

THE REVIEW OF THE AUSTRALIAN FRANCHISING CODE OF CONDUCT

KEY RECOMMENDATIONS & WHAT THEY COULD MEAN FOR YOU

By Judith Miller and Jennifer Tetstall

Major reforms, which could significantly impact all franchisors, are currently under review by the Australian Government.

On 17 May 2013, The Department of Industry, Innovation, Climate Change, Science Research and Tertiary Education released its report (**Report**) following an independent review of the Franchising Code of Conduct (**Franchising Code**).

The four month review, conducted by industry expert, Mr Alan Wein, has resulted in 18 recommended changes to the Franchising Code dealing with disclosure, good faith, dispute resolution and the introduction of fines and penalties.

If these recommendations are adopted by the Government there could be significant advantages and disadvantages for franchisors. The recommendations of most consequence include:

- Replacing the existing requirement that a foreign or master franchisor provide a long-form disclosure document with a short-form disclosure document.
- The obligation on franchisors to prepare for prospective franchisees a short standalone statement summarising the key risks.
- The introduction of penalties for breach of the Franchising Code as well as a general strengthening of the enforcement regime.
- Increased disclosure about online activities.
- Great rigour will be required regarding marketing funds.

THE REVIEW - KEY FACTS

- The review of the Franchising Code was announced by the Australian Government on 4 January 2013.
- This is the fourth major review of franchising and the Franchising Code at the Commonwealth level since 2006 and fulfils the Government's 2009 commitment to review the code in 2013.
- Mr Wein received 73 submissions (including that of DLA Piper) and conducted over 30 face to face consultations with industry in the preparation of the review.

The recommendations represent the largest overhaul of the Franchising Code since its inception. Overall, and depending on which ones the government adopts, they should generally improve the administrative burden on franchisors although the strengthening of the enforcement regime represents increased exposure for franchisors.

This update provides a summary of the key recommendations and their potential impact for franchisors.

SUMMARY OF RECOMMENDATIONS

THE RECOMMENDATIONS	WHAT THIS COULD MEAN FOR FRANCHISORS
<p>Disclosure obligations</p>	
<p>The franchisor must provide a disclosure document to the franchisee if the franchisor notifies the franchisee of its intention to renew the franchise agreement in accordance with section 20A of the Franchising Code. (Section 20A deals with end of term arrangements and requires the franchisor to give at least 6 months' notice of its intention to either renew or not renew).</p>	<p>The Franchisor must provide a disclosure document when notifying of its intent to renew a franchise agreement.</p> <p>The recommendation seeks to clarify the ambiguity highlighted by several submissions to the review regarding section 20A namely whether a disclosure document was required on notification by a franchisor that it intends to renew a franchise agreement.</p>
<p>A foreign franchisor (or master franchisor) will, in most cases, only be required to submit a short-form disclosure document (rather than the long form that is currently required to be provided to all prospective franchisees). This short form document will need to be provided to franchisees.</p> <p>Only franchisees who do not also act as franchisors will be provided with the full disclosure document by their immediate franchisor.</p> <p>The short-form disclosure document must contain:</p> <ul style="list-style-type: none"> ■ basic contact details and background of the foreign or master franchisor; ■ the essential obligations that have been delegated under the master franchise agreement; ■ information regarding intellectual property (including the ownership or licensing arrangements that the franchisee will have rights to); and ■ the impact will be on the subfranchisee if the master franchisee is terminated or not renewed. 	<p>The short form document (where it can be used) should result in a greatly reduced regulatory burden for foreign franchisors and master franchisors.</p>
<p>The franchisor must disclose rights associated with the conduct of online sales, including any ability of the franchisor to conduct online sales.</p>	<p>Franchisors must be transparent about their online sales plans. This may force franchisors to consider their online strategies earlier than they may wish to.</p> <p>Currently, item 8 of Annexure 1 to the Franchising Code provides that a franchisor must disclose certain information about a franchisee's right to operate in an exclusive or non-exclusive territory, including, for example, whether the franchisor or other franchisees may operate a business that is substantially the same as the franchised business in the franchisee's territory. The internet is not what is conventionally considered a territory and it is currently not clear whether the franchisor is required to disclose its ability to compete with a franchisee online.</p>

