



## GUIDING YOU THROUGH THE FRANCHISE CODE 2015

### A PRACTICAL GUIDE FOR FRANCHISORS

#### Franchising 2015 – A whole new world - what you need to know and what you need to do

The new Code under the Competition and Consumer (Industry Code – Franchising) Regulation 2014 comes into effect on 1 January 2015.

#### What you need to know

##### 1. Transitional Provisions under the New Code

- The franchise Code applies to *conduct* occurring on or after 1 January 2015 in relation to a franchise agreement entered into on or after 1 October 1998;
- Conduct means obligations arising after 1 January 2015.

##### 2. Carve Outs

There are certain provisions that do **not** apply under the New Code to agreements dependent on their date.

These are as follows:

- The requirement that a party not bring a proceeding or conduct a mediation in a State **outside**, where the franchisee is based or outside Australia (Clause 21), will not apply to a franchise agreement entered on or after 1 October 1998 and up to 1 January 2015.
- The requirement that a franchise agreement must **not** contain an obligation on the franchisee to pay the franchisor's costs in settling a dispute (Clause 22) will not apply to a franchise agreement entered into on or after 1 October 1998 and up to 1 January 2015.
- The effect on a restraint of trade, where the franchisor does not extend the franchisees agreement and has not offered to pay genuine compensation for the franchisee's goodwill (Clause 23) will **not** apply to franchise agreements entered into on or after 1 October 1998 and up to 1 January 2015.
- The restriction on the agreement having a clause that allows a waiver or general release of any verbal or written representations made by the franchisor (Clause 20(1)(b) ) will **not** apply to franchise agreements entered into on or after 1 October 1998 and before 1 March 2008.
- The carve outs were a constitutional issue.

- The carve out of Clause 21(2) (Proceedings and Mediation) will **not** apply if the franchise agreement is entered on or after 1 March 2008 and before 1 January 2015 is varied or transferred on or after 1 January 2015.

## 2.1 Disclosure Document - Transition

- If a franchisor has an existing disclosure document as at 1 January 2015, then the franchisor can still use that disclosure document up until **1 November 2015**.
- Franchisors must update their existing disclosure documents to comply with the new Code by **31 October 2015**.
- Once a franchisor updates its existing disclosure document, the schedule to update its documentation reverts to its usual financial year.
- Franchisors can elect to update their disclosure documents between 1 January 2015 and up to 1 November 2015, but once updated, the new Code provisions will apply, that is:
  - Clause 8(6) – franchisors will need to update it within four months after the end of each financial year subject to Clause 8(7).
  - Disclosure documents must reflect the financial position of the Franchisor as at the end of the year before the financial year in which the request is made by the franchisee.

## 3. Application of the new Code

- The new Code commences on 1 January 2015 and applies to *conduct* occurring on or after that date, in relation to a franchise agreement entered into on or after 1 October 1998.
- The application of the new Code is somewhat complex in that certain of the new Code provisions will not apply to franchise agreements depending on when they were entered into (see carve out and transitional provisions under 2. above).
- An obligation that arose under the 1998 Code, that is outstanding on 1 January 2015 continues despite the repeal of the 1998 Code
- **The excluded or carve out provisions will not apply if the franchise agreement is varied, transferred or extended after 1 January 2015.**
- The new Code does not apply to pre 1 October 1998 franchise agreements or where sales are less than 20% of the franchisees' gross turnover and franchisees have sold the same goods and services for at least 2 years before entering into the agreement.

#### 4. Definition of a “franchise” or “interest in a franchise”

- Clause 4 of the Code defines an “interest in a franchise” to include:
  - a legal or beneficial interest in a franchise agreement or franchise business whether as a guarantor of a franchisee’s obligation (**Therefore where there is a third party guarantor they will require disclosure, just as if they were a franchisee**)
  - shares and voting rights in a company (not listed)
  - units, voting rights in a trust
  - Capital or income of a partnership that owns a franchised business (**this means that any party that holds a minority interest in an entity that operates a franchise business whether as shares units capital or income will require disclosure under the Code**).
- Under Clause 5 the definition of a “franchise agreement” has not altered from the definition under the 1998 Code.
- A Franchise agreement is an agreement wholly or partly in writing, oral or implied and includes a transfer, renewal or extension of the term.
- Franchisors are now required to give franchisees notice in writing if they intend to extend the franchise agreement or enter into a new one. **A notice must be given at least 6 months before the end of the term.** A civil penalty of 300 penalty (\$8,500) may apply for a breach.

