

FRANCHISING UPDATE

COMMONWEALTH GOVERNMENT RESPONDS TO THE REVIEW OF THE FRANCHISING CODE OF CONDUCT

The Australian Government has released its response to the review of the Franchising Code of Conduct (*Report*) and has accepted in full or in principle the majority of recommendations made by the independent reviewer and industry expert, Mr Alan Wein, including changes to the disclosure provisions, a requirement to act in good faith and greater enforcement powers to the Commonwealth regulator, the Australian Competition and Consumer Commission (ACCC). The Government's response can be accessed in full [here](#).

The proposed changes, once legislated, will represent the largest overhaul of the Franchising Code since its inception and should strengthen the uniform national framework for the regulation of franchising, which has been under attack from certain State legislatures in recent years. Generally, the changes improve the administrative burden on franchisors although the strengthening of the enforcement regime represents increased exposure for franchisors.

THE REVIEW

KEY FACTS

- The review of the Franchising Code was announced by the Australian Government on 4 January 2013.
- This was 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 efficacy of the 2008 and 2010 amendments to the Franchising Code.
- The review received 73 submissions (including that of DLA Piper) and conducted over 30 face to face consultations with industry in the preparation of the Report.
- On 17 May 2013, The Department of Industry, Innovation, Climate Change, Science Research and Tertiary Education released its Report recommending 18 changes to the Franchising Code dealing with disclosure, good faith, dispute resolution and the introduction of fines and penalties.

SUMMARY OF THE PROPOSED CHANGES TO THE FRANCHISING CODE

| THE RECOMMENDATIONS | WHAT THIS WILL MEAN FOR FRANCHISORS |
|---|--|
| Disclosure obligations | |
| <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>In addition, foreign and master franchisors will have no obligation to annually update disclosure documents.</p> | <p>The Government accepted that the current disclosure requirements create unnecessary "red tape" in certain multi-level franchise systems.</p> <p>The short-form document (where it can be used) should result in a greatly reduced regulatory burden for foreign franchisors and master franchisors. In particular, this will reduce on-going compliance costs to businesses.</p> <p>The Government has indicated that it will engage in further consultation with participants in the sector in relation to the content that the alternative short-form disclosure document should contain.</p> |
| <p>The franchisor must disclose the respective rights of the franchisor and franchisee to conduct and benefit from online sales, including any ability or intention 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.</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 the franchisee of its intention to renew a franchise agreement.</p> |
| <p>The Franchising Code will be amended to remove Annexure 2 (Short-form disclosure document for franchisee or prospective franchisee).</p> | |
| <p>Franchisors will be required to provide a short summary of key risks. The summary should be provided to franchisees at their first point of contact with a franchisor.</p> <p>This risk statement is only required in respect of the first grant of a franchise and will not need to be provided to franchisees who are renewing,</p> | <p>The introduction of this document will increase the administrative burden on franchisors but should not be overly onerous.</p> <p>The Government has indicated that it believes alerting franchisees to the following will be important:</p> <ul style="list-style-type: none"> ▪ considering whether the franchise system is a good |

| THE RECOMMENDATIONS | WHAT THIS WILL MEAN FOR FRANCHISORS |
|--|--|
| <p>extending, or extending the scope of their franchise agreement.</p> | <p>fit for them;</p> <ul style="list-style-type: none"> ▪ the importance of obtaining professional advice from a person with expertise in franchising; ▪ researching the franchise system; ▪ the possibility of incurring unforeseen, significant expenditure; and ▪ the risks of franchising generally. |
| <p>Franchisor failure</p> | |
| <p>Subject to further consultation by the Government, franchisees may:</p> <ul style="list-style-type: none"> ▪ have the right to terminate the franchise agreement in the event of a franchisor's insolvency; and ▪ be recognised as creditors in the event of a franchisor insolvency. | <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.</p> <p>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 no longer have to disclose "unforeseen capital expenditure" in item 13A of Annexure 1.</p> <p>However, franchisors will be required to:</p> <ul style="list-style-type: none"> ▪ include a risk statement which will include some common examples of potential unforeseen capital expenses; and ▪ to be able to demonstrate that significant capital expenditure is reasonable when it is not initially disclosed in the franchise agreement or disclosure document. | <p>This proposed change 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>The Franchising Code currently 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 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. In addition, the introduction of a non-limiting definition of good faith into the Franchising Code is likely to address situations where "unreasonable" capital expenditure is imposed on a franchisee.</p> |

| THE RECOMMENDATIONS | WHAT THIS WILL MEAN FOR FRANCHISORS |
|---|--|
| <p>Marketing funds are to be administered more transparently based on the following principles:</p> <ul style="list-style-type: none"> ▪ marketing and advertising costs should be separately accounted for; ▪ 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 yearly audit should be conducted; and ▪ the results of the audit 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> <p>The Government has encouraged franchisors to consult with franchisees on the use of marketing and other cooperative funds.</p> |
| <p>Good faith obligations</p> | |
| <p>Subject to further consideration by the Government, 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> <p>The Government recognised concerns from stakeholders about the application of the duty of good faith to the negotiation of a franchise agreement. The Government has promised to provide guidance to parties on the application of the duty following further consultation.</p> <p>The Government has asked the ACCC to prepare additional educational materials to improve understanding of good faith in the franchise sector.</p> |

