

THE NEW FRANCHISING CODE OF CONDUCT

After many months of draft releases and countless submissions from all areas of the franchise sector, the new Franchising Code of Conduct has been finalised. Unlike previous changes, this is a major overhaul. Totally new concepts such as the obligation to act in good faith have been introduced into the Code. Penalties now apply for breaches and these are not insubstantial penalties.

The following is an overview of some of the important changes but it by no means covers all the changes to the Code.



Application of the New Code

The Code applies to conduct that occurs on or after 1 January 2015 in regard to all franchise agreements entered into both before and after 1 January 2015.

There are some provisions in franchise agreements entered into before 1 January 2015 that will still be effective even though they are contrary to the new Code. These are known as transitional provisions and relate to clauses such as for example restraints or jurisdiction which may be covered by a pre January 2015 agreement. But if there is a new franchise agreement or a renewal, sale or variation then the transitional provisions no longer apply.

Penalties

The introduction of the penalties and the availability of infringement notices (see below) are seen as an increase to the enforcement options available to the ACCC. Penalties are only applicable to the specified provisions in the new Code – but there are a lot of them.

The Code specifies penalty units. Penalty units are currently \$170 each and this value is not set under the Code. Therefore if the value of a penalty unit changes then the money payable for a breach of the Code will change. A breach attracts 300 penalty units which is \$51,000 at the moment for each breach.

Penalty units apply per breach. For example, a franchisor commits the same breach of the Code against 5 franchisees – this will be treated as 5 separate breaches attracting penalty points for each individual breach.



Infringement Notices

Infringement Notices are not covered by the Code but by an amendment to the Competition and Consumer Act.

The ACCC may issue an infringement notices for an alleged contravention to certain sections in the Competition and Consumer Act. The penalty imposed with an infringement notice is not discretionary and will be \$8,500 each. If the penalty is paid, that is the end of the matter and the ACCC will not take it further. If it is not paid then the matter will go to court. The biggest issue is that the penalty is usually paid without admission of liability because the cost to fight the infringement notice is more than \$8,500.



Contact : Janice Bywaters

E: jbywaters@btlaw.com.au

Contact : Luke McKavanagh

E: lmckavanagh@btlaw.com.au



or contact us using the details below

Liability limited by a scheme approved under professional standards legislation

Warning—this article is only meant to give you general information and should not be relied on as legal advice. If you want more information then talk to one of our lawyers.

Disclosure

Franchisors can continue to use disclosure documents in accordance with the existing Code up to 31 October 2015, but after this date they must be in accordance with the new Code. At least that is what has been said in the Explanatory Statement issued by the Minister for Small Business but there are issues for any company with a financial year that ends before 30 June 2015. There are also issues in that the Franchise Agreements may need to be updated to comply with the Code if there is a new grant, transfer, renewal etc. If that occurs then the disclosure document should be updated as well.

Franchisors do not need to update their disclosure documents within 4 months of the end of a financial year if:

1. no franchise agreements were entered into in the previous financial year (which includes new franchise grants, renewals, transfers or variations to existing agreements); and
2. in the franchisor's reasonable opinion they will not be entering into any new franchise agreements, renewals, transfers or variations within the next 12 months; but

if an existing franchisee requests a current disclosure document, then the franchisor must update their document within 2 months of the request and provide it within 14 days of it being updated.



Financial Reports – a disclosure document must still include copies of financial reports for the past 2 years, unless an independent audit statement is provided within 4 months of the end of the financial year for that statement's financial year (under the old Code the requirement was to provide the statement within 12 months).

Information Statement – the new Code includes an Information Statement which must be provided to a prospective franchisee or purchaser of an existing franchised business. This must be provided as early as possible. For the transfer of an existing franchised business this would be at the time the existing franchisee applies for consent. For a new application, the Statement should be given with the information pack. It must be in 11 point font and no longer than 2 pages.

Franchisors are to provide details of whether the territory or site has been subject to a franchised business operated by a previous franchise in the system in the previous 10 years in the disclosure document. No time was previously specified.

When issuing disclosure documents from 1 January 2015, a copy of the new Code is to be attached – this applies both to disclosure documents in accordance with the old Code and new Code. This will create confusion if the disclosure document is not updated to comply with the new Code.

Breach of some disclosure requirements attract penalties.

Good Faith

Franchisors and franchisees must act in good faith in their dealings with each other. The new Code does not define good faith so it will be determined on a case-by-case basis. Good faith will however include acting honestly in dealings with one another and not arbitrarily, and cooperating to achieve the purpose of the franchise agreement. Good faith does not prevent a party from pursuing their legitimate commercial interests.

It should be noted:

- A franchise agreement cannot limit or exclude the obligation to act in good faith.
- A franchisor who does not grant a franchisee an option to renew their franchise agreement will not be held to have acted in bad faith.
- The provision attracts penalties and is applicable to any conduct that occurs on or after 1 January 2015, and it does not matter whether the franchise agreement was entered into before 1 January 2015.



Marketing Funds

The new Code does not make a marketing fund mandatory – it only regulates franchise agreements which have a marketing fund:

- If a franchise agreement requires a franchisee to contribute towards a marketing fund, the franchisor must keep a separate bank account for that fund.
- If a franchisor owns their own franchised outlet, then they must also contribute to the marketing fund for each outlet.

