

## Article Information

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## Competition and Consumer Alert - Imminent changes to franchising code of conduct

**The current Franchising Code of Conduct will be repealed and replaced with a new Franchising Code of Conduct, which will take effect from 1 January 2015.**

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*The current Franchising Code of Conduct will be repealed and replaced with a new Franchising Code of Conduct, which will take effect from 1 January 2015. The changes will have a significant impact on the franchise industry.*

Key changes fall within the following six areas:

- Good faith
- Marketing and advertising
- Restraints
- Disclosure
- Imposition of infringement notices and court imposed penalties
- Dispute resolution

These changes are discussed in more detail below.

### Good Faith

The most publicised change to the Code is the introduction of an obligation to act in good faith. This obligation will apply to franchisors, franchisees and potential franchisees from 1 January 2015.

A definition of good faith is not included in the Code. A significant change from the Exposure Draft is that the Code now specifies that the term “good faith” is to be interpreted within the meaning of the unwritten law from time to time. The revised drafting of the Code makes it clear that the Code and the common law are to operate concurrently. While this will allow certain elements of the Code, including the interpretation of “good faith”, to evolve as the common law evolves, it also results in uncertainty.

There is no single, clear interpretation of the meaning of “good faith” at common law. Courts have interpreted its meaning very differently in different Australian jurisdictions. Participants in franchising will need to engage in costly court proceedings to determine how it will be interpreted including whether its meaning under the Code will be interpreted with reference to decisions of the courts within the jurisdiction in which the franchise business to which the dispute relates is located. If so, this could result in the term “good faith” being interpreted as having a different meaning for different franchisees within the same franchise network.

Key elements to which a court may have regard in considering whether a person has acted in good faith include whether the party acted honestly and not arbitrarily and whether the party acted cooperatively to achieve the purposes of the franchise agreement. An example given by the ACCC of a franchisee not acting in good faith may be where the franchisee makes public criticisms of a franchisor which could devalue the franchise system. As the elements to which a court may have regard are not fully specified, the scope of the duty is uncertain and will similarly need to be determined by the courts.

The Code specifically states that it does not prevent a person from acting in his, her or its legitimate commercial interests. However, this will be subject to the obligation to act honestly and not arbitrarily and to cooperate to achieve the purposes of the franchise agreement.

The broad wording of the Code will also need to be interpreted by the courts. For example, presumably the obligation to “act” in good faith includes an obligation to “refrain from acting” in a particular way and uncertainty is likely to arise as to the meaning of a person that “proposes to become a party” to a franchise agreement.

### **Marketing and advertising fees**

The intention behind the changes in this area is to introduce transparency and equality. Company owned and franchised stores will be required to contribute equally in proportion to their interest. Money received by franchisors for the purpose of maintaining a marketing fund will be required to be kept in a separate bank account from 1 January 2015. The account will be audited each year unless more than three quarters of all contributing stores (including both franchisees and company owned stores) agree to waive the required audit each year.

Franchisors will not be able to require a franchisee to contribute large outlays in relation to a franchised business, referred to as a “significant capital expenditure”, for example for substantial changes to a fit out, unless one of the following is satisfied:

- The outlay has been disclosed by the franchisor to the franchisee upfront, such as in the disclosure document.
- The franchisor obtains the consent of the individual franchisee.
- The franchisor obtains the approval of a majority of franchisees that are affected.
- The outlay is required due to a change of law, for example OH&S requirements.
- The franchisor has a good rational which justifies the expenditure and gives a written statement to that effect to the franchisees. The Code sets out the requirements for such a statement which includes a list of the risks and benefits involved.

### **Restraints**

At the end of a franchise agreement, franchisees must be able to continue to trade if:

- the franchisee wants to extend the agreement
- the franchisee has not breached the franchise agreement
- the franchisee has not infringed the intellectual property or confidentiality of the franchisor
- the franchisee has not received genuine compensation for giving up its goodwill in the franchise business.

If each of the above elements is satisfied then the franchisee is able to continue to operate in the same industry (but without the franchisor’s brand name unless otherwise agreed).

This is an important provision which invalidates legitimate restraints that would otherwise be valid and enforceable and has the potential to take away rights of franchisors in their goodwill without compensation on just terms.

It is important for restraint provisions to be reviewed in light of these changes and for franchise agreements to be carefully drafted to provide franchisors with maximum protection of their goodwill.

### **Disclosure**

The short form disclosure document will be repealed and there will be only one disclosure document. Master franchisors will no longer be required to give a disclosure document to sub-franchisors and updates have been made to the disclosures prescribed in Annexures 1 and 2. There are 23 key items in the disclosure document.

The amended disclosure document requires the franchisor to make additional disclosures in relation to arrangements for online sales and associates of the franchisor that are involved with the franchise system.

Sensibly, franchisors do not need to initially update their disclosure documents to comply with the Code until 31 October 2015. It then needs to be updated within 4 months of the end of each financial year of the franchisor. These obligations are subject to the general obligation of franchisors to disclose materially relevant facts and not to engage in misleading and deceptive conduct.

### **Penalties and Infringement Notices**

From 1 January 2015, the ACCC will have additional powers to issue infringement notices in the amount of up to \$1,700 for minor infringements of the Code by an individual or \$8,000 for minor infringements by a body corporate. For more serious breaches the ACCC may seek court imposed penalties in the amount of up to \$51,000.

There are 24 breaches of the Code that may attract penalties.

The ACCC has advised that in seeking to impose penalties it will consider the seriousness and importance of the breach. Factors that it will consider include the number of franchisees affected, whether the nature of the breach is major or minor and whether it was an innocent mistake.

When an infringement notice is issued for less serious infringements, payment of the infringement notice will not be taken as an admission of liability, but will bring the matter to an end.

The ACCC will also have additional powers to collect information and to conduct compliance audits. Accordingly, it will be important for franchisors to ensure that all documents required to comply with their obligations under the Code and all documents supporting their decision making processes are properly completed and retained.

The ACCC has advised that it intends to exercise these new powers from 1 January 2015.

### **Dispute resolution**

There are significant changes to the Code in relation to the resolution of disputes. These include the application of the “good faith” obligation referred to above and a new requirement that a franchise agreement must not contain a clause requiring a party to the agreement to bring an action or proceedings in relation to a dispute under the agreement in any State or Territory outside that in which the franchise business is based.

The Code introduces a new requirement that a franchise agreement must not contain a clause that requires the franchisee to pay to the franchisor “costs incurred by the franchisor in relation to settling a dispute” and provides that if it does it is of no effect.

As these changes are required to be made to franchise agreements, they will not affect all parties to a franchise agreement immediately. They will apply immediately in any varied franchise agreement that is already in place. Where an existing franchise agreement is in place the changes will need to be applied when the franchise agreement is renewed and will apply from that date.

Other than the carve outs referred to above there will be no moratorium on the changes and compliance will be required from the commencement date of 1 January 2015.