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Franchising reforms expand franchisor disclosure obligations

Summary

Franchisors will face increased disclosure requirements under the comprehensive reforms to the *Franchising Code of Conduct*, [1] announced by Small Business Minister Craig Emerson on 3 March 2010. [2] The Government is currently drafting amendments to *Trade Practices Act* [3] and *the Franchising Code of Conduct* to incorporate some of the recommendations of the recently released expert panel report. [4] The proposed amendments will result in expanded disclosure requirements for the franchisor and will address five areas of problematic franchising behaviour considered by the expert panel:

- (1) unilateral contract variation;
- (2) unforeseen capital expenditure;
- (3) franchisor-initiated changes when a franchisee is trying to sell their business;
- (4) attribution of legal costs; and
- (5) confidentiality agreements. [5]

The draft amendments are scheduled to be released by mid-2010 and it is anticipated that they will come into effect by either late this year or early next year.

This Legal Update provides an overview of the proposed changes to the Franchisor disclosure requirements and other reforms.

Changes to Franchisor Disclosure Requirements

1) Unilateral contract variation

Franchise agreements commonly require franchisees to comply with the terms of a franchise manual; manuals are frequently varied by franchisors without agreement by the franchisees (i.e. unilaterally). Despite concerns over franchisors making inappropriate unilateral variations, such as changing fees or performance requirements, both the expert panel and the Government have acknowledged the commercial legitimacy of this practice in certain circumstances. [6] For example, unilateral variation enables the franchisor to respond efficiently to market and regulatory demands. [7] However, the Government has accepted that some protection is required for franchisees against unilateral variations of franchise agreements by franchisors. Under the proposed changes to the *Franchising Code of Conduct*, franchisors will be required to disclose to prospective franchisees the circumstances where unilateral variation may take place, and provide examples from the past three financial years of when such changes have previously occurred. [8]

2) Unforeseen capital expenditure

Franchisees are often required to undertake additional capital expenditure in order to retain competitive advantage; examples include requiring the purchase of new equipment or refurbishments. Whilst such outlays are not always foreseeable from the outset of the franchise arrangement, the Government has indicated that the amended disclosure obligations will require franchisors to disclose whether significant capital expenditure would be a factor in deciding to renew the franchise agreement and whether that has been a factor in the past three financial years.

[\[9\]](#)

3) Franchisor-initiated changes when a franchisee is trying to sell the business

Franchisors sometimes implement changes to franchise agreements when a franchisee is seeking to sell their business, particularly when amendments are necessary in order to respond to new market conditions or regulatory alterations. [\[10\]](#) As such changes could impact upon the franchisee's ability to maximise return on the investment, the Government has accepted the expert panel recommendations that franchisors provides more comprehensive details on end-of-term arrangements, [\[11\]](#) including :

- whether the prospective franchisee would be entitled to an exit payment at the end of the agreed franchise term, and the calculation of the payment;
- how unsold stock or equipment purchased by the franchisee during the arrangement will be dealt with; and
- whether franchisees would have the right to sell the business at the end of the term, whether the franchisor would have first right of refusal and how the market value of the franchise is determined. [\[12\]](#)

Franchisors will also be required to give franchisees at least six months notice before the end of the agreement of their decision to either renew or terminate the franchise agreement. However, the Government has indicated that the changes relating to end of term arrangements will only apply to franchise agreements signed after the Franchising Code of Conduct is officially amended. [\[13\]](#)

4) Attribution of legal costs

Franchise agreements commonly include clauses which outline the attribution of legal costs in the event of a dispute. Under the current *Franchising Code of Conduct*, parties are equally liable for the costs of attending mediation, unless otherwise agreed. [\[14\]](#) The expert panel was hesitant to advise the Government to constrain parties' ability to contract freely on this issue. However, the Government has accepted the panel's recommendation that franchisors should disclose if they are likely to seek to attribute the costs incurred in a dispute resolution process to franchisees. [\[15\]](#)

5) Confidentiality agreements

Franchise Agreements contain confidentiality clauses protecting the franchisor's confidential information and trade secrets relating to the franchise system. However, these clauses often do not clearly identify the categories of confidential information/trade secrets which are to be protected and the circumstances under which disclosure may be permitted. For example, where a franchisee is selling the franchise business, the franchisee will have to make disclosure of some categories of confidential information to prospective franchisees. [\[16\]](#) The Government has advised that the reforms will require franchisors to alert prospective franchisees to the categories of information that cannot be discussed with existing and former franchisees. [\[17\]](#)

Other Reforms

"Short, simple, plain English document"

In addition to the expansion of the disclosure requirements, the Government is preparing to develop a "plain English" document which will be provided to franchisees to inform them of 'the key costs, benefits and risks of the franchise system'. [18] The details of this proposed document are currently unknown, and the Government is seeking assistance from the industry in its development.

