

5 NOVEMBER 2014

NEW FRANCHISING CODE OF CONDUCT FROM 1 JANUARY 2015

FRANCHISE UPDATE

The biggest overhaul of the Franchising Code of Conduct (**Code**) since its introduction is reaching completion following registration of the Code on the Federal Register of Legislative Instruments on 3 November 2014. The new Code can be found [here](#).

OVERVIEW

The most significant changes implemented by the new Code are:

- The introduction of pecuniary penalties for certain breaches of the Code;
- A new general duty for franchisors and franchisees to act in good faith;
- New disclosure obligations;
- New information statement;
- Capital expenditure reforms; and
- New requirements regarding end of term restraint clauses.

As expounded by the Minister for Small Business, the Honourable Bruce Billson, the guiding principles of the new Code are the reduction of red tape, the promotion of growth in the sector, and the

intention to make all participants in the industry follow best practice.

Overall, the new Code represents a significant victory for supporters of the uniform national regulation of franchising. From a franchisor's perspective, the Code has both positive and negative outcomes; the reduced administrative burden tempered by the introduction of significant pecuniary penalties for certain breaches.

WHEN WILL THIS APPLY?

The new Code is intended to take effect from 1 January 2015 (although there are some transitional provisions relating to disclosure documents and the application of certain clauses).

The *Competition and Consumer (Industry Codes—Franchising) Regulation 2014 (Select Legislative Instrument No. 168, 2014) (Regulation)*, which prescribes the new Code, has been registered on the Federal Register of Legislative Instruments.

The Regulation must be tabled in Parliament within six sitting days and is placed on the List of

Disallowable Instruments. Following the tabling of the Regulation, a party has 15 sitting days to file a notice of motion to disallow the Regulation.

We will keep you updated as to the status of the Regulation and let you know if there are any amendments to the current version of the new Code.

SUMMARY OF THE KEY CHANGES TO THE FRANCHISING CODE

	The Changes	What this will mean for Franchisors
1.	Enforcement	
1.1	<p>Pecuniary penalties will apply for certain breaches of the Code. The maximum penalty for such breaches is 300 penalty units (up to \$51,000).</p> <p>Sections which attract pecuniary penalties for breach are:</p> <ul style="list-style-type: none"> ▪ The obligation to act in good faith (clause 6) ▪ The obligation to create and maintain a disclosure document (clause 8) ▪ The obligation to provide a disclosure document, a copy of the Code, franchise agreement, and other relevant documents (clause 9) ▪ The requirement to update the disclosure document (clause 8(6)) ▪ The requirement to give the franchisee a copy of the lease if the franchisee leases premises (clause 13(1)) ▪ The requirement to give the franchisee a copy of the lease within one month after the lease is signed (clause 13(2)) ▪ If the franchisee is not leasing but occupying premises, the obligation to provide a copy of the franchisor's lease (clause 13(3)) ▪ The requirement to give the franchisee a copy of the lease within one month after occupation (clause 13(4)) ▪ The obligation to give the franchisee a copy of other agreements required to be signed by the franchisee (clause 14) ▪ The obligation to give the franchisee a copy of the annual financial statements of the marketing fund and audit report (clause 15) ▪ The obligation to give a franchisee a disclosure document upon written request (clause 16) 	<p>This change exposes franchisors to a risk of incurring civil pecuniary penalties. Franchisors will need to be diligent in updating their procedures to ensure that they comply with the new Code, and in adhering to those procedures.</p>

