

17 July 2014

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Dear Mr Srivastava

### **Fair Trading Act 1986: Warning**

The Commerce Commission has been investigating your conduct as former owner of Bio Enterprises Limited (in Liquidation) (formerly Advance Diagnostics NZ Limited) under the Fair Trading Act (the Act). We have now completed our investigation and are writing to warn you of our concerns.

The conduct in question relates to the sale of Advance Diagnostics licences to four complainants whom the Commission has previously disclosed to you. The Commission considers it likely that you have breached the Act in respect of representations made about:

- The extent of the existing client base and income stream for the territories being sold.
- The availability of future drug testing work and income from that work.
- The uniqueness of the SureStep drug testing cup.
- The availability of a Magnum software package tailored to the licences sold.
- That each complainant would have exclusive rights to the territory they bought.

### **The Investigation**

Complainants spoken to by the Commission alleged that:

- You represented that you had many existing clients and you could not cope with the amount of business you had, when in fact almost none of the 'clients' referred to on lists that you provided to complainants after purchase were current clients.

- In the case of two complainants, you made specific representations about the income stream that was available to them in their territory and that was not accurate.
- You represented that future drug testing work was available and included this in financial projections when that information was not sufficiently substantiated and inaccurate.
- You would provide a superior turn-key software product (Magnum) in conjunction with the franchise, when that product never functioned properly, was therefore unusable and was eventually discontinued.
- You promised exclusive rights to the territories sold, when that was not the case for the Taupo and Waimate areas.

In investigating these complaints the Commission considered a large volume of information supplied by you, Mr Lindstrom, the complainants, and Alere Limited.

### **The law**

Section 22 of the Act states that it is unlawful for anyone to make a representation that is false or misleading in a material particular regarding the profitability or risk, or any other material aspect of the business activity that they are inviting people to engage or participate in, if that activity requires them to perform work or invest money and perform work.

### **The Commission's view**

In our view, you have engaged in conduct that is likely to breach section 22 of the Fair Trading Act.

#### *Representations about existing client base and existing income stream*

Representations about these matters were made in written material such as a newspaper advertisement, marketing material and disclosure documents, and also verbally during face-to-face pre-purchase meetings (where complainants were shown customer lists).

In our view, while there were some sales of drug testing products nationally, there is evidence that 'clients' contacted post-purchase were usually not clients (although you may have dealt with those firms in the past) and the number of current customers was low. Accordingly, the representations about the number of existing clients and, for two complainants, an ability to earn a certain sum of money, were likely to be misleading and therefore in breach of the Act.

#### *Representations about future availability of drug testing work and an income stream from that work*

You have told us that you advised complainants there was potential for excellent growth if they carried out drug testing (in addition to selling the drug testing cups and other medical products). You supplied a financial growth model that included projected turnover based on drug testing cup sales and the conduct of drug tests. Complainants say that there was little or no demand for drug testing and where it was undertaken they had strong competition.

You explained that you based your financial growth model on an estimate of conducting 5 drug tests per week day (25 per week), which you considered reasonable because of a likelihood of a very high number of tests because each site was likely to be a large factory-type operation. You also pointed to a newspaper article suggesting that the New Zealand Drug Detection Agency completed approximately 170 tests per week. You also advised (and provided some email evidence) that you spoke to many firms and received some direct inquiries for drug testing across New Zealand from 2008 onwards.

In our view you did not have an adequate basis for the financial projections you used to market these franchises. In addition, the actual client numbers post-purchase do not support the representation about potential revenue to be earned from drug testing.

Two complainants, having regard to the experience and expertise you emphasised you had in this area, relied on your representations about the drug testing business. In our view these representations gave rise to a likely breach of the Act in respect of those complainants.

#### *Representations about the uniqueness of the SureStep drug testing cup*

All complainants say that the superior and unique nature of the SureStep cup was a strong incentive for them to purchase the franchise. They thought this gave them a competitive edge. You refute this, and say that you never said the SureStep product was unique.

The complainants are consistent with their allegations and, in our opinion, their view that the unique aspect of the product was influential in their purchase decision is credible. There is evidence that, after they purchased the licenses they discovered that the product was not unique and that another company was offering the same or a similar product at a lower price. In our view the evidence of comparable products being offered by competitors gave rise to a likely breach of the Act.

#### *Representations about the Magnum software package*

The marketing material, license proposal and disclosure documents provided to complainants pre-purchase promoted Magnum as tailor-made, sophisticated software that would give licensees a competitive advantage. Most of the complainants say you emphasised the value of this software and that it was specifically written for Advance Diagnostics.

There is good evidence that the Magnum system never worked properly for complainants throughout their licence agreements and that the system ceased to be operational on 30 November 2011. Accordingly, it is likely that representations you made about the availability and merits of this product were misleading.

#### *Representations about exclusive rights to the territory*

Taking into account complainant evidence about the territories they were promised, we consider it likely that the cross-over of territory for complainants in the Waimate and Taupo areas was contrary to what they were promised and therefore a likely breach of the Act.

#### *Other complaints considered*

We also investigated complaints that you made misrepresentations that:

- the SureStep drug testing cup was exclusively available to complainants, when it was not; and
- you would supply products to the complainants at wholesale prices. The complainants alleged that you imposed a mark-up on these products.

We have considered the evidence we have available and have reached the view that the evidence does not support these complaints. As a result, the Commission will be taking no action on these two complaints at this time.

### **Next steps**

While we will not be taking any further action against you, this warning will be taken into account if the conduct continues and if you engage in similar conduct in the future. We may also draw this warning to the attention of a court in any subsequent proceedings brought by the Commission against you.

This warning letter is public information and will be published on our website. We may also make public comment about our investigations and conclusions, including issuing a media release or making comment to media.

### **Penalties for breaching the Act**

Only the courts can decide if there has been a breach of the Act. The court can impose penalties where it finds the law has been broken. A company that breaches the Act can be fined up to \$600,000, and an individual up to \$200,000 per offence.

You should be aware that our decision to issue this warning letter does not prevent any other person or entity from taking private action through the courts.

### **Further information**

We have published a series of fact sheets and other resources to help businesses comply with the Act and the other legislation we enforce. We encourage you to visit [www.comcom.govt.nz](http://www.comcom.govt.nz) to better understand your obligations and the Commission's role in enforcing the Act.

Please contact me on 03 964 3458 or by email at [stuart.wallace@comcom.govt.nz](mailto:stuart.wallace@comcom.govt.nz) if you have any questions about this letter.

Yours sincerely



Stuart Wallace  
Consumer Manager