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<p>Franchisors must provide a short summary of the key risks. The summary should:</p> <ul style="list-style-type: none"> ■ be generic; ■ provide more detail than the current item 1 of Annexure 1 to the Franchising Code, (but 1-2 pages in length); ■ be a standalone document; and ■ be provided to franchisees at their first point of contact with a franchisor. 	<p>The introduction of this document will increase the administrative burden on franchisors but should not be overly burdensome.</p>
<p>Franchisor failure</p>	
<p>Franchisees and franchisors will be provided with a right to terminate the franchise agreement if any administrator of the other party does not turn the business a round, or a new buyer is not found for the franchise system, within a reasonable time (for example 60 days) after the appointment of the administrator.</p> <p>The courts can extend this timeframe in appropriate cases and the parties can negotiate a right to terminate at an earlier stage.</p> <p>Franchisees will be made unsecured creditors of the franchisor in the case of franchise failure (that is the insolvency of the franchisor). The amount will be determined by apportioning the franchise fee across the whole term and determining the amount for the unexpired term.</p>	<p>As these recommendations will only ever apply in the case of franchisor failure, they are not so much a concern for franchisors as they are for major creditors of the franchisor. The qualification on that assessment is that the right to terminate the franchise agreement in the case of franchisor administration will make it very difficult for the franchisor to trade its way of out administration.</p>
<p>Increased transparency of financial information in a franchise</p>	
<p>Franchisors will be prohibited from imposing unreasonable significant unforeseen capital expenditure. ‘Unreasonable’ and ‘significant’ should be defined, so that a franchisor can demonstrate a business case for capital investment in the franchised business.</p>	<p>This recommendation is aimed at ensuring that franchisors do not impose unreasonable significant unforeseen expenditure and will require more diligence from franchisors and may restrict them in their redevelopment plans if there has been no adequate disclosure.</p> <p>Although the Franchising Code already requires franchisors to disclose whether franchisees will be required to undertake unforeseen significant capital expenditure that was not disclosed by the franchisor before the franchisee entered into the franchise agreement, a number of submissions to the review reviewed indicated that some franchisors do not disclose any information under this item while others disclose a long list of expenses which provided little valuable information to a franchisee.</p>

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<p>Marketing funds are to be administered as follows:</p> <ul style="list-style-type: none"> ■ marketing and advertising costs should be separately accounted for; ■ contributions to marketing funds from individual franchisees should be held on trust (although the franchisor will have wide discretion on their application); ■ company-owned units must contribute to the marketing and advertising fund; ■ the marketing and advertising fund should only be used for expenses which are clearly disclosed to franchisees by way of the disclosure document and are legitimate marketing and advertising expenses; ■ an annual independent audit should be conducted (the ability of franchisors to escape the requirement by the consent of 75% of franchisees will be removed); and ■ the results of the audit and other detailed information about the expenditure of marketing and advertising funds should be made available to franchisees annually. 	<p>Franchisors will now be required to administer their marketing funds with increased diligence and disclosure. The recommendation not only increases the franchisor’s reporting and regulatory requirements, but also its costs.</p> <p>Currently, the Franchising Code requires franchisors to provide franchisees with a statement detailing the receipts and expenses for such funds each financial year within three months of the end of each financial year.</p> <p>In addition, a franchisor is required to have the marketing fund statement audited each year and provide franchisees with a copy of the auditor’s report (unless 75 per cent of franchisees agree that it is not necessary). Franchisors will no longer be able to escape the auditing requirement via this method.</p> <p>Many submissions alleged that marketing funds were a common source of dispute between franchisees and franchisors, are prone to improper or questionable use by the franchisor and lack transparency.</p>
Good faith obligations	
<p>The Franchising Code will include an express obligation to act in good faith, which will:</p> <ul style="list-style-type: none"> ■ apply to both the franchisor and the franchisee; ■ extend to the negotiation and performance of a franchise agreement including, the resolution of any disputes between the parties irrespective of whether there is a valid franchise agreement at the time of the dispute; ■ not be statutorily defined; ■ not be able to be limited or excluded by contract; ■ not prevent a party from acting in its legitimate commercial interests; and ■ prohibit an argument that a franchisor has not acted in good faith because there is no term in a franchise agreement specifying a right of renewal. 	<p>This proposed amendment may cause some uncertainty for franchisors when exercising any of their rights under the franchise agreement as the law on good faith is not consistent across each of the Australian states. This potential uncertainty was acknowledged in the report particularly as there will be no definition in the Franchising Code.</p>
Transfer, renewal or end of a franchise agreement	
<p>A written request from a franchisee to keep its details confidential must come from that franchisee without procurement, initiation or encouragement from the franchisor.</p>	<p>Some franchise agreements will include a term that requires the franchisor to keep the franchisee’s details confidential. This effectively allows a franchisor to avoid disclosing the contact details for ex-franchisees in a disclosure document.</p> <p>This recommendation would require that any such terms be removed from the franchise agreement unless requested by the franchisee.</p>

