

FRANCHISE MARKETING AND OTHER COOPERATIVE FUNDS

Introduction

Unfortunately there is a lot of angst caused by the amount of contributions to marketing funds and the use of those funds by a franchisor.

The new Franchising Code of Conduct which took effect 1 January 2015 has changed some of the rules regulating marketing funds which franchisors and franchisees must be aware of.

Most franchise agreements require that the franchisee contribute either a fixed amount or a percentage of their turnover to a marketing fund. Most franchise agreements drafted prior to 1 January 2015 also say that the fund will be used at the discretion of the franchisor and the franchisor does not need to spend a certain amount or for that matter any amount of the money contributed in the franchisee's area.

That is the first area of contention. Some franchisors spend the money in areas which the franchisees do not believe is strictly marketing. For example: a franchise system which uses the money for the registration and maintenance of existing or new trade marks. The agreement also says they can use the money to defend any action against the trade marks.

Others want to spend the money attending franchise expos because they believe that is marketing of the system. Some others want to spend the money on conferences.

Those uses of funds are not what would be thought of by any reasonable franchisee as being what was contemplated by the franchisee when they were originally told they were expected to contribute to a fund. It might be in the document, but unless it is pointed out by the solicitor, the franchisee will be very surprised at those uses of the funds.

Franchising Code of Conduct

Franchisees want to know where their money is spent. The new Franchising Code of Conduct ("the Code") provides in section 15:

- (1) If a franchise agreement provides that a franchisee must pay money to a marketing or other cooperative fund, the franchisor must:
 - a. within 4 months after the end of the last financial year, prepare an annual financial statement detailing all of the fund's receipts and expenses for the last financial year; and
 - b. ensure that the statement includes sufficient detail of the fund's receipts and expenses so as to give meaningful information about:



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- i. sources of income; and
 - ii. items of expenditure, particularly with respect to advertising and marketing expenditure; and
- c. have the statement audited by a registered company auditor within 4 months after the end of the financial year to which it relates; and
- d. give to the franchisee:
- i. a copy of the statement, within 30 days of preparing the statement; and
 - ii. a copy of the auditor's report, if such a report is required, within 30 days of preparing the report.

Failure to comply with 15(1) carries 300 penalty units, equating to a penalty of \$51,000.

However, a franchisor does not have to comply with the audit requirement if 75% of the franchisor's franchisees in Australia, who contribute to the fund, have voted to agree that the fund does not need to be audited. This is no longer a requirement for a vote every 3 years. If a franchise agreement provides that a franchisee must pay money to a marketing or other cooperative fund, the reasonable costs of administering and auditing the fund must be paid from the fund.

The new Code further provides for the regulation of marketing funds in clause 31, the main points being:

- A franchisor must maintain a separate bank account for marketing fees and advertising fees contributed by franchisees.
- If a franchisor operates one or more units of a franchised business, the franchisor must pay marketing fees and advertising fees on behalf of each unit on the same basis as other franchisees.
- Franchisors must be careful to disclose all expenses which the marketing fund will be used for in the disclosure document. Expenses not disclosed must only be used for genuine marketing or advertising expenses, agreed to by a majority of franchisees, or the reasonable costs of administering or auditing the fund.

Prior to 1 January 2015, the former Code did not contain an equivalent to clause 31.

Issues

These simple sections in the Code create a number of issues which need to be addressed one by one (and this is not an exhaustive list):

- Sometimes it is hard to have the funds accounts finalised in 4 months. That is a short amount of time and some systems delay in instructing the accountant or the accountant is slow in finalising the accounts.
- A registered company auditor – it is important to ensure the auditor is a registered company auditor, and not just a qualified auditor.
- Franchisors often forget to get permission from 75% of the franchisees to not get the fund audited. This means that strictly the franchisor must get the fund audited which could be a “waste” of the money in the fund if the franchisees would have agreed that the audit is not necessary. Of course, getting 75% of the franchisees to actually vote can be difficult in itself.

- Franchisees are not happy with the accounts. They do not believe the accounts show enough detail. Franchisors do not want to give specific outlays from the fund for a variety of reasons such as franchisees do not want other franchisees to know what they are earning. If the accounts show each franchisee's contribution to the fund, and the contributions are calculated on a percentage basis, then every franchisee can easily work out what the others are earning. Franchisees do not like the amount spent by franchisors on management fees. They do not realise sometimes the amount of time and effort from the franchisor in administering the fund. It requires staff, telephone, desks, office space etc.
- A franchisee may think they can demand to see all the receipts and expenditures from the fund. They are not entitled to see them. Franchisees are entitled to see the accounts, not every individual item in the accounts.
- Franchisors do not want their competitors to know how much they are spending in a specific area. If the accounts are too specific then it may give a competitor an advantage to know that a particular competitor spends a certain sum on television advertising. Accounts have a way of ending up in the wrong hands.

Franchisees are however entitled to receive the statement and audit statement.

The introduction of the new clause 31 requires a franchisor to set up a separate account for the marketing fund. Formerly franchisors would often mix the fund money with their own money which could be confusing and costly when it came to the accounts for the fund and the audit. From 1 January 2015 franchisors must have a separate bank account for the marketing fund and keep the administration of the fund completely apart from the franchisor's own funds.

Some franchise agreements provide that there is to be a marketing committee. That committee has varying degrees of say on the administration of the fund. From a franchisor's point of view, they do not want to be instructed by a committee to conduct certain advertising that is not in line with the system as a whole. It is the franchisor's system and in the end they probably need the final say in the advertising/marketing to be conducted.

As can be seen, more and more issues arise with marketing funds all the time and it is an area where franchisees and franchisors are often in dispute and undoubtedly will continue to be for as long as there is franchising.

Other cooperative funds

Finally the words "or other cooperative fund" need to be considered. A franchisor may set up a fund for the national conference. Attendance at the conference can be an expensive outlay for a franchisee and a weekly or monthly payment to a fund for the conference would ease the financial burden. That type of fund would also be covered by section 15 of the Code and care must be taken by franchisors to ensure they comply with the Code in regard to any fund established.