Good Faith Requirement

The Government has declined to include an obligation of good faith into the *Franchising Code of Conduct*, indicating that the vagueness of the term may result in adverse commercial consequences for the industry. [19]

Unconscionable Conduct

Whilst the expert panel was concurrently asked to investigate the possibility of further amending the unconscionable conduct provisions in the *Trade Practices Act*, no substantial amendments will be implemented. The government has rejected the inclusion of a clear list of examples of unconscionable behaviour, but will instead add four interpretative principles [20] which will indicate to the courts that statutory unconscionable conduct can be interpreted more broadly than under existing case law. [21]

Implications

The expansion of the disclosure requirements will increase franchisors' disclosure obligations and compliance costs but not necessarily protect franchisees from unscrupulous operators. Further, the proposed "plain English" document may cause confusion particularly if it is inconsistent with franchisors' comprehensive disclosure requirement. In order to be fully informed of all relevant legal and commercial issues, prospective franchisees should obtain professional legal and accounting advice and perform appropriate due diligence before entering into a franchise agreement. Rather than the proposed "plain English" document, the Government should consider providing franchisees with a comprehensive due diligence checklist in order to assist them in evaluating a franchise business having regard to their personal and financial circumstances, before entering into the franchise system.

Stephens Lawyers & Consultants have a high level of expertise in trade practice and franchise law.

Our lawyers represent leading companies in both litigious and commercial matters, and have significant experience in writing submissions to government on behalf of clients.

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[1] The *Franchising Code of Conduct* is a mandatory industry code, prescribed under the *Trade Practices Act* and is administered by the ACCC, Section 51AE *Trade Practices Act 1974* (Cth).

[2] Minister for Innovation, Industry, Science and Research, *Media Release: 'Better protection for franchisees'*, 3 March 2010, at <http://minister.innovation.gov.au/Emerson/Pages/BETTERPROTECTIONFORFRANCHISEES.aspx>.

[3] *Trade Practices Act 1974* (Cth).

[4] *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct: Report to the Hon Dr Craig Emerson MP*, February 2010, available at: http://www.innovation.gov.au/Section/SmallBusiness/Documents/ExpertPanelReportUCC_FCCFinal100302.pdf.

[5] *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct: Report to the Hon Dr Craig Emerson MP*, February 2010, available at: http://www.innovation.gov.au/Section/SmallBusiness/Documents/ExpertPanelReportUCC_FCCFinal100302.pdf, pg xi.

[6] Minister for Innovation, Industry, Science and Research, *Speech, 'Keynote Address to the BRW Franchising Conference'*, 3 March 2010, at <http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[7] *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct: Report to the Hon Dr Craig Emerson MP*, February 2010, available at: http://www.innovation.gov.au/Section/SmallBusiness/Documents/ExpertPanelReportUCC_FCCFinal100302.pdf, pg 50.

[8] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[9] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[10] *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct: Report to the Hon Dr Craig Emerson MP*, February 2010, available at:

http://www.innovation.gov.au/Section/SmallBusiness/Documents/ExpertPanelReportUCC_FCCFinal100302.pdf,
pg 61.

[11] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[12] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[13] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[14] *Franchising Code of Conduct*, cl 31(2).

[15] *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct: Report to the Hon Dr Craig Emerson MP*, February 2010, available at:

http://www.innovation.gov.au/Section/SmallBusiness/Documents/ExpertPanelReportUCC_FCCFinal100302.pdf,
pg 70.

[16] *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct: Report to the Hon Dr Craig Emerson MP*, February 2010, available at:

http://www.innovation.gov.au/Section/SmallBusiness/Documents/ExpertPanelReportUCC_FCCFinal100302.pdf,
pg 78.

[17] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[18] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[19] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.

[20] The recommended interpretative principles to be introduced into the *Trade Practices Act* in assessing unconscionable conduct are: 'the statute is not limited to equitable and common law doctrines; courts may examine the terms and progress of a contract; the provisions may apply to systemic conduct or patterns of behaviour; and the identification of special disadvantage is not necessary to attract the application of the provisions'.

Strengthening statutory unconscionable conduct and the Franchising Code of Conduct: Report to the Hon Dr Craig Emerson MP, February 2010, available at:

http://www.innovation.gov.au/Section/SmallBusiness/Documents/ExpertPanelReportUCC_FCCFinal100302.pdf, pg ix.

[21] Minister for Innovation, Industry, Science and Research, *Speech*, 'Keynote Address to the BRW Franchising Conference', 3 March 2010, at

<http://minister.innovation.gov.au/Emerson/Pages/BRWFRANCHISINGCONFERENCE.aspx>.