A franchisor can only distribute from a marketing fund account for genuine and legitimate purposes, or for expenses agreed to by a majority of franchisees. The vote for this majority is the majority of all franchisees in a system, not just those who voted. A franchisee who does not vote would be deemed to have voted 'no'. The 3 year vote has been deleted and the vote is now annual.

Capital Expenditure

A franchisor cannot require a franchisee to incur capital expenditure, i.e. excessive refurbishment costs or new mobile units, unless:



1. it is disclosed to the franchisee in the disclosure document;
2. it is to be incurred by all franchisees, or a majority of franchisees who have approved it;
3. it complies with legislative requirements (i.e. work place health and safety);
4. the franchisee agrees to the expenditure;
5. the franchisor has a business justification and considers the expenditure necessary.

The clause does not mention the requirement for a franchisee to comply with capital expenditure required by a landlord under a lease, therefore franchise agreements may need to reflect this.

Incentives

If a franchisee leases premises from a franchisor or an associate of the franchisor, then the franchisee must be given a copy of the lease or agreement to lease, as well as details of any incentive or financial benefit that the franchisor is entitled to receive.

There is an argument these details do not need to be put into a disclosure document – just a notice to the franchisee. However it would be more prudent to include them under clause 10.1(j) (the old 9.1(j)) in the disclosure document.

This section does not require the franchisor to pass on the benefit of the incentive to the franchisee, but only to disclose that there is an incentive.

Breach of this provision attracts penalties.

End of Term Restraints

At least 6 months before the end of a term of a franchise agreement, a franchisor must provide a franchisee with a notice as to whether the franchisor intends to renew or extend the franchise agreement. Unless the franchisor is not providing an option to extend/renew, the notice must provide a statement that the franchisee has a right to request a disclosure document. (Breach of this brings a penalty).

This section only applies to franchise agreements entered into on or after 1 January 2015, therefore restraints in franchise agreements entered into prior to this date may be enforceable subject to their terms.

The restraints in a franchise agreement will not be enforceable at the end of the term if:

1. the franchisee provides the franchisor with notice that the franchisee wishes to extend the agreement;
2. the franchisee was not in breach of the franchise agreement or related agreement;



3. the franchisee had not infringed the franchisor's intellectual property or a confidentiality agreement during the term of the agreement;
4. the franchisor does not extend the franchise agreement; and
 - a. the franchisee claimed compensation for goodwill because the agreement was not extended and the franchisor only provided a nominal amount and no genuine compensation for goodwill; or
 - b. the franchise agreement did not allow the franchisee to claim compensation for goodwill in the event that that the agreement was not extended.

Record Keeping Requirements



If the Code requires the franchisee to provide the franchisor with something in writing, then the franchisor must keep a copy of the document for at least 6 years – i.e. a franchisee requests consent to transfer the franchised business or the franchisee issues a notice of dispute.

This requirement also applies to documents a franchisor uses to substantiate their statements or claims – i.e. a franchisee will make \$X if they do Y, or if a review is conducted and issues are found in the business and the franchisor gives advice on how to fix the issues. For example if you do the upgrade/buy the new vehicle your turnover will increase! Not a statement we recommend you make but unfortunately it does occur. You must have clear evidence as it is a representation as to a future matter and you must keep that evidence.

Franchisors should keep a file/register for each franchisee where they store these documents.

Disputes

A franchise agreement entered into on or after 1 January 2015 must not contain a clause requiring that:

1. a mediation be effected in a different jurisdiction that where the franchised business is based; or
2. a franchisee pay the franchisor's costs of settling a dispute.

The parties to a dispute must follow either the franchisor's complaint handling procedure or the complaint handling procedures in the Code. The franchisor's procedures may be more specific than those in the Code and include additional steps the parties are to undertake. If there is no procedure laid down by the franchisor then the parties follow the procedure in the Code.

Franchisor's Consent to Transfer

A franchisor is still required to provide its consent for the transfer of a franchised business within 42 days of a request, and if they do not provide a decision within 42 days, they will be deemed to have given consent. But a franchisee must provide all information needed by the franchisor with the application and if more information is requested then the 42 days runs from the date the last of the information is provided to the franchisor.

The new Code allows a franchisor to provide consent, but then revoke it within 14 days. The franchisor must give reasonable reasons for doing so. Any sale contract will need to take this into account. Most contracts are only subject to the franchisor granting consent. There will now need to be a new clause stating that consent must not be withdrawn.

Disclosure of Online Sales

The disclosure documents include a new section under which the franchisor is to give details of whether the franchisee may sell goods or services online. Franchisors also need to disclose if the franchisor or an associate sell online



Franchisors need to include the domain name or URL if goods or services are made available via a third party website. This only seems to apply when a third party website is used by the franchisor or their associate or other franchisees.

Unfair Contracts Legislation

The Unfair Contracts legislation is likely to be passed and take effect in 2015. This will give Courts the power to strike out clauses in a franchise agreement which they deem to be unfair. Briefly speaking, unfair terms would be those that cause a significant imbalance to parties' rights and are not necessary to protect a party's legitimate business interests.



Changes to Franchise Agreements

The amendments to the Code mean Franchise Agreements will need to be updated. As to what updates you need depends on your system and the current agreement, so please give us a call for any questions.