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<p>The Franchising Code be amended as follows:</p> <p>1.) The franchisor is taken to have given consent to the transfer or novation if the franchisor does not, within 42 days after the request was made, <u>or all information reasonably required by the franchisor under the franchise agreement has been provided, whichever is the latter</u>, give to the franchisee written notice:</p> <p>i) that consent is withheld; and</p> <p>ii) setting out why consent is withheld.</p> <p>2) <u>The franchisee should take all reasonable steps to provide all information required under the franchise agreement to enable the franchisor to be able to properly evaluate the request.</u></p>	<p>This amendment will benefit franchisors. The effect of this recommendation would be that franchisors are given sufficient time to respond to a request by the franchisee to transfer or novate an agreement before consent is deemed.</p> <p>Currently, clause 20(4) of the Franchising code provides that the franchisor is taken to have given consent to the transfer or novation if the franchisor does not, within 42 days after the request was made, give to the franchisee notice that the consent is withheld and setting out its reasons.</p> <p>It was submitted that franchisees often write to franchisors stating that there is a proposed deal but does not include terms of the contract to enable the franchisor make an informed decision.</p>
<p>The Franchising Code be amended to provide that any restraint of trade clauses in the franchise agreement are not enforceable if all of the following conditions are satisfied:</p> <ul style="list-style-type: none"> ■ the franchisee wishes to have the franchise agreement renewed on substantially the same terms; ■ the franchisee is not in breach of the agreement; ■ the agreement does not contain provisions allowing a franchisee to make a claim for compensation in the event that the franchise is not renewed; ■ the franchisee abides by all confidentiality clauses in the agreement and does not infringe the intellectual property of the franchisor; and ■ the franchisor does not renew the franchise agreement. 	<p>This recommendation may have large impact on a franchise. Effectively, it allows a franchisee to open a competing business in the territory if all of the conditions listed are met.</p>
<p>Dispute resolution</p>	
<p>In order to provide clarity and consistency, the alternative dispute resolution framework under the Franchising Code should apply to any franchise dispute in any alternative dispute resolution process.</p>	<p>Parties to a franchise agreement will be required to comply with Part 4 of the Franchising Code (which outlines a certain procedure) regardless of the alternative dispute resolution process engaged. This will prevent franchisors adopting a course of action to avoid the dispute resolution procedure under the Franchising Code.</p>
<p>The Franchising Code should be amended to ensure that franchisors cannot:</p> <ul style="list-style-type: none"> ■ attribute the legal costs of dispute resolution to a franchisee unless ordered by a court; or ■ impose a requirement on a franchisee to litigate in a jurisdiction other than the state/territory in which the franchisee’s business is principally conducted. 	<p>This, in effect, may increase franchisee disputes because these matters discouraged franchisees from litigating.</p> <p>The review pointed to the costs to franchisees in raising a dispute with a franchisor as having an inhibiting effect. Restricting the ability of franchisors to attribute the costs of dispute resolution unless by court order, would assist with reducing the costs of dispute resolution for franchisees and improve their access to justice. In addition, requiring parties to litigate in the jurisdiction where the franchise is operated reduces travel and other associated costs as well as removing the obstacle of the franchisee having to litigate in an unfamiliar (and possibly foreign) forum.</p>

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Enforcement	
<p>The Franchising Code be amended to:</p> <ul style="list-style-type: none"> ■ allow civil pecuniary penalties of up to \$50,000 to be available as a remedy for a breach of the Franchising Code; ■ allow the ACCC to issue an infringement notice for a breach of the Franchising Code; ■ allow the ACCC to use its powers under s 51ADD of the CCA (its random audit powers) to assess a franchisor’s compliance with all aspects of the Franchising Code; ■ include a breach of the Franchising Code in the contraventions for which the court may make an order under section 86E (Order disqualifying a person from managing corporations); and ■ specify that the court can make franchising specific orders under section 87, including orders requiring a franchisor to: <ul style="list-style-type: none"> ■ give a royalty free period to a franchisee affected by a breach of the Franchising Code; and ■ pay a sum of money specified by the court into any marketing or cooperative fund applicable to that franchise system. 	<p>This recommendation would expose franchisors to risk of incurring civil pecuniary penalties, which previously were not expressly available. Franchisors would have to be more careful in their overall approach and diligent to ensure strict compliance.</p> <p>There are already a number of available remedies and penalties which can be applied when a party breaches the Franchising Code. For example, courts can impose a number of remedies (such as compensation, court enforceable undertakings or public warning notices) and civil pecuniary penalties in some circumstances (such as for misrepresentation). Further, any aggravating conduct would be caught by the Australian Consumer Law. These will continue to apply in addition to the increased enforcement powers.</p>

WHAT'S NEXT?

The Government views the recommendations as a ‘roadmap for reforms’ which will be an important step in ensuring that the franchise sector ‘can continue to grow and develop as an essential part of our [Australia’s] economy’. As a result of the independent review, the Government is now considering its response and intends to prepare a Regulatory Impact Statement, which may involve further consultation with key stakeholders before any of recommended changes are included in the Franchising Code. It is possible that the Government will seek further submissions on this.

“The Government is committed to providing certainty and confidence in the franchising sector”

Bernie Ripoll, Parliamentary Secretary for Small Business

Whilst the timing of the Government’s response is unknown at this stage, based on previous reviews of the Franchising Code and the Government’s unwavering commitment to strengthen franchising in Australia, we expect that any reforms will come into play within the coming six months.

Once this review has concluded and any reforms are in place, it has been recommended by Mr Wein that any further review of the Franchising Code should not take place for a minimum of five years.