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CHANGES TO THE FRANCHISING CODE OF CONDUCT

Introduced on 1 July 2010

The Federal Government, by *Trade Practices (Industry Codes - Franchising) Amendment Regulations 2010 (No.1) (Cth) (2010 Amendments)*, has made a number of changes to the Franchising Code of Conduct (**Code**). These amendments apply to disclosure documents issued and franchise agreements entered into on or after 1 July 2010.

Most significant 2010 Amendments

The most significant issues in the 2010 Amendments are as follows:

- The introduction of a new obligation on the franchisor (new clause 20A of the Code) under which the franchisor must inform the franchisee, at least six months before the end of the franchise agreement, whether the franchisor decides to renew or not the franchise agreement, or enter into a new one. The pre-expiry notice is reduced to one month if the term of the agreement is less than six months. Such obligation did not exist in the Code before the 2010 Amendments.
- A new statement to be added on the first page of the disclosure document to declare that franchising is a business and, like any business, the franchise (or franchisor) could fail during the franchise term, and this could have consequences for the franchisee.
- A new obligation on the franchisor (under Item 13A of the disclosure document) to disclose whether the franchisor will require the franchisee to undertake significant capital expenditure that was not foreseen, so not disclosed by the franchisor before the franchisee entered into the franchise agreement.

- A new obligation on the franchisor (new Item 17A of the disclosure document) to disclose the circumstances in which the franchisor has unilaterally varied a franchise agreement in the past three financial years, and the circumstances in which such unilateral variations may happen in the future. For instance, such variations may be necessary because of changes to legislation or the franchise system.

- A new obligation on the franchisor (new Item 17C of the disclosure document) to disclose to franchisees the arrangements to apply at the end of the franchise agreement. It includes:

- whether the prospective franchisee will have any options to renew or extend the franchise agreement, or extend the scope of the franchise agreement, or enter into a new agreement
- whether the prospective franchisee will have a right to an exit payment, and if so, how the exit payment will be determined
- the arrangements that will apply to unsold stock, marketing material, equipment, and other assets purchased
- whether the franchisee will have the right to sell the business at the end of the agreement, and if so, whether the franchisor will have first a right of refusal
- whether the franchisor has, during the last three financial years, considered or will consider any significant capital expenditure undertaken by the franchisee during the franchise agreement, in determining the arrangements to apply at the end of the franchise agreement.





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Further 2010 Amendments

The 2010 Amendments make further changes which include the following:

Application dates

The 2010 Amendments clarify under clause 5 (1) of the Code the application date of the successive changes to the Code. The Code applies to a franchise agreement entered into on or after 1 October 1998. The amendments to the Code are made on a prospective basis. Therefore, the amendments to the Code that commenced on or after 1 March 2008 apply to franchise agreements entered into on or after 1 March 2008. The 2010 Amendments to the Code that are to commence on 1 July 2010 apply to franchise agreements entered into on or after 1 July 2010.

The 2010 Amendments rewrite clause 16 of the Code as amendments to the Code are made on a prospective basis. Now clause 16 (1A) of the Code provides that franchise agreements entered into on or after 1 March 2008 must not contain, or require a franchisee to sign a waiver of any verbal or written representation made by the franchisor.

Before the 2010 Amendments, this applied to franchise agreements entered into on or after 1 October 1998.

Novation

A new definition of 'novation' is added to clause 3 (1) which means, 'in relation to a franchise, the termination of the franchise and entry into a new franchise with a proposed transferee on the same terms as the terminated franchise'.

Clause 20 of the Code is renamed 'Transfer or novation of franchise', instead of 'Transfer of the franchise'. Before the 2010 Amendments, the franchisee could request the franchisor's consent to a transfer of the franchise agreement. The 2010 Amendments extend this request to novation of the franchise.

The 2010 Amendments include in clause 20 (5) a new definition of 'transferee' which is defined as 'a franchisee who seeks to acquire a franchise business through either transfer or novation of the franchised business'.

The 2010 Amendments impose a new obligation on the franchisor to disclose under clause 17D.1 of the disclosure document whether the franchisor will amend or require the amendment of the franchise agreement on or before the transfer or the novation of the franchise.

Disclosure requirements

Under paragraph 6 (2) (c) of the Code before the 2010 Amendments, the disclosure document provided by the franchisor was to be signed by 'a director or other officer of the franchisor'. The 2010 Amendments will entitle 'the franchisor, or a director, officer or authorised agent of the franchisor' to sign the disclosure document.

