

The Franchising Code of Conduct (Transcript)

Hello. My name is Jason Gehrke and I am an adjunct lecturer at the Griffith Business School.

If you are considering buying a franchise, it's important to have an understanding of the regulations which govern the sector.

These are known as the Franchising Code of Conduct and in this module I will take you through a tour of the Code and what it means to you as a potential franchisee.

Franchise Code of Conduct Overview

The Code applies to all franchise agreements from July 1, 1998.

The purpose as stated in the Code is "to regulate the conduct of participants in franchising towards other participants in franchising."

It is a mandatory industry Code and sits under the Competition and Consumer Act, the main body of law which regulates commercial conduct in Australia.

The Code is enforced by a national government agency known as the Australian Competition & Consumer Commission (or ACCC) which has offices around the country.

And the Code applies to all businesses which offer franchise agreements.

There are three key elements to the Franchising Code of Conduct:

- One is Disclosure, and the upfront information that must be provided by a franchisor to potential franchisees;
- The second is the Franchise Agreement itself, and specific provisions within those agreements;
- And finally Dispute Resolution procedures and a prescribed method for resolving disputes when they may occur in franchise relationships.

Definition of a Franchise

Let's briefly look at a definition of a franchise under the Code.

The Code itself says that a franchise is the rights and obligations under a franchise agreement. So to understand what a franchise is, we must look at this definition of what is a franchise agreement.

The definition of a franchise agreement is found to have four parts:

- The first of these is that the agreement can be written, oral or implied. This is a common definition for an agreement to exist, however in a franchise only written agreements should be considered.
- Secondly, the franchisor grants to a franchisee the right to carry on a business under a system substantially determined, controlled or suggested by the franchisor. In other words, the franchisor provides significant direction for the operation of the franchisee's business.
- Thirdly, the business is substantially associated with a trademark or brand owned by the franchisor, or which the franchisor has the rights to use;
- And finally, the franchisee must pay an upfront fee, or pay for goods or services, or pay a fee based on gross or net income, or pay a training fee before starting or to continue operating the business. (There is at least some financial relationship between the franchisee and the franchisor).

It's important to note that some business opportunities which may claim to be licenses, distributorships or something other than a franchise may actually have all four of these elements present and in fact be a franchise in the eyes of the law irrespective of what they have called themselves.

If this is the case, it will be considered to be a franchise and the Franchising Code of Conduct applies, including the obligation to provide a disclosure document, dispute resolution and meet the other provisions of the Code.

In this respect, there is no government requirement to register franchises in Australia, and therefore no definitive list of franchise systems exists. Through this education program and by reading the Code, franchisees should equip themselves with the working knowledge to query both franchised and non-franchised business offers.

Franchise Disclosure Information

Let's now look at the first main aspect of the Franchising Code, and that is Disclosure.

Disclosure is information provided by the franchisor about themselves, their system and their business offer to help a franchisee make a reasonably informed decision.

It is provided up front to a potential new franchisee, or to an existing franchisee contemplating renewal of their franchise agreement.

The disclosure document must be **provided at least 14 days before entering into a franchise agreement**. During this 14 day period, potential franchisees have time to

obtain independent legal, accounting and business advice about the proposed business, and time to consider the pros and cons of the offer before them without being pressured into a hasty decision.

The franchise disclosure document must be updated within four months of the end of the financial year (ie. by October 31 for most franchise systems).

The document contains an extensive range of information about the franchisor and their business – approximately 270 items of information, which must be provided in a pro-forma manner irrespective of how long the business has been franchising, or how many franchisees are in the system. The same disclosure is required of a brand new start-up franchise system as is required for a long-standing system with a large number of franchisees.

So a disclosure document must include, for example, things like:

- A summary of the franchisor's business experience, and litigation history;
- A list of current franchisees (or for very large systems, a list of franchisees in the relevant state or region);
- A list of outlets sold, bought back, not renewed or terminated in the last three financial years, as well as a list of the contact details for the former franchisees of those outlets (unless the franchisees themselves have opted not to have their details made available).

Contacting both current and former franchisees provided in these lists to enquire about their experience with the franchise is a critical form of due diligence that all potential franchisees should undertake in conducting their research before making a business investment decision.

Financial details of the franchisor, or a solvency statement, should also be provided.

This information, among others, is all relevant to a potential franchisee in helping make an informed decision about the proposed business investment. They should, as much as possible, examine this information and satisfy themselves as to its accuracy and detail.

In addition to the disclosure document and its approximately 270 items of information, a franchisor must also provide a copy of the franchise agreement to a franchisee in the form in which it is to be signed, as well as a copy of the Franchising Code of Conduct itself. All of which – as we learned earlier – must be provided at least 14 days prior to the signing of a franchise agreement.

Franchise Agreement Regulations

Let's move on to the next key aspect of the Code, which is regulation around the franchise agreement itself. (The franchise agreement is the contract which joins the franchisee and franchisor together in their business relationship.)

Firstly the Code introduced a 7-day cooling-off period after the signing of the franchise agreement. This is intended to create an opportunity for a franchisee to reflect on the commitment they are undertaking in the cold light of day, and if need be, to reconsider that decision.