#### 5. Definitions to note under the Code

1. **“Associate”** – is now extended to include an entity or person that owns IP used in the franchise system or is involved in market research testing, market development, sales, promotion or management.

**This requires disclosure of those persons integral to the operation of the system, not just Directors and officers.**

**“Extend”** – now refers to a material change to the terms and conditions of the Agreement or a person’s rights and liabilities. Extension occurs where the term is extended, **not** by exercise of an option.

**“Renew”** – refers solely to where a franchisee exercises its option (if any) under the Agreement.

**Therefore, an extension is absent exercising an option, and renewal is where there is the exercise of an option.**



Renewals can be subject to conditions such as sales targets and licensing requirements.

**Note:**

**The new agreement does not have to be identical to the existing agreement on a renewal.**

**“Transfer”** – a transfer now includes:

- A sale of an existing franchise where the existing franchise agreement is terminated on the basis of a new franchise agreement being entered into with a prospective new franchisee/purchaser.
- A franchisee assigning its rights.
- The agreement sets out certain transfer rights.

Note: **“novation”** as was defined in the 1998 Code is now deleted, and falls under the **“Transfer”** definition.

**“Master Franchise and Sub-Franchisor”** – these are no longer defined in the new Code.

**6. Division 3 – Clause 6 – Good faith obligation:**

The Code now entrenches the common law notion of good faith. The matters a Court can have regard to in considering whether a party has acted in good faith include:

- whether a party has acted honestly not arbitrarily;
- whether a party cooperated to achieve the purpose of the agreement.

*Note: Clause 6(6) does not prevent a party acting in its legitimate commercial interests;*

*Also, **not** granting a further term or option to a franchisee or not allowing a franchisee to extend the agreement does **not** mean that the franchisor has not acted in good faith.*

**7. Master Franchisors – Part 2 – Clause 7**

Master franchisors no longer need to give separate disclosure to its sub-franchisees, nor comply with the disclosure obligations under Division 2, Clause 13 to 19.

## 8. Disclosure requirements

Clauses 8 and 9 require a franchisor to create a disclosure document in compliant form and provide a copy of the Code, Disclosure Document and related documents, and end of Financial Year Accounts to the franchisee at least 14 days before the franchisee enters into a franchise agreement, or an agreement to enter into a franchise agreement or makes a non-refundable payment to the franchisor or an associate.

Clause 9(2) requires Disclosure on the renewal, extension or change of scope of a franchise agreement.

**Note:**

Clause 9(3) removes the obligation to re-disclose if within the fourteen days disclosure period negotiations occur with the franchisee or their lawyers and changes are made to the franchise agreement. There is now **no** need to re-disclose.

**Note:**

*Clause 10 (previously Clause 11) Certificates of independent legal, business and accounting advice need to be supplied to a first time franchisee and on transfer of a franchise agreement, (that) is on sale by a franchisee of the business to the new incoming franchisee.*

Advice certificates are **not** required on renewal, extension of the term or change of scope of an existing franchise agreement.

Clause 10.3(b) a franchisor can **still** insist on receiving all certificates from a franchisee. **This may be a sensible precaution in some circumstances.**

**Note:**

- On renewal, extension or change of scope of a franchise agreement, a franchisor must provide an up-to-date disclosure document, however, there does **not** appear to be a requirement to obtain further section 10 advice certificates.
- **We recommend that every time there is disclosure the advice certificates are provided to the franchisee and received by the franchisor.**

## 9. Clause 11 Information Statement:

The franchisor **must** provide an Information Statement to prospective franchisees in the form set in the Code and in the font size required. It is only required to be given to new franchisees, **not** on:

- a. renewal; or
- b. extension of the term or change of scope.



The Information Statement is to be given on:

- a. formal application; or
- b. expression of interest.

