ones has been somewhat arbitrary and ignores factors such as whether a party had an opportunity to negotiate the terms or the fairness or otherwise of the agreement.

The solution we have propounded in response to these considerations is remarkably simple. It is to work within the parameters of existing consumer and contract law but to undertake a thorough refurbishment of this framework in order to better adapt it to the needs of the 21st century. Accordingly, we have suggested amendments and additions to the existing provisions contained within the CRA, FTA and CGA. In doing so, the changes we have proposed are entirely consistent with both the structure and the principles contained in this legislative framework. Indeed (this is particularly so in the case of the CRA), it is the case that existing principles contain within them many of the solutions that are needed. The rest is merely a matter for statutory drafting.

Finally, the recent debate surrounding franchising has, we believe, served a useful function as the catalyst for a wider discussion as to the adequacy of New Zealand's fair trading, contract and consumer law. Should a review of this law result in a modernisation along the lines we have recommended, franchisees along with many other small businesses would be the beneficiaries. To use a metaphor, the argument is not whether to add a room to the existing house, but instead to fix its somewhat leaky and decrepit roof.