| THE RECOMMENDATIONS | WHAT THIS WILL MEAN FOR FRANCHISORS |
|---|--|
| <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>The Franchisor can no longer ask the Franchisee whether it wishes to keep its details confidential and nor can it have standard terms in franchise agreements that requires a franchisor to keep these details confidential.</p> |
| <p>Transfer, renewal or end of a franchise agreement</p> | |
| <p>Franchisors will be able to request certain information from an existing or current franchisee before they agree to a transfer or novation of franchise agreement.</p> | <p>This amendment will benefit franchisors. The Government has encouraged the franchising industry to promote increased clarity in franchise agreements through the use of standard paragraphs concerning the information that should be provided when a franchisor or franchisee seeks a transfer or novation of the agreement.</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>Subject to further consultation the Government will also ensure that restraint of trade clauses are unenforceable in situations where the franchisor has not extended a franchise agreement, and where the franchisor has terminated the franchise agreement "without cause".</p> | <p>For franchisors who impose post-termination restraints on all exiting franchisees, this amendment will have the effect of forcing franchisors to pay for the protection afforded by such a restraint when it declines a franchisee request to renew its franchise agreement in the circumstances outlined.</p> |
| <p>Dispute resolution</p> | |
| <p>The principles outlined in clause 29(8) that apply to OFMA mediation under the Franchising Code will apply to any type of mediation conducted in respect of franchising dispute, whether expressly conducted under the auspices of the Code's mediation provisions or not.</p> | <p>Parties to a franchise agreement will be required to act in a reconciliatory manner and take the steps outlined in clause 29(8) of the Franchising Code in all mediations of franchising disputes.</p> |

| THE RECOMMENDATIONS | WHAT THIS WILL MEAN FOR FRANCHISORS |
|---|---|
| <p>The Franchising Code will be amended so 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> |
| <p>Enforcement</p> | |
| <p>The Franchising Code be amended to:</p> <ul style="list-style-type: none"> ▪ allow civil pecuniary penalties 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; and ▪ 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. | <p>This proposed change will 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>The Government will undertake further detailed consideration of the appropriate maximum pecuniary penalties and will consider whether different maximum penalties will be prescribed for different breaches of the Franchising Code.</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> <p>The Government did not agree that disqualification from being a company director was appropriate for breach of the Franchising Code however, noted that there may be scope for a more limited partial disqualification power.</p> |

OTHER PROPOSED CHANGES

The Government also accepted that an analysis of the impact of a minimum term and standard contractual terms for motor vehicle agreements should be undertaken prior to a future review of the code. This will be relevant to all dealer networks captured by the definition of motor vehicle agreements, be they car, boat, motor cycle, industrial equipment or other "motor vehicle" dealer networks.

In addition, the Government agreed that there should not be another review of the Franchising Code for a minimum of five years after any amendments to the Franchising Code take effect following the response to the review.

WHAT'S NEXT?

The Government has indicated that the changes will only apply to franchise agreements entered into after the passage of the legislation through Parliament however, this does not include the extended enforcement powers given to the ACCC which will commence at a date yet to be confirmed.

To implement this Government response, amendments will be needed to both the *Competition and Consumer Act 2010 (Cth)* and the *Trade Practices (Industry Codes-Franchising) Regulations 1998*.

The Government has announced that it will implement these changes "as soon as feasible".

The Federal Minister for Small Business, Gary Gray, claims that the government has bipartisan support to introduce changes to the Code. As at the date of writing, the 43rd Australian Federal Parliament has been dissolved in anticipation of the Federal election which has been called for 7 September, 2013. Any new legislation will be introduced in the next Parliament and, assuming bipartisan support does exist and continues, it will be introduced regardless of the outcome of the election.

www.dlapiper.com

DLA Piper is a global law firm operating through various separate and distinct legal entities. For further information, please refer to www.dlapiper.com. Copyright © 2013 DLA Piper. All rights reserved. [12015581/JPS/082013]

MORE INFORMATION

For more information, please contact:



Judith Miller
Partner
T +61 2 9286 8581
judith.miller@dlapiper.com



Cynthia Sica
Special Counsel
T +61 3 9274 5232
cynthia.sica@dlapiper.com

CONTACT YOUR NEAREST DLA PIPER OFFICE:

BRISBANE

Level 29, Waterfront Place
1 Eagle Street
Brisbane QLD 4000
T +61 7 3246 4000
F +61 7 3229 4077
brisbane@dlapiper.com

CANBERRA

Level 3, 55 Wentworth Avenue
Kingston ACT 2604
T +61 2 6201 8787
F +61 2 6230 7848
canberra@dlapiper.com

MELBOURNE

Level 21, 140 William Street
Melbourne VIC 3000
T +61 3 9274 5000
F +61 3 9274 5111
melbourne@dlapiper.com

PERTH

Level 31, Central Park
152-158 St Georges Terrace
Perth WA 6000
T +61 8 6467 6000
F +61 8 6467 6001
perth@dlapiper.com

SYDNEY

Level 38, 201 Elizabeth Street
Sydney NSW 2000
T +61 2 9286 8000
F +61 2 9286 4144
sydney@dlapiper.com