

Franchising (No. 3) – The Code of Conduct

Franchising is one of the most common ways of growing a business, and if done well it may turn out to be an extremely profitable business venture; benefiting both the franchisor and the franchisee. It is possible to franchise any type of business, regardless of the goods or services being sold (unless illegal). One should not think about franchising their business unless their business is successful and profitable, as statistics show that any small business has an 80% chance of failing within the first five years of operation. Franchising an existing business will also take time and capital. Importantly, both the franchisor and the franchisee must comply with the Franchising Code of Conduct.

The Franchising Code of Conduct (“**the Code**”) has the primary aim of outlining the rights of franchisees and the obligations of franchisors. Adherence to **the Code** is mandatory pursuant to Section 51AD of the *Trade Practices Act* (1974), [later amended by the *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001*]. It is the job of the Australian Competition and Consumer Commission (ACCC) to administer and enforce **the Code**.

The Franchising Code of Conduct was implemented on 1 October 1998, and it is one of the most comprehensive and stringent national codes for franchising in the world. One of the primary provisions of **the Code** details what is known as a Disclosure Document. A Disclosure Document must be provided to the prospective franchisee at least 14 days prior to signing a franchise agreement. There are 23 categories (approximately 250 items) in which information is to be disclosed. Some of the information required to be disclosed includes details of the franchisor, the franchise territory, costs relevant to franchise and the financial position of the franchisor. Disclosure is a continuing obligation which the franchisor must undertake.

Other important provisions under **the Code** include a 7 day cooling off period for franchisees.

The Code also requires that independent legal, business or accounting advice be sought, or that there is evidence that the franchisee had been told to seek such advice. Further, all franchise agreements must contain provisions in regards to the areas of assignment, termination and dispute resolution.

For more information on statutory requirements you might like to look at *Comasters Law Firm’s* article entitled *Franchising (No.2) – Rights and Obligations of the Franchisor and the Franchisee*.

Amendments to the Franchising Code of Conduct

The Federal Government amended the early version of the Franchising Code of Conduct through the introduction of the *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001*. This piece of legislation came into effect on 1 October 2001. The amendments to the Franchising Code of Conduct were aimed at making the code more flexible in regards to compliance and clearer in terms of the operation of **the Code**.

The main amendments to the Franchising Code that were brought about by the legislation were:

- a. *The introduction of a short form disclosure document.* This document can be used by franchised businesses that have an expected annual turnover of less than \$50,000. This short form disclosure document only requires information from 11 of the 23 categories otherwise needed in a normal disclosure statement. It must be noted that if the franchisee asks for any information from the other 12 categories, the franchisor must provide this information, unless it is reasonable to withhold it. In that sense, some critics have called the benefits of a short form disclosure document ‘illusory.’
- b. *Extension of the purpose of the Disclosure Document.* Prospective franchisees are now able to gain important information on the daily running of the business. The widening of the purpose of disclosure documents supplements the new requirement that franchisors continue to give franchisees current disclosure documents for at least one year after entering into a franchise agreement.
- c. *Disclosure to Sub-franchisees.* Prior to the amendments being passed, it was believed that sub-franchisees could only gain disclosure documents from sub-franchisors. The *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001* has clearly stated that the original

franchisors need to give potential sub-franchisees the same treatment as purchasers of the new franchise. In effect this means that sub-franchisees will receive the same disclosure document that new franchisees do.

Comasters is able to advise a franchisor, or a franchisee, on franchising matters. We are also able to set up a franchise business for a franchisor, entailing the production of suitable franchise agreements, disclosure documents and operations manuals.

- d. *Amendments to mediation.* If a dispute arises between the franchisor and the franchisee, all mediation must be conducted in Australia. To make mediation effective, it must be attended by someone who has the authority to make decisions in order to settle the dispute on behalf of the disagreeing parties. Mediation may be terminated by the mediator if no resolution seems forthcoming after 30 days of commencement. This is to allow parties to try other avenues of dispute resolution.

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Technical or Minor Amendments to the Franchising Code

- Disclosure documents can be produced in electronic form.
- Proposed franchisees may keep the disclosure document. This may raise the issue of franchisors being selective in giving out disclosure documents and giving disclosure documents only to those with a clear intention to purchase.
- Drawing attention to waiting and cooling off periods (14 day waiting period before entering into agreement and 7 day cooling off period whereby the buyer may terminate the agreement after signing it without any cost) by inserting new sentences on the front page of the disclosure document.
- The inclusion of intellectual property as constituting the list of ‘materially relevant facts’ that must be disclosed to a franchisee.

Conclusion

Franchising can be a beneficial venture for both the franchisor and the franchisee. However, awareness and compliance with the Franchising Code of Conduct and the *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001* is essential to ensure adherence to Australia’s laws and standards.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this paper. Our formal advice should be sought before acting on any aspect of the above information.

Comasters Law Firm and Notary Public

Suite 101, Level 1, Capitol Terrace
743-755 George Street
Sydney NSW 2000, Australia
Phone: (612) 9288 0300 Fax: (612) 9288 0399
Email: comasters@comasters.com.au
Website: www.comasters.com.au