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	<ul style="list-style-type: none"> ▪ The ongoing obligation to disclose materially relevant facts (clause 17) ▪ The obligation to given notice for renewal or non-renewal (clause 18) ▪ The obligation for the renewal notice to include a statement that a franchisee can request a disclosure document (clause 18) ▪ The obligation to repay any moneys paid by the franchisee within 14 days after termination by a franchisee during cooling off period (clause 26) ▪ The obligation to comply with the specified process for termination for breach by the franchisee (clause 27) ▪ The obligation to comply with the specified process for termination where there has been no breach by franchisee (clause 28) ▪ The obligation not to induce or influence a former franchisee to make a request for non-disclosure (clause 32) ▪ The obligation not to prevent franchisees associating for a lawful purpose (clause 33) ▪ The obligation to attend mediation when a dispute arises (clauses 39 and 41). 	
2.	Disclosure obligations	
2.1	A master franchisor does not need to provide a disclosure document to a subfranchisee (other than where the master franchisor is a party to the subfranchise agreement).	This will alleviate the need for double disclosure for master franchisors.
2.3	<p>Franchisors will be required to provide a short summary of key risks, called an Information statement for prospective franchisee.</p> <p>The Information statement forms Annexure 2 to the Code.</p> <p>The Information statement will need to be provided "as soon as practicable after the prospective franchisee formally applies or expresses an interest in acquiring a franchise business".</p>	The introduction of this requirement will increase the administrative burden on franchisors but should not be overly onerous. Franchisors will however need to ensure that their procedures now contemplate the provision of this document at the appropriate time.
2.4	<p>There is a new form of disclosure document which must be used and contains information which previously did not need to be provided.</p> <p>This information includes:</p> <p><i>2.4.1 Details of litigation involving directors of associates of the franchisor</i></p>	<p>Franchisors have been given an extended period, until 1 November 2015, during which they can use their existing disclosure documents.</p> <p>2.4.1 This increased obligation of disclosure is intended to provide greater transparency across the</p>

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	<p>2.4.2 <i>Disclosure of master franchise details:</i></p> <p>2.4.3 <i>Information in relation to online sales:</i> 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>2.4.4 <i>Options to renew:</i> The franchisor must include details of whether there is a right to renew and, if not, whether the franchisee will be entitled to compensation. There is also mandatory wording to be included when there is no right of renewal.</p> <p>2.4.5 <i>Statement of the franchisee's rights at the end of the term:</i> The new provisions prescribe wording which must be used depending on whether the franchisee has a right to extend, a right to renew or neither of those rights.</p>	<p>franchisor group to franchisees.</p> <p>2.4.2 To cover the reduced disclosure from master franchisors (described in paragraph 2.1 above), franchisors will now need to provide details of the master franchisor.</p> <p>2.4.3 Franchisors must be transparent about their online sales plans. This may force franchisors to consider their online strategies earlier than they may wish to but should reduce the chances of dispute in this area.</p> <p>2.4.4 This change ties in with the amendments (described below) regarding end of term restraints.</p> <p>2.4.5 These changes should assist both franchisors and franchisees as there will be no doubt about the franchisee's end of term rights.</p>
3.	Obligation to maintain a disclosure document	
3.1	<p>There is now an exception to the obligation to update the disclosure document within 4 months after the end of the financial year. The exception applies where:</p> <p>(a) the franchisor did not enter into a franchise agreement or only entered into one franchise agreement during the year; and</p> <p>(b) the franchisor does not intend to enter into another franchise agreement in the following year.</p>	<p>This should provide some relief to franchisors (and in particular, foreign and master franchisors). The exception will only have limited effect if a franchisee asks for an updated disclosure document. If there is such a request, the franchisor must update the disclosure document to reflect the franchise's position as at the end of the financial year before the financial year in which the request was made.</p>
4.	Good faith obligations	
4.1	<p>Parties to a franchise agreement "must act towards another party with good faith". This obligation applies to any dealing or dispute relating to the agreement as well as the negotiation of the agreement.</p> <p>Franchise agreements cannot limit or exclude the obligation.</p>	<p>This provision at least provides certainty to franchisors that a duty to act in good faith applies to all aspects of franchising relationship. However, the application to pre-contractual negotiations and</p>