If a franchisee does then change their mind within the 7-day period, the Code also provides for them to get a full refund of their investment less any reasonable expenses incurred by the franchisor (such as say travel or accommodation for the franchisee to commence training, etc).

This refund must then be paid back to the franchisee within the following 14 days.

Another provision of the Code is the requirement for the franchisor to provide a copy of the lease within a month of signing the franchise agreement if the franchisee is to lease premises from the franchisor or an associate of the franchisor, plus a copy of documents that give the franchisee rights to occupy the premises, and written details of the conditions of occupation.

The Code also requires there be freedom of association among franchisees, and that a franchisor cannot prevent franchisees from gathering together for a lawful purpose, which might include discussing common interests in relation to their businesses.

The Code also prohibits a general release of liability and a waiver of representations made by the franchisor prior to the signing of the franchise agreement.

Additionally there's a requirement to audit a franchise system's marketing fund. Where franchise systems collect marketing contributions from franchisees for the overall promotion of the brand and its products and services, substantial sums of money may be involved. The purpose of the audit is to verify the expenditure of the marketing fund. An audit is not required however, if 75% or more of the franchisees in the network have voted accordingly.

There is also a requirement for certain ongoing disclosure under the Code. This is for information that is materially relevant to the franchise, such as:

- a change of the franchisor's ownership
- a criminal or civil judgement against the franchisor
- contravention of competition and consumer law or corporations law
- the franchisor coming under administration
- other scenarios outlined in the Code

All of this requires the franchisor to provide written notice to franchisees within 14 days of the franchisor becoming aware the contravention or change has occurred.

Existing franchisees are entitled to receive a current disclosure document during their relationship with the franchisor. They must receive one prior to renewing their franchise, and can request a disclosure document once every 12 months during their term.

Another requirement of the Code is that the franchisor cannot be unreasonable in withholding consent to the transfer of a franchise, between a franchisee who wishes to sell, and another party who wishes to buy their business. A common clause in most franchise agreements states that the franchisor must approve the buyer if a franchisee would like to sell their business. This provision of the Code ensures that the approval cannot be withheld without good reason, and that the reasons must be set out in writing.

The Code also requires that the franchisor must notify the franchisee in writing if the franchisee has breached any terms of the franchise agreement, and to advise what is needed to fix the breach and provide a reasonable timeframe for this to occur.

Otherwise, if the franchisee is not in breach of their agreement and the franchisor proposes to terminate the agreement, the franchisor must provide the franchisee reasonable written notice of the proposed termination and reasons for it. In special circumstances outlined in the Code, such as a franchisee no longer holding a license essential to the operation of the business, or becoming bankrupt, abandoning the business and so on, then the agreement may be terminated without providing reasonable notice.

Dispute Resolution

Let's now look at the third main aspect of the Franchising Code, and that is Dispute Resolution.

The Code provides a standard Dispute Resolution procedure that all franchisors must follow.

It acknowledges that disputes may occur in business arrangements and consequently lays down a procedure for both franchisors and franchisees to resolve disputes between each other.

In the first instance, this procedure requires a written notice of the dispute to be submitted by one party to the other, the outcome that they seek, and the actions that may be involved in achieving that outcome.

If this written notice does not result in a satisfactory resolution to the dispute, then either party can request mediation. If the franchisee and franchisor do not know of

any mediators, or cannot agree on one between them, then they can apply to the Office of the Mediation Adviser to have one appointed to mediate their dispute. (The Office of the Mediation Adviser has an extensive panel of mediators located around Australia).

Both parties are equally liable for the costs of the mediation, and the process of mediation itself does not necessarily prevent legal proceedings under the franchise agreement.

Accessing the Franchising Code of Conduct

A potential franchisee does not have to wait until a franchisor provides them with a copy before reading The Franchising Code of Conduct.

The Code is available online and can be download for free by [clicking on this link here](#), or if the link is not working, by copying and pasting the following URL into the address bar of your web browser:

<http://www.accc.gov.au/content/index.phtml/itemId/815503>.

This will take you to the official Australian Government law website, where you can select your preferred format, and download, view and save the document.

In total, the Code is 61 pages long. You are strongly encouraged to read the first 28 pages which explain in more detail the concepts that have been presented here, and which establish the legal rights and obligations of franchisees and franchisors around the franchise agreement.

You are also encouraged to read through the Annexure 1 pro forma Disclosure template on pages 29 to 47. This shows the “standard” disclosure information that all franchisors – no matter how big or small, new or old – must provide to their franchisees.

Annexure 2 disclosure (covered in pages 48 to 60) is simply a condensed version of the Annexure 1 format, which franchises with an annual turnover of \$50,000 or less may use, however a potential franchisee of such a system is entitled to request the long format, and therefore it is rarely used.

Take your time to read through the Code and the Annexure 1 disclosure template.

You can self-assess your understanding of the Franchising Code of Conduct by undertaking the questionnaire later in this online learning program.

Changes to the Franchising Code of Conduct

Federal Minister for Small Business, Dr Craig Emerson, has recently announced that changes are to be made to the Franchising Code of Conduct, effective July 1, 2010.

These changes result in amendments to both the provisions of the Code, as well as the nature of the information to be disclosed in future by franchisors to franchisees.

The details of the changes are provided in the following video of this module.

Thank you for your attention.