**What does this mean?**

We recommend that franchisors obtain a franchisee's written acknowledgement of receipt of the Information Statement and the Information Statement be given to all franchisors' agents and/or brokers to provide to a prospective franchisee.

**10. Disclosure of Rebates, Lease incentives and benefits:**

**10.1 Rebates:**

The requirement to disclose is set out in Items 10.1(j) and (k) of the Disclosure document itself.

This requires franchisors to disclose if the franchisor or an associate of the franchisor will receive a rebate or other financial benefit for provision of goods or services including the name of the business providing the rebate, and if the rebate will be shared directly or indirectly with the franchisees.

**Note:**

- **The Code does not require the franchisor to share the rebate with the franchisee, it just requires the franchisor to disclose that the franchisor receives a rebate.**
- **The Code does not state the franchisor must disclose the amount or value of the rebate – franchisors should consider whether they should still disclose the value of the rebate under its good faith and material disclosure obligations.**

**10.2 Online sales:**

Item 12 of the Disclosure document requires the franchisor to disclose:

- whether the franchisee can sell goods or services online;
- if so, any restrictions or conditions to do so;
- if via a third party website, any third party terms and conditions of use;
- can the goods and services online be supplied outside the franchisee's territory and if so, how?
- if the franchisor or associate of the franchisor (or other franchisees) will supply the products or services online and if so:
  - will they supply the goods or services in the franchisee's territory; and

- if via a third party website, the domain name/url of the third party website;
- disclose any profit share arrangements for sales online that may affect the franchisee and whether they can unilaterally change by the franchisor;
- franchisors must now set out information of its online sales activities;
- if the franchisee is able to sell goods or services online, the franchisor must provide details of the arrangement and whether any share of the profit from online sales will be shared with franchisees if sold within the franchisee's territory.

### 10.3 Lease incentives and benefits

Clause 13 Regulation, a franchisor must now provide franchisees with a copy of the lease or agreement of lease within one (1) month after the lease or agreement to lease is signed.

Provide details of any incentive or financial benefit a franchisor or associate receives as a result of the lease or agreement to lease (Clause 13(1)(b) and 13(3)(a)(ii) and (b)(iii)).

This will apply whether the franchisee occupies the premises under a licence or occupancy agreement or if the franchisee holds under a sub-lease from the franchisor.

The details must be given within one (1) month after occupation commences or documents are signed.

**Note:** Clause 13(5) provides that the details of the incentive or financial benefit **must** include the name of the business providing the incentive or financial benefit.

**Note:** the financial benefit may comprise a contribution by the landlord to fit out, or rental concessions or any other direct or indirect benefits.

**Note:** there is no obligation on the franchisor to pass on the benefit to the franchisee.

Unlike the Rebate provision this provision does require the franchisor to disclose "details" of the benefit, that is the value of the benefit.

### 11. Continuing disclosure obligations:

Clause 16 requires a franchisor to provide within two (2) months of a request, an updated disclosure document to a franchisee.

Clause 8(8) of the Code and clause 16(1) of the Code need to be read together.

The requirement to provide the disclosure within two (2) months of the date a request is made is subject to clause 8(8) which provides that where the franchisee makes a request, the franchisor must update its disclosure document so that it reflects the position of the franchise as at the end of the financial year before the financial year in which the request is made.

There is an exemption under clause 8(7) where a franchisor only enters into one agreement during the year.

In any other case, the franchisor must supply the disclosure document within fourteen (14) days of the request by the franchisee (clause 16(1)(b)) but a request can only be made *once every twelve months* by a franchisee.