Under clause 6B (1) (b) of the Code before the 2010 Amendments, a franchisor was to provide a disclosure document to a prospective franchisee or a franchisee proposing to renew or extend (the scope or the term) of a franchise agreement. The 2010 Amendments extend this obligation to provide a disclosure document whether **the franchisee or the franchisor** proposes to renew or extend or extend the scope of the franchise agreement.

Likewise, under clause 10 of the Code, the franchisor must now give a copy of the Code, a disclosure document and a copy of the franchise agreement in the form in which it is to be executed to a prospective franchisee or a franchisee, **if the franchisor or the franchisee** proposes to renew or extend or extend the scope of the franchise agreement.

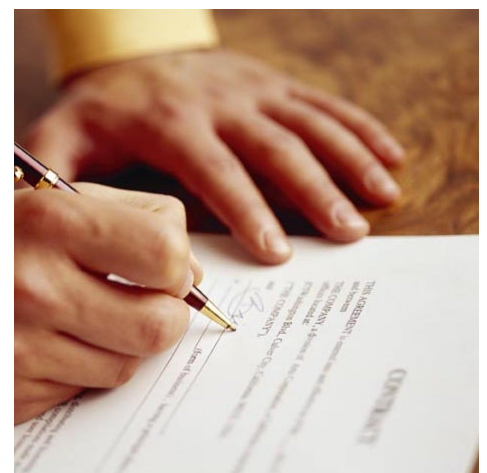
The 2010 Amendments insert a new clause 13B in the Code to require the franchisor to disclose whether the franchisor will attribute the franchisor's costs, including legal costs, incurred in dispute resolution, to the franchisee.

The 2010 Amendments under clause 17B add a new obligation on the franchisor to disclose whether a confidentiality obligation will be imposed by the franchisor on the franchisee, and the matters the confidentiality obligation may cover, such as intellectual property and trade secrets.

Marketing and other cooperative funds

Under clause 17(1) of the Code, a franchisor must provide a franchisee, within four months after the end of the financial year, with an audited statement of marketing and other cooperative funds. Since the 2010 Amendments, the franchisor does not need to have the funds audited if 75% of the franchisor's Australian franchisees agree to the exemption, and if their agreement is made within **3 months** after the end of the financial year instead of 5 months previously.

Moreover, the 2010 Amendments replace the previous clause 17(3) by a new clause stating that where franchisees have exempted the franchisor from having the marketing statement audited, the franchisees will have to vote to agree every three years to keep this exemption in force.





Good faith

The new clause 23A of the Code preserves and recognises any developments at common law on the concept of good faith.

Clause 23A provides that nothing in the Code limits any obligation imposed by common law on the parties to a franchise agreement to act in good faith.

Behaviour in dispute resolution processes

The 2010 Amendments add a new clause 29(8) to interpret the meaning of 'try to resolve the dispute' under clause 29(6) of the Code. Clause 29(8) lists some behaviours expected from the franchisor and the franchisee when engaging in dispute resolution processes, which include:

- participating in meetings at reasonable times
- not taking action that could result in damaging the reputation of the franchise system
- requiring the parties to disclose their aims in attending mediation.

Payments

Under the Code, the franchisor must disclose in the disclosure document details of each payment payable by the franchisee to the franchisor, or collected by the franchisor for another person. The 2010 Amendments add a new obligation under Item 13.6A of the disclosure document which requires the

franchisor to disclose details of each payment payable by the franchisee to another person, where the payment is within the knowledge or control of the franchisor, or reasonably foreseen by the franchisor.

Under clause 31(3) of the Code, franchisors and franchisees must pay for their own costs of attending mediation. The 2010 Amendments under clause 31(4) clarify the meaning of 'costs of mediation' to include:

- the cost of the mediator
- the cost of room hire
- the costs of any additional input (excluding expert reports) agreed by both parties to be necessary to the conduct of the mediation.

Update your documents

All disclosure documents issued from 1 July 2010 and all franchise agreements entered into on or after 1 July 2010 will have to comply with the Code including the 2010 Amendments. As a franchisor, under clause 6(1) of the Code, is required to update the disclosure document by 31 October each year, it is important for a franchisor to update the disclosure document before 31 October this year.

If you would like us to update your existing disclosure document and franchise agreement or to prepare new documents, please contact us.



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