

Update

Franchising

March 2010

Franchising code: government report flags more changes

After a long and uncertain period and considerable speculation regarding various proposals to revamp regulation of the franchising sector, the Federal Government has released another significant report in relation to the regulation of the franchising sector. This report contains further details about a number of amendments to the Franchising Code (and the Trade Practices Act) which the Federal Government is proposing to make. While the changes to the Code proposed by the Government are not as extensive as some franchisees were seeking, the report has some significant implications for franchisors and the level of disclosure required to be made to franchisees appears set to increase yet again.

Background

On 1 December 2008 the Parliamentary Joint Committee made recommendations for improving conduct within the sector. This followed a Government review in 2006 into the disclosure provisions of the Code and the subsequent regulations amending the Code. These came into effect on 1 March 2008 and were aimed at increasing the transparency, quality and timeliness of disclosure of information by franchisors to existing or prospective franchisees.

On 5 November 2009, the Government provided its response to the Joint Committee. The key recommendations were to:

- increase franchisor disclosure, particularly in relation to end-of-term arrangements
- include a statutory good faith obligation within the Franchising Code
- grant the ACCC greater enforcement powers
- review the Code in the future
- develop a list of necessary and desirable behaviours in relation to dispute resolution.

An Expert Panel was subsequently set up to specifically look at:

1. unconscionable conduct – whether a list of examples that all parties agree constitute unconscionable conduct, or a statement of principles concerning unconscionable conduct, should be incorporated into the Trade Practices Act; and
2. whether there is a need to introduce into the Code additional disclosure requirements in relation to, or other provisions to address, five specific areas of major concern to franchisees or ‘behaviours’. These were:
 - a. unforeseen capital expenditure
 - b. unilateral contract variation
 - c. attribution of legal costs
 - d. confidentiality agreements; and
 - e. franchisor-initiated changes to franchise agreements when a franchisee is trying to sell the business.

On 3 March 2010, the Minister for Small Business released the Expert Panel's report and indicated the Government's support for its findings.



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Expert Panel Recommendations

- 1. Reform of Unconscionable Conduct Provisions* – the Panel concluded in its report that a list of examples of unconscionable conduct would not improve the understanding or implementation of the unconscionable conduct provisions. Instead, the Panel's view is that a set of interpretative principles would assist the courts (in interpreting the provisions), stakeholders (in understanding them) and regulators (in enforcing them). These principles would be drawn from relevant cases and the intention is that:

 - the court may consider both the terms and progress of a contract
 - the provisions may apply to systems of conduct or patterns of behaviour
 - the identification of a special disadvantage is not necessary to trigger the application of the provisions
 - potentially the unconscionable conduct provisions may be interpreted more broadly than they have been under existing case law.

The Panel also recommended that regulators pursue further test cases to draw on conduct in diverse industries and to assist in the development of these interpretive principles. It remains to be seen what form the principles will take and what impact they may have on negotiations and agreements between franchisors and franchisees in practice.
- 2. Unforeseen capital expenditure* – rather than prohibit unforeseen capital expenditure, the Panel recommended disclosure under the Code of the possibility of unforeseen capital expenditure by the franchisee, particularly as a result of a franchisor amending an operations manual. This would also require disclosure of whether significant capital expenditure would be a factor to be considered in deciding to renew a franchise agreement.
- 3. Unilateral contract variation* – the Panel formed the view that franchisors should disclose the circumstances in which unilateral variations to their agreements may take place and the circumstances in which the franchisor has unilaterally varied a franchise agreement in the past three financial years.
- 4. Attribution of legal costs* – the Panel indicated that franchisors needed to improve disclosure up front of the cost-attribution of dispute resolution to enable franchisees to better weigh the risks and rewards of entering a particular franchise system. The Panel also felt that unconscionable conduct provisions of the Trade Practices Act may apply where a weaker party is coerced into accepting a clause which attributes legal costs irrespective of the outcome.
- 5. Confidentiality agreements* – the Panel recommended that franchisors should be required to disclose to prospective franchisees certain categories of confidential information that cannot currently be discussed with existing and former franchisees such as outcomes of mediation, settlements, intellectual property, trade secrets or particular aspects of individual agreements.
- 6. Franchisee seeking to sell business* – as there may be legitimate commercial and regulatory reasons for the franchisor to amend the franchise agreement (where a franchisee seeks to sell its franchise business or renew its franchise agreement), rather than prohibit amendments to a franchise agreement where a franchised business is being sold, the Panel concluded that there should be up front disclosure of the possibility that a franchise agreement may be amended in these circumstances. The provisions of the Code relating to transfer of a franchise agreement could be extended to cover novation.
- 7. Short form document* – The Panel also indicated that a short, simple plain English document should be developed to be provided to prospective franchisees as a ready reference to explain further the nature of the franchise relationship. This would be provided to prospective franchisees in addition to the disclosure documents they currently receive. The Panel suggested that while provision of this short form document to prospective franchisees should not necessarily be mandatory, consideration should be given to making this a mandatory requirement if evidence emerges over time that franchisees remain unaware of some of the key risks associated with owning and operating a franchised business.



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Where to from here?

In addition to adopting the Expert Panel's findings, the Government has announced it will:

- amend the Trade Practices Act to allow the ACCC to conduct random audits under the Code
- subject rogue or unscrupulous franchisors to a public "naming and shaming"
- enable the ACCC to apply to the courts for orders providing redress to all franchisees without requiring every franchisee to be a party to legal proceedings
- introduce fines and penalties of up to \$1.1 million for corporations and \$200,000 for individuals for breaches of the unconscionable conduct provisions of the Trade Practice Act in addition to existing remedies

No amending legislation has yet been released and a timeframe for the introduction of these changes is yet to be announced. It is possible that the timing of the amendments may be affected by this year's scheduled Federal election. However, it is important that franchisors begin reviewing their current disclosure documents and franchise agreements to ensure they comply once legislation to amend the Code is introduced. Close consideration will also need to be given to any unconscionable conduct principles which are developed to ascertain whether they will impact on negotiation of franchise agreements, as well as their terms.

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