



Update

Franchising

June 2010

Further Franchising Code Changes

The Australian Government has introduced new regulations which will amend the Franchising Code from 1 July 2010. The amendments will apply to any franchise agreement that is entered into, renewed or extended on or after that date. The changes affect franchisors and will have an impact on franchise documentation, particularly the content of disclosure documents.

Under the amended regulations:

- new “end-of-term arrangements” will apply;
- additional matters must be included in disclosure documents;
- new disclosure requirements are triggered where there is an extension of the scope of a franchise;
- new obligations apply in relation to the novation of a franchise agreement; and
- parties to a franchise dispute will be required to adopt a “reconciliatory approach” to the resolution of the dispute.

What Are the New End-of-term Arrangements?

Franchisors will be required to notify franchisees at least six months before the end of the term of the franchise agreement of a decision to renew or not to renew the franchise agreement, or to enter into a new franchise agreement. If the term of the franchise agreement is less than six months, only one month’s notice must be provided.

There are also obligations to make further disclosure about end-of-term arrangements in the disclosure document (see below).

What are the Changes to Disclosure Documents?

A key aspect of the Code amendments is that franchisors must include a number of additional matters in disclosure documents. Before entering into the franchise agreement, the franchisor must disclose the details of the process that will apply at the end of the franchise agreement. These details will include:

- whether the prospective franchisee will have any options to renew, or extend the franchise agreement and its scope;
- whether the prospective franchisee will be entitled to an exit payment at the end of the franchise agreement;
- the arrangements that will apply to unsold stock, marketing material, equipment and other assets purchased by the franchisee when the agreement was entered into;

- whether the prospective franchisee will have the right to sell the business at the end of the agreement and in that case, whether the franchisor will have first right of refusal; and
- whether the franchisor will consider any significant capital expenditure undertaken by the franchisee during the franchise agreement.

Additionally, the franchisor must include in the disclosure document:

- an express statement that franchising is a business and, like any business, the franchise (or franchisor) could fail during the franchise term. It must be stated that this could have consequences for the franchisee;
- the circumstances in which the franchise agreement may be varied unilaterally by the franchisor in the future. On and from 1 July 2011 the franchisor will also need to make certain disclosures about the exercise of unilateral variation rights;
- whether the franchisee will be required, through the franchise agreement or any other means, to undertake unforeseen significant capital expenditure that was not disclosed by the franchisor before the franchisee entered into the franchise agreement;
- whether a confidentiality obligation will be imposed by the franchisor on the franchisee;
- whether the franchisor will amend or require the amendment of the franchise agreement on or before the transfer or novation of the franchise;
- whether the franchisor will attribute the franchisor’s costs, including legal costs, incurred in any dispute resolution, to the franchisee.

What are the new Documentation Requirements where the Scope of the Franchise Agreement is Extended?

Where the franchisor extends the scope of a franchise agreement, the franchisee must be given a disclosure

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document, a copy of the Code, and a copy of the franchise agreement in the form in which it will be executed, at least 14 days before the extension. However the cooling off period does not apply in these circumstances.

What are a Franchisor's Obligations on the Novation of a Franchise Agreement?

It is proposed that the requirements of Clause 20 of the Code (not to unreasonably withhold consent) with respect to transfer of a franchise will also be extended to novation of a franchise. "Novation" is defined as the termination of the franchise and entry into a new franchise with a proposed transferee on the same terms.

What is the "Reconciliatory Approach"?

The Code already requires that parties to a franchise agreement must attend mediation if there is a dispute. The amendments to the Code will provide that if there is a dispute both the franchisor and franchisee will be required to approach dispute resolution in a "reconciliatory manner". This means that the franchisor and franchisee must:

- attend and participate in meetings at reasonable times;
- at the beginning of the mediation process, make their intentions clear as to what the party is trying to achieve through the mediation process;
- observe any obligations relating to confidentiality that apply during the mediation process; and
- refrain from taking action during the dispute, including by providing inferior goods, services or support, or by failing to take action which has the effect of damaging the reputation of the franchise system.

What do Franchisors need to do?

Franchisors will need to review their franchise documentation and amend it appropriately for use on and after 1 July 2010. In particular, disclosure documents will need to be amended to accommodate the new information required from 1 July. This is a short timeframe and we recommend that franchisors commence this review as soon as possible to ensure that they will be in a position to comply with the amendments to the Code.

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