

NEWSLETTER 3



The Great Battle of Trafalgar - where information is everything . . .

What do the Charge of the Light Brigade and the Battle of Trafalgar have in common? Answer, They are lessons to be learnt in regard to the value of information.

Some background. **Charge of the Light Brigade** - The commander failed to take account of the fact that he was on a hill and could see what was going on and his troops could not. The result was a disaster with 157 of the total 673 men in the charge losing their lives. Basically Lord Lucan misunderstood a message given to him by Captain Nolan to advance his cavalry nearer the enemy. Instead he took the instructions to mean to attack the line of Russians.

The Battle of Trafalgar - this was a victory due to clear understanding, collection of correct information and the appropriate information being relayed to other ships in the fleet. In this particular instance Nelson and his command were able to effectively assess the risk and implement an action plan.

Accurate information will assist you in protecting yourself and your asset.

INFORMATION - EDUCATION IS POWER. Power assists you to think strategically to achieve your goals in life.

In response to demand and positive feedback from the franchise industry on our previous Newsletters we will shortly be setting up a Question and Answer section on our developing web-site. We will keep you advised of progress.

Since many of you have again asked about the changes to legislation with regard to the "Employment Relations Act" we have dedicated this edition to the subject.

Q: Are there any changes in my liabilities as an employer due to the new Employment Relations Act and will the recent court decisions in regard to employee stress have an impact?

A: Briefly, there is an impact upon your responsibilities as an employer and possible exposures under your Directors & Officers Liability. This also relates to your contingency planning in the event of a disaster to your business and to your estate.

Please note that the following is a discussion on the impact on your business from the point of view of Directors & Officers Liability and Employers Liability. It is not a discussion about employment relations within your business. In this regard you should seek advice from professionals in this specific area.

The Employment Relations Act has created a situation whereby employers are now **responsible for protecting the interests of their employees** - i.e. in the event of the sale of a business the employees' positions within the company needs to be protected.

Secondly, **failure to secure your employees' ongoing employment with the new owner of the business can cause action against the directors and**

officers of a company. You need to be aware that as per Section 234 of the Act, if a director or officer has taken a decision to pay below the minimum wage and/or failed to pay holiday pay due, then through action of the Labour Inspector they can bring action against the director or officer responsible for this decision and that person can be pursued for the minimum wages and holiday pay due at the time of liquidation. This of course raises

a number of issues for directors and officers of a business and it also needs to be pointed out that the Act also brings in 'agents' of the company. In talking to Chapman Tripp we were continually reminded of the importance of maintaining your Directors & Officers liability policy even after closure of your business.

We often find that employees within a business are the last people to be considered at a time when the business needs to be sold (i.e., to realise its true value should the partners of the company or the owner of the company wish to move out due to death, sickness or illness).

There is also a further issue in regard to management of stress within a business and it has now become evident (and proven in court) that **an employee can take action against an employer for failing to dealing with the employee's stress levels.** The employer now needs to show that the employees have been well catered for and are being looked after. This can be accomplished by the purchase of health and medical schemes within the business. An employee can bring action against the employer should the employer not find an alternative occupation or assist the employee for relieving stressful situations within the work place. It is thus the employer's responsibility to

identify and mitigate stress within the workplace.

Under the Employment Relations Act there is an objective to promote good faith collective bargaining and effective resolution of employment relationship problems. The Act protects employees on the sale, transfer or contracting out of a business. Under the Act, employees are categorised as either 'vulnerable' or 'invulnerable'. 'Vulnerable' employees have the right to elect to transfer on the same terms and conditions of employment to the new employer. The new employer must pay any subsequent redundancy compensation (which will be determined by the Employment Relations Authority) if it is not already established in terms and conditions of employment or agreed between employees and the new employer.

It is also important to note that all employees of companies should now have (and need to have) an employment contract in place. This is required by statute and businesses were given until 1/4/05 to have this in place.

