

## Practice Update

# U.S. Franchisors Face New Compliance Hurdles In Australia

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Australia today holds claim to being one of the major players in the world of franchising.

As a concept, though, franchising was virtually unknown in Australia until the early 1970's. An influx of successful U.S. fast food franchise systems — such as [Yum Brands Inc.'s KFC](#) and [Pizza Hut](#), and [McDonald's Corp.'s](#) namesake restaurants — into the local marketplace led to the rise in popularity of franchising as a format for creating and expanding businesses in Australia. Franchising is now a mature sector of the Australian economy, with some 90,000 franchised outlets spread throughout most Australian industries. The sale of franchises in Australia has been regulated by the Franchising Code of Conduct since 1998. The code has been amended several times over the last 20 years, including this year. Following a lengthy parliamentary inquiry that began in March 2018, amendments to the code were released June 1. These changes will affect disclosure and dispute resolution processes and the form of franchise documents used by U.S. franchisors who have franchisees in Australia.

Given the timing of effectiveness of the changes, U.S. franchisors with operations in Australia should give immediate attention to the reforms.

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## Commencement

Effective immediately, new dispute resolution provisions will apply to all franchise agreements, while changes to the prescribed form of the disclosure document won't be applied until Nov. 1. Other amendments will apply to agreements entered into, extended, or renewed on or after July 1, 2021. Importantly, under the code definition, an extension is any material change to the terms of a franchise agreement, which means that a number of new code provisions will apply to any material amendment made after July 1, even if the franchise agreement was in place prior to that date.

## Key Changes Affecting U.S. Franchisors

### Timing of Updates

The code requires a franchisor to update its disclosure document and prepare — and if applicable, audit — financial statements for its marketing fund within four months after the end of the fiscal year. However, while most U.S. franchisors have a Dec. 31 fiscal year end, most Australian business entities mark the closure of their fiscal year as June 30. The Nov. 1 start date for the amended form of disclosure document — four months after June 30 — was intended for franchisors to be able to amend their franchise disclosure document to comply with the new form as part of their annual update.

However, if a U.S. franchisor needs to issue a disclosure document between Nov. 1 and the completion of its fiscal year end update, it will need to undertake an interim update to ensure its franchise documents comply with the amended code. Although a comprehensive review of the disclosure document may not be required for the purposes of granting franchises between now and Nov. 1, certain changes to a franchisor's template documents are prudent to address the changes that became effective July 1.

## **Key Fact Sheets**

An online smart form of a new mandatory key facts sheet has been made available through the Australian Competition and Consumer Commission website. But no other format has been made available and on release there were a number of limitations to using the smart form. For example, it did not permit the user to specify the currency in which payments will be required under the franchise agreement or the currency of estimated costs of establishing and operating the franchise.

Many U.S. franchisors require payments to be made in U.S. dollars and provide estimated costs in U.S. dollars. The form of the key facts sheet is under review and companies will need to consider the best approach to completing that document.

## **Franchise Agreement Changes**

Amendments to a franchisor's template franchise agreement are recommended to address:

- The new prohibition on franchisors recovering their legal document costs. This is particularly relevant where franchisors collect such costs initially or on a renewal or transfer of a franchise.
- The extension of the cooling off period to 14 days and changes to the timing of the expiration of the cooling off period.
- Changes to the mandatory dispute resolution process, including insertion of a provision for conciliation as an alternative to mediation.
- The new requirement for seven days prior notice of immediate termination. As this period can be extended to 28 days in the event of a dispute, franchisors should consider inserting a provision for suspension of operation of the franchise for that period. Inclusion of such a provision is expressly permitted by a new clause of the Code.

## **Disclosure**

Key changes to the disclosure process and the form of the disclosure document are as follows:

- Further information regarding supplier rebates is required. Specifically, item 10 of the disclosure document must include:
  - The nature of each rebate or other financial benefit received from each supplier;
  - The name of each business providing the rebate or other financial benefit; and
  - The total amount of rebates or other financial benefits received in the previous fiscal year from each supplier, expressed as a single aggregate percentage of total group purchases from that supplier — not including any purchases made by units of the franchised business operated by the franchisor, master franchisor, or associate.
- The code amendments have reduced the circumstances allowing a franchisor to require franchisees to incur significant capital expenditure. Previously, the franchisor could require the expenditure where it provided in writing a good business case for the requirement. The removal of that provision means that franchisors now must focus more attention on disclosure of future capital expenditures prior to signing the franchise agreement. If significant capital expenditures may be required, the disclosure document should include as much information as practicable about that expenditure, including the following:
  - The rationale for the expenditure;
  - The amount, timing and nature of the expenditure;
  - The anticipated outcomes and benefits of the expenditure; and
  - The expected risks associated with the expenditure.

Under the new code provisions the franchisor must discuss this expenditure with the franchisee prior to entering into, renewing, or extending the term or scope of the agreement.

That discussion must include the circumstances under which the franchisee or prospective franchisee considers that it is likely to recoup the expenditure, having regard to the geographical area of operations of the franchise. Franchisors would be wise to retain written evidence of such discussions.

- If the franchisor provides earnings information it must include this within the disclosure document. Previously, it was not clear whether the code provisions relating to earnings information applied where that information was not included in the disclosure document.
- If the franchisor leases locations to franchisees it should ensure that it complies with the new provisions relating to disclosure of lease documents. These franchisors should also consider the impact of timing of delivery of these documents on commencement of the disclosure period and the expiration of the cooling off period.

## Conclusion

Before these recent changes, most U.S. franchisors found the Australia disclosure requirements to be challenging since they required more information than the U.S. Federal Trade Commission's franchise rule. These recent changes will make compliance with the Franchising Code even more challenging. Despite these factors, Australia is expected to remain a target for expansion of U.S. franchise systems. The amendments, though substantial, do not alter the overall regulatory approach and can be addressed with considered amendments to franchise offering documents and the franchise sales process and an understanding of the amended dispute resolution procedures.

Franchisors already operating in Australia will need

to consider how and when the changes will impact their existing agreements. From the franchisee perspective, time will tell if the reforms deliver their principal objective of promoting fairness within the franchising industry.

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