

LEGAL FOCUS: Franchisee Recruitment



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The Franchise Recruitment Process: Understanding your legal rights and obligations as a prospective franchisee.

The franchisor's application form requires prospective franchisees to provide information of a personal nature. Will this be kept confidential?

The Privacy Act 1998 (Cth) ("**Privacy Act**") sets out the National Privacy Principles, which provide a minimum standard that organisations, including franchisors, must apply to the handling of personal information. Personal information has a specific meaning under the Privacy Act. It is any information or opinion about an individual, whether true or not and whether in recorded or material form ("**Personal Information**"), and would include a person's name, address and date of birth, and also more complex information such as a resume.

As a general rule, the National Privacy Principles requires that a franchisor should only use or disclose Personal Information for the primary purpose for which it was collected. Accordingly, unless a franchisor obtains the consent of a prospective franchisee to disclose their personal information to a third party, it is unlikely that the franchisor would be entitled to do so. Regardless, it is advisable that prospective franchisees confirm with the franchisor that appropriate arrangements are in place to ensure that their personal information is kept confidential.

What legal documents should prospective franchisees receive from the franchisor during the recruitment process?

The Franchising Code of Conduct ("**Code**") requires a franchisor to provide prospective franchisees with the following documents:

- (a) **The Franchise Agreement, Disclosure Document and a copy of the Code:** When a person proposes to become a franchisee, the franchisor must give them

the franchise agreement in the form it is to be executed, the franchisor's current Disclosure Document and a copy of the Code, at least 14 days before that person either:

- (i) enters into a franchise agreement or an agreement to enter into a franchise agreement; or
- (ii) pays any non-refundable money or other valuable consideration to the franchisor (or its associate).

The Disclosure Document must be in the form specified by the Code, which may be in either short form or long form depending on the circumstances. A long form Disclosure Document is required where it is expected that the franchised business will have an annual turnover of over \$50,000 at any time during the term of the franchise agreement. If the turnover is expected to be less than \$50,000 per annum, a short form Disclosure Document will suffice.

- (b) **Other documents:** If a franchisee is entitled to a long form Disclosure Document, the franchisor must give the franchisee a copy of all the following agreements (where applicable) that the franchisee is required to enter into under the franchise agreement, at least 14 days before the Franchise Agreement is signed (or if they are not available at that time, as soon as they become available):

- (i) a lease, sub-lease, licence or other agreement;
- (ii) a chattel lease or hire purchase agreement;
- (iii) an intellectual property agreement;
- (iv) a security agreement, such as a guarantee or bank guarantee;
- (v) a confidentiality agreement; and
- (vi) a restraint of trade agreement.

Where a franchisor is only required to provide a short form Disclosure Document, the franchisee is entitled to request that the franchisor provides details of these agreements where applicable.

The franchisor requires prospective franchisees to sign a receipt confirming the date they received the Disclosure Document and the Code. Why is this required?

A franchisor must not enter into a franchise agreement, or receive any non-refundable payment from a franchisee (or prospective franchisee as the case may be), if it has not received a written statement from that person that they have received, read and had a reasonable opportunity to understand the Disclosure Document and the Code.

Does a franchisor have to provide its financial details to prospective franchisees?

The Code requires franchisors to provide certain financial information with the Disclosure Document, including a document signed by a director of the franchisor confirming that the franchisor is able to pay its debts as and when they fall due. The franchisor must also provide either financial reports for the last two completed financial years prepared in accordance with the Corporations Act 2001 (Cth), or a copy of an independent audit provided by the franchisor's auditor supporting the director's statement.

The franchisor requires prospective franchisees to sign an "offer to franchise". Why is this required?

Once a franchisor is ready to offer a franchise to a prospective franchisee, they will usually require an "offer to franchise" to be signed. This document confirms that the prospective franchisee is making an "offer" to purchase a franchise from the franchisor.

A franchisor will require this to ensure that a prospective franchisee is committed to buying the franchised business. However, as the franchisor is prevented by the Code from entering into an “agreement to franchise” prior to providing a prospective franchisee with the 14 days disclosure period as set out above, the offer to the franchisee will typically be drafted in such a way as to allow a prospective franchisee to withdraw their offer at any point prior to signing the final form of the franchise agreement.