For other employees the employer must negotiate regarding the availability and terms of transfers and employee's settlements and entitlements if transfers do not

occur. The effective outcome is that **at least for vulnerable employees there is an absolute right to redundancy compensation, which must be factored into the cost of any transfer of business undertaken.** Thus in industries characterised by frequent cost cutting restructuring, an additional cost presents an opportunity to secure greater stability for longer term employment and the employer must find someone to take on its employees.

It is also stated in the Act that there needs to be an express obligation for employers to notify and **consult with its employees** in relation to decisions adversely affecting their employment and a satisfactory time period for fulfilling this obligation is 12 months.

So what does this have to do with the franchising industry? There has been an article in the NZ Herald written by Tim Hunt whereby he alluded to the fact **"in others the franchisee is effectively an employee who forks out capital to get a job"**. In discussing this particular aspect with a well-known and highly qualified franchise consultant there was a debate about this specific issue. It is quite clear that some franchise

agreements are constructed in a form, which could permit the interpretation of the contract to be that of an employer/employee relationship. I.e. the parameters of obligations are quite narrow and furthermore the level of support given by a franchisor to a franchisee could determine that the franchisee is in effect a contracted employee to the franchisor. The franchisor provides the plant, equipment, stores etc. **So what is the solution to this specific issue which has been created by our current Government?** This is of course the worst case scenario and subject to proper drafting of a Franchise Agreement. Also it leads to numerous questions and issues on the subject of Franchise Agreement construction and wording.

From a recent exercise that we have completed for another business it is quite clear that the employees and their salaries could be considered as a liability in the event that the business needs to be sold quickly or for that matter if the business goes into liquidation. The franchisor that may have staff (or even the franchisee that may have staff), has a responsibility under the Companies Act to ensure that the business is being run effectively and efficiently and thus protecting the interests of all creditors - which includes the employees. Therefore there is

the necessity to seriously consider the purchase of Directors & Officers Liability

insurance for the franchisor and the franchisees.



Will this represent an image of your creditors, employees/franchisees in the event of your default?

Let us take another situation of death, critical illness or total permanent disability of the franchisor - or for that matter, the franchisee. Under the Act there is now the necessity for the estate that takes over the business to protect its employees so that should there be the necessity to sell the business, the interests of the employees are protected. Furthermore, if, as mentioned above, the franchise agreement can be construed as being an employment contract, the estate needs to consider protecting the interests of franchisees. This would mean that the new buyer of a business system would have to buy the system with the existing contracts in place and guarantee continuity. Failure to do so could bring a case against

the estate and/or the surviving directors or officers of the defunct business. Please note that a director or officer can still be pursued even after the sale of a business. Thus it is important to maintain Directors & Officers Liability insurance on a run-off basis.

Also, as per our earlier newsletter, this issue is the tip of the iceberg because if a business system is sold and the franchisee has lost their livelihood and thus has to make staff redundant, the franchisees can also be held liable by **their** staff. There are a number of contractual relationship issues here and you need to discuss these with your franchise lawyer.

The solution to this is our **Acropolis^R** product. The model is based on the fact that the franchisees take over operation of the business system and buy out the franchisor's estate. Additional benefits can also be added to this such as superannuation, health insurance, etc. It is a very cost-effective method of protecting the estate and the interests of Franchisees.

For professional advice on these franchise related subjects refer:

Chapman Tripps 'Counsel' Publication - 5 Feb 2004

Stewart Germann, Stewart Germann Law Office

Callum Floyd, Franchise Consultants

Post note: An extract from 'Counsel 5 Feb 2004' - Changes in Business Ownership.

- All employment agreements within 12 months to identify process and subject of negotiations between present and prospective employer in anticipation of change of ownership, and employees' entitlements if not transferring to the new employer.
- Specified 'vulnerable' employees may elect to transfer on existing terms of employment to new employer, who is then obliged to provide redundancy compensation as agreed by parties or determined by Authority.

The best protection for you and your business is an effective **risk management plan**
and
Franchise Foundation has been established specifically with this in mind to assist the
franchise
Industry - tailored with you in mind.

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