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	A party may be liable for a civil penalty if it breaches the obligation to act in good faith.	dispute resolution extends the common law position and therefore creates great uncertainty as to what constitutes good faith during these phases.
5.	Capital Expenditure Reforms	
5.1	<p>A franchisor is prohibited from requiring a franchisee to undertake significant capital expenditure (Clause 30(1)), unless one the following exceptions apply:</p> <p>(a) the expenditure is disclosed in the disclosure document that is given to the franchisee before:</p> <ul style="list-style-type: none"> (i) entering into or renewing the agreement; or (ii) extending the term or scope of the agreement; <p>(b) if the expenditure is to be incurred by all or a majority of franchisees—expenditure approved by a majority of those franchisees;</p> <p>(c) if the expenditure is to be incurred by the franchisee to comply with legislative obligations;</p> <p>(d) if the expenditure is agreed by the franchisee;</p> <p>(e) if the expenditure is considered by the franchisor to be necessary as capital investment in the franchised business, justified by a written statement given to each affected franchisee of the following:</p> <ul style="list-style-type: none"> (i) the rationale for making the investment; (ii) the amount of capital expenditure required; (iii) the anticipated outcomes and benefits; and (iv) the expected risks associated with making the investment. 	<p>The purpose of these requirements is to prevent franchisors requiring franchisees to undertake significant capital expenditure without notice or justification. Although at first glance the prohibition appears to be quite restrictive on franchisors, the exception relating to the inclusion of the information in the disclosure document is already common practice for most well operated franchise systems. The exception does not require the franchisor to state the exact amount in the disclosure document and therefore should be an easy option available.</p>
6.	Marketing and Advertising Fees	
	Franchisors are required to keep a separate bank account for marketing and advertising fees and to pay the fees on the same basis as other franchisees for franchisor operated stores within the system.	This reform is designed to increase transparency and introduce greater equality in relation to marketing funds.
7.	Transfer, renewal or end of a franchise agreement	
7.1	Franchisors will be able to request certain information from an existing or current franchisee before they agree to a transfer or novation of the franchise agreement.	This addition is a great benefit to franchisors who will have now have the ability to require the provision of this information.

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8.	Post term restraints of trade	
8.1	<p>Any restraint of trade clause will not be enforceable if:</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 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; and <p>either:</p> <ul style="list-style-type: none"> ▪ the franchisee claimed compensation because the agreement was not renewed, but the compensation given was merely a nominal amount and did not genuinely compensate the franchisee; or ▪ the agreement did not allow the franchisee to claim compensation in the event that it was not renewed. 	<p>This is the most controversial amendment to the Code and, together with the good faith obligations, will be of most concern to franchisors. For franchisors who impose post-termination restraints on all exiting franchisees, this amendment has the effect of forcing those franchisors to pay for the protection afforded by such restraints when they decline a franchisee's request to renew its franchise agreement in the circumstances outlined.</p>
9.	Dispute resolution	
9.1	There is a new dispute resolution framework which will allow for disputes to be dealt with by an internal dispute resolution procedure.	This does provide for some flexibility away from mediation however either party still has the option to insist on attending a mediation.
9.2	Franchisors may not include a clause in a franchise agreement which requires mediation or litigation to take place outside the state or territory in which the franchised business is based.	This will be a major amendment for many foreign franchisors.
9.3	Franchise agreements cannot include a clause requiring franchisees to pay for any costs of settling any dispute under the agreement.	Such clauses were often used to dissuade franchisees from raising disputes.

WHAT NEXT?

The Government intends for the new Code to commence by 1 January 2015.

However, there is a limited grace period for existing franchise relationships that allows until November 2015 for disclosure documents to be updated to comply with the new Code. Further the Code provides that a number of its provisions will not apply to certain franchise agreements:

- Clauses 21(2), 22 and 23 do not apply to agreements entered into on or after 1 March 2008 but before 1 January 2015; and

- Clauses 20(1)(b), 21(2), 22 and 23 do not apply in relation to agreements entered into on or after 1 October 1998 but before 1 March 2008.

However, these exclusions will not apply if the franchise agreement has been varied or transferred on or after 1 January 2015.

Any new franchises must commit to the Code by 1 January 2015.

The above is a summary of the major amendments to the new Code but is by no means exhaustive, and franchisors will need to move quickly to ensure that they are familiar with the extensive amendments that have been made. Given the introduction of

pecuniary penalties, it will be even more important that franchisors update their systems and procedures to ensure compliance with the new Code.

MORE INFORMATION

For more information, please contact:



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

Contact your nearest DLA Piper office:

BRISBANE

Level 28, 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 22, No.1 Martin Place
Sydney NSW 2000
T +61 2 9286 8000
F +61 2 9286 8007
sydney@dlapiper.com

www.dlapiper.com

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