## 12. Ongoing disclosure requirements:

Clause 17(1) of the Regulation needs to be read in conjunction with Item 21 of the Disclosure Document which requires the franchisor to:

- provide a statement of solvency signed by at least one director of the franchisor
- provide financial reports for each of the last two completed financial years (if it existed) in accordance with the *Corporations Act 2001*
- if the franchisor is part of a consolidated entity that requires audit and the franchisee requests them the reports for the last two completed financial years prepared by the consolidated entity

### Note:

**This requires the franchisee to request the Financial Statement. There is no obligation on the franchisor to attach them to the Disclosure Document.**

### Note:

The financial reports for the last two completed financial years are **not** required if:

- the franchisor's director's statement of solvency under 21.1 is supported by an independent audit by a registered company auditor (or foreign equivalent) within four (4) months after the end of the financial year to which the statement relates, and
- a copy of the audit reports given with the solvency statement

Where a franchisor (or consolidated entity) has **not** existed for two or more financial years, the franchisor **must** then supply:



- a statutory declaration of the entity's solvency (note, it does not say by its director)
- an independent audit report on the entity's solvency, **as** at the date of the entity's declaration

Where the franchisor (consolidated entity) was insolvent in either or both of the last two completed financial years, the franchisor must supply:

- a **statement of the period during which the entity was insolvent with a statutory declaration of the entity's solvency and an independent audit report on the solvency as at the date of the declaration.**

**Note:**

- Item 22 of the Disclosure document requires the franchisor to disclose between the date of the disclosure document and the date the disclosure document was given to the franchisee if there has been any change in its financial position. (material ongoing disclosure.)

**13. Disclosure of Materially Relevant Facts**

Clause 17 of the Regulation provides if a statement or declaration of solvency is not provided in the Disclosure document, the franchisor must give it to the franchisee as soon as possible **but in any event before** the prospective franchisee enters into the franchise agreement.

Franchisors have an obligation to update the Disclosure document annually within four months of the end of each financial year.

- *Franchisors should note Clause 17(2) and (3) Regulation, the obligation to tell a franchisee within "a reasonable time" (not more than fourteen (14) days), if the franchisor becomes aware of matters such as:*
  - a. a change of material ownership or control of the franchisor or an associate;
  - b. proceedings under clause 17(3)(b);
  - c. a judgment is entered;
  - d. proceedings by at least 10% or 10 of the franchisees in Australia (whichever is lower);
  - e. judgment is entered against the franchisor (or an associate) in Australia and not discharged within 28 days of a small proprietary company for not less than \$100,000, or for any other company \$1,000,000;
  - f. the disclosure of litigation is set out in Item 4 of the disclosure document;
  - g. if the franchisor or an associate enters into voluntary administration or liquidation;

- h. there is a change in the ownership of the IP;
- i. undertakings are required to be given to the ACCC, or an order made in the Federal Court.

## 14. End of term arrangements and Restraints of trade:

### 14.1 Restraints of trade:

The new Code limits the enforceability of a restraint of trade clause in a franchise agreement subject to certain conditions being met.

These clauses do not prevent a franchisor from having a non solicit and confidentiality provisions to protect the franchisor's IP and knowhow.

Firstly, the franchisor has an obligation to notify the franchisee in writing not less than **six (6) months** from the end of the Term, whether it intends extending the Franchise Term or enter into a new agreement (Clause 18).

The franchisor's notice (6 months notice) must include a statement as follows:

"Subject to Clause 16(2) the franchisee may request a Disclosure once in every 12 months. The franchisor may request a Disclosure document where the franchisor **does** intend to extend the Franchise Agreement (Clause 18).

Clause 23 of the Regulations has significant implications for franchisors.

In essence, the provisions mean that if there is a restraint of trade clause in a franchise agreement, a franchisor will be put to an election.

- The government clearly intended to provide relief to franchisees where through no fault of their own, the franchise agreement is **not** extended by the franchisor where the franchisee is not in default and the franchisor does not agree to pay genuine compensation for the franchisees' goodwill.

#### Note:

- These provisions, **however**, do **not** apply to existing franchise agreements entered into after 1 October 1998 and up to 1 January 2015 unless the agreement is varied, extended or transferred on or after 1 January 2015.

This is one of the most far reaching changes affecting franchisors in the new Code. It recognises that franchisees develop their own goodwill in their franchise businesses over time.

- Franchisors will need to consider whether they should extend the franchise term if requested by the franchisee. If they **do** extend the term, they can enforce the restraint and non-compete provisions (if reasonable).
- If they do not extend nor pay the franchisee a genuine amount of goodwill compensation, the franchisor **cannot** enforce the restraint of trade provision.

## 15. **Transfer of a franchise agreement:**

The Code requires consent not to be unreasonably withheld.