Why does a franchisor require prospective franchisees to obtain legal and/or accounting advice?

The Code states that a franchisor must not enter into a franchise agreement before receiving a statement, signed by the prospective franchisee, indicating that the prospective franchisee has received independent legal and/or accounting advice, or that the prospective franchisee has decided not to seek that kind of advice despite being advised by the franchisor that they should.

From a practical perspective, a franchisor will typically recommend that prospective franchisees seek legal and accounting advice as early in the process as possible, and particularly once they have received any draft franchise documents from the franchisor (or the final franchise documentation if no draft documentation is provided). Franchise documentation can be lengthy and complex, so seeking the appropriate advice early in the process ensures that delays are avoided and any issues can be dealt with promptly.

A franchisee signed a Franchise Agreement two days ago. They have since changed their mind and would like to terminate the agreement. Are they entitled to do so?

The Code provides that a prospective franchisee is entitled to a cooling-off period of seven days after entering into a new franchise agreement or making any payment under the agreement, whichever occurs earlier. If the franchisee terminates within the cooling off-period, the franchisor must fully refund all payments made by the franchisee under the agreement within 14 days. The franchisor is entitled to deduct its reasonable expenses from the amount to be repaid provided that this information has been set out in the franchise agreement.

A prospective franchisee is purchasing an existing franchise. Does this change anything in the

recruitment process?

The Code sets out two fundamental differences when dealing with a transfer of a franchise, as opposed to the grant of a new franchise.

- (a) **Consent to the transfer:** The Code sets out a process that must be followed for the transfer of an existing franchise agreement to a third party. Of particular relevance is the requirement that a franchisor cannot unreasonably withhold consent to the transfer of a Franchise Agreement. However, the Code does set out a number of situations in which a franchisor is permitted to reasonably withhold consent to a proposed transfer including:
- (i) the proposed transferee is unlikely to be able to meet the financial obligations under the franchise agreement;
 - (ii) the proposed transferee does not meet the franchisor’s selection criteria;
 - (iii) agreement to the transfer will have a significantly adverse effect on the franchisee system;
 - (iv) the franchisee has breached the franchise agreement and has not remedied the breach; and
 - (v) the franchisee has not paid or made reasonable provision to pay an amount owing to the franchisor.
- (b) **Cooling-off period:** A franchisee’s right to a cooling-off period of seven days after a franchise agreement is signed does not apply where the franchise is transferred.

INTERVIEW WITH A FRANCHISOR:

Craig Peters, Red Clean

Red Clean has been operating as a cleaning business for the past 18 years on the east coast of Australia. Red Clean franchised the business three years ago and has three distinctive franchise models in the Domestic, Commercial and Construction cleaning industry. All three models support unlimited growth within all three growth sectors of the cleaning industry.

What are the stages involved in your recruitment process?

Our recruitment process has five stages after an initial telephone inquiry:

- (1) Brief presentation of the Red Clean proposals in a one-on-one meeting;
- (2) Formal interview explaining the Red Clean System in detail (approximately 2 hours);

- (3) Tour of existing franchised sites and introduction to existing franchisees;
- (4) Deposit is paid and draft franchise documentation is issued; and
- (5) Any additional questions are answered and profile test is completed by the franchisee.

After these five stages are complete, we determine the success of that applicant.

What information is provided to prospective franchisees throughout the recruitment process?

In addition to providing a franchisee with the legal documents required by the Code, a “Franchise Recruitment Pack” with detailed financials and cost analysis is provided to prospective franchisees. We also recommend prospective franchisees visit our website for additional information (www.redclean.com.au).

Is all personal information provided by prospective franchisees kept confidential?

Yes, it is kept confidential. Both parties sign a confidentiality deed before any confidential information is exchanged. Red Clean maintains a strict file management database to ensure all prospective franchisees details are kept confidential.

Do you encourage prospective franchisees to seek legal advice and if so, at what stage of the process do you recommend they do this?

Absolutely, we typically suggest this after the fourth meeting and after providing a prospective franchisee with draft franchise documents. If they have not already sought legal and accounting advice at that point, Red Clean strongly recommends that they do so and we require that they sign a “Prospective Franchisee Advice Statement” indicating they have done so. In fact, not one franchisee has signed up with Red Clean without obtaining either independent legal or accounting advice! ❖

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