

Franchising legislation possible

The Government was considering legislation to regulate the franchise industry following recent heavy media publicity about difficulties relating to a home services franchise, said Miles A Agmen-Smith of ASCO Lawyers.

Mr Agmen-Smith told the ADLS seminar, "Licensing and Franchising", that following discussions with Commerce Minister Lianne Dalziel, it was possible that the government would act to regulate the sector. At least initially, this was expected to coat-tail on the *Financial Services Provider (Registration and Disputes Resolution) Bill* currently before the finance and expenditure select committee.

Provisions under consideration included a registration system for organisations offering franchises for sale, registration of advisers to the franchise industry, and a system for registration of sub-franchisees with their franchise system. Other possibilities included extension of disclosure document requirements, and making pre-arbitration or pre-mediation litigation mediation compulsory before a party was allowed to commence either in a franchise context.

Mr Agmen-Smith said that the value of franchising was now so widely recognised that worldwide growth was likely to continue for a long time to come. He described the major advantages of franchising as being that the provision of capital was shared between the different parties, leverage allowed growth to occur far more quickly, risk was shared, and commercial advantage was given to the parties over competitors.

"Lawyers will well appreciate that advantages also being risks in a variety of ways and much care needs to be taken to ensure that clients are aware of the implications of the steps they take and to assist in mitigating avoidable risks."

Mr Agmen-Smith said that franchising legal work involved the application of laws across a broad range of areas, including trade practices, intellectual property and contract. He discussed four franchise models – basic, master franchise, offshore franchise, and ownership structure. Mr Agmen-Smith noted that the New Zealand market was relatively small, meaning that businesses commonly had to look offshore to continue growing. However, this brought a raft of additional – and often unexpected issues – to be dealt with.

"For lawyers the first of these should be the limitations of their professional negligence insurance. Most policies do not or severely restrict coverage in relation to advice concerning external legal systems. That does not mean that lawyers should have nothing to do with clients seeking to extend their businesses offshore. It does, however, mean that care should be taken and, in particular, it cannot be too highly stressed that the advice of competent local

lawyers should be obtained in each jurisdiction on all aspects of what is required. It should be made clear to clients that if they fail to do so it is at their peril."

Issues to be considered in respect of offshore expansion included treating Australia as different territories rather than one market, structure, taxation and different business laws. Simon Rowell of James & Wells Lawyers spoke about licensing, noting that it was a highly specialised discipline, which involved manipulating and transferring complex and sometimes fragile intangible property rights.

"A strong working knowledge of all aspects of intellectual property law, amongst other things, is essential. Best practice, if there is such a thing, varies from country to country, and frequently changes with developments in the law and changes to legislation. As most New Zealand companies are forced to be outwardly focused, it is therefore also essential to have access to a network of experienced associates in overseas jurisdictions."

'The advice of competent local lawyers should be obtained in each jurisdiction on all aspects of what is required. It should be made clear to clients that if they fail to do so it is at their peril'

*Miles A Agmen-Smith
of ASCO Lawyers.*

Mr Rowell described a licence as permission to do something that would, in the absence of permission, infringe intellectual property rights. All forms of intellectual property could be licensed, including patents, trade secrets, copyright, trade marks, designs and plant variety rights. The rewards obtained by the licensor for the grant of rights could include an upfront payment, ongoing royalties, milestone payments, equity, services, research and development funding, and access to improvements.

Mr Rowell went on to discuss eight specific issues relating to licensing. The first was whether licensing was the most appropriate vehicle for commercialisation. He said that a number of factors needed to be considered in determining whether licensing was right for a client. These included the ongoing support the licensee might require, resource investment, intellectual property protection, the competitive landscape, and risk and return.

Mr Rowell said that there were a number of

other forms of commercialisation, including in-house expansion, joint ventures, and trade sales, and these options needed to be weighed against the advantages and disadvantages of licensing.

Secondly, it was essential to understand the nature of the licensed rights. He said that failure to adequately define the subject matter placed the parties at risk of a dispute, and could have a dramatic impact on the quantum of royalties likely to be payable under the agreement. Practitioners needed to consider when drafting licence agreements whether the subject matter was defined in terms of an intellectual property right, a technology or product, or both.

Thirdly, Mr Rowell said that it was necessary to be familiar with implied terms. In the absence of any contractual terms to the contrary, there were a number of terms that could be implied into a licence agreement by virtue of intellectual property law statutes.

These included contracting beyond the life of a patent, a presumption against perpetual agreements, and rights of licensees. Restrictions on freedom of contract were a tricky area, Mr Rowell said, as laws such as section 66 of the *Patents Act*, which contained a rule against restrictive covenants in patents, could render void many common contractual provisions. Fifthly, he warned that solicitors should beware of co-ownership issues.

Clients who were co-owners would be guaranteed access to a patent, but the flip side was that they would have no control over how the other party used the patent. In relation to advising on appropriate royalty provisions, Mr Rowell said that the key definition was not the size of the royalty rate, but the base to which it was applied.

"Should the royalty be a percentage of the invoiced sale price of the product, the manufactured cost or profit margin? Should the royalty be a piece rate – that is a set figure per product sold or manufactured? Sometimes the royalty is a set fee per time period (this is usually the case in software licences). For a cost saving manufacturing technology, the royalty may be based on the time utilised, or be a percentage of the cost savings made."

Mr Rowell then said that a number of key terms should be addressed in every licence agreement. These included sole versus exclusive licence, field of use, territory, and duration. He noted that licensing practice and law varied significantly between jurisdictions.

Finally, as many licences were international, it was essential to be aware of the risks that these different regimes presented. Practitioners should consider the IP registration regime in the relevant jurisdiction, as well as the law of contract and any other statutory obligations such as competition laws.