If it is withheld, reasons must be given.

- Franchisors need to bear in mind their *good faith* obligations when doing so. Legitimate reasons for withholding consent are set out in the Code and can include financial if the franchisee is not capable, owes money, or was in breach to the franchisor.
- Franchisors must reject or accept the transfer within 42 days of:
  - the date a request is made by the franchisee; or
  - the date the last information is given to the franchisor.

If they do not respond within the 42 days, consent is deemed to have been given.

### **Note:**

- Clause 24.4(v) which states that the franchisor can give consent and then revoke it within 14 days subject to reasonable reasons being given.

## 16. **Termination provisions:**

**Clause 26 – Cooling off** - the Code provides 7 days cooling off or after the earlier of a franchisee entering into the agreement and making any payment of money or consideration.

There is no cooling off on a transfer, renewal or extension of the term or change of scope of an agreement.

**Clause 29 – Mutual termination** – this right must be set out as a contractual right in the franchise agreement to be relied upon.

## 17. **Capital Expenditure:**

**Clause 30** – Franchisors cannot require a franchisee to outlay significant capital expenditure during the term unless it is set out in the disclosure document and franchise agreement, or if it is agreed to by a majority of franchisees.

Significant capital expenditure *excludes*:

- a. that disclosed in the document;
- b. where incurred by a majority of franchisees who approve it;
- c. to comply with legislation;
- d. if agreed to by the franchisee;
- e. if there is a business case and considered necessary.

**18. Marketing and co-operative funds:**

- Clause 15 of the Code now requires marketing or co-operative fund statements to be provided by the franchisor to the franchisee within **four (4) months** of the end of the financial year (**30 October** in each year).
- Audited statements and the financials are to be provided to the franchisee within a further thirty (30) days (**30 November**) unless 75% of franchisees who are in Australia and who contribute to the marketing fund vote and agree to waive that requirement.
- That vote needs to be made within three (3) months of the end of the financial year (**30 September** in each year). Franchisors will need to manage this process.
- The reasonable costs of administration and audit of the fund can be paid from the marketing fund provided there is a right set out in the franchise agreement to do so.

**19. Internal complaints handling procedure:**

**Clause 38** – requires franchisors to have in place an internal complaints handling procedure. Where the dispute cannot be resolved within three weeks, either party can then appoint a mediator.

If no agreement is reached within 21 days, the mediation adviser is to appoint a mediator within fourteen days.

**20. Clause 19 – Record Keeping**

Franchisors must keep all email letters in writing given to it by a franchisee for 6 years after it was created.

**SUMMARY**



The key areas franchisors will need to review will be:

- the process of signing up and induction of franchisees, and the Disclosure compliance regime at the outset;
- the ongoing good faith obligations and material disclosure obligations;
- ensure transparency in relation to its marketing fund, online sales, rebates and lease incentives;
- consider its position whether to extend the franchise term agreement, pay compensation or lose the protection of restraint of trade provisions.

This guide addresses the key changes and issues, however, is not intended to be relied on for detailed legal advice nor does not purport to cover all of the matters addressed in the new Code.

Franchisors are recommended to seek franchise legal advice relevant to their own system and circumstances.

It is a whole new world in franchising and will be more so from 1 January 2015.

**The Author of this Guide:**

Robert Toth has been involved in the franchise sector for over 30 years and is a recognized leader in the franchise sector in Australia.

Robert has published many articles on Franchising Law and International Franchising and continues to contribute regularly to franchise journals, franchisee publications and online publications.

Robert has recently moved and is now head of the Marsh & Maher Franchise Group.

We can upgrade your existing franchise documentation to be Code compliant for a fixed fee.

Contact Robert Toth at [rxt@marshmaher.com.au](mailto:rxt@marshmaher.com.au) or 9604 9400 or mobile 0412 673 757.

**Robert Toth**  
Partner  
**MARSH&MAHER**  
Level 1, 551 Lt Lonsdale Street  
Melbourne, Victoria, 3000  
PH: 03 9604 9401  
FAX: 03 9600 3313  
Email: [rxt@marshmaher.com.au](mailto:rxt@marshmaher.com.au)