



2009 REVIEW OF INTERNATIONAL FRANCHISING DEVELOPMENTS

December 2009

Updates Include:

Australia
Brazil
Canada
People's Republic of China
Japan
South Africa
United Kingdom

With the ever-expanding prominence of franchising as a global distribution method, more countries moved to enact or refine laws and regulations pertaining to the offer and sale of franchises and/or the relationships between franchisors and franchisees, and more and more courts and tribunals found opportunities to interpret those laws and regulations. Several developments in 2009 bear noting and watching into 2010:

A. Australia

In November 2009, the Australian government announced that it would be making changes to strengthen the Franchising Code of Conduct and the Trade Practices Act to give franchisees greater protection from anti-competitive behavior by more powerful franchisors. These measures are intended to:

(1) give the Australian Competition and Consumer Commission (ACCC) increased enforcement powers, including the ability to:

- a. publicly "name and shame" "rogue or unscrupulous" franchisors in order to warn unsuspecting franchisees,
- b. assess penalties against non-compliant franchisors of up to AUD\$1.1 million for corporations and AUD\$225,000 for individuals,
- c. conduct random audits of franchisors, and
- d. seek redress for franchisees (even those not a party to legal proceedings) where a large number of franchisees have been harmed by a franchisor's actions,

(2) make it clear that nothing in the Franchising Code is intended to limit the evolving common law concept of "good faith" in relation to franchise agreements;

(3) require franchisors to clearly disclose what happens at the end of the term of a franchise agreement (such as renewal), and to provide franchisees with at least 6 months' notice before the end of the term as to whether the franchisor intends to renew the franchise agreement (note this would apply prospectively and would not apply to franchise agreements that are in existence at the time the regulatory changes become effective); and

(4) require the parties to participate in proscribed procedures to facilitate dispute resolution (such as mediation and other informal dispute resolution procedures).

The government intends to appoint an expert panel which will be charged with reporting, by the end of January 2010, on whether further changes should be made to the Franchising Code to address other "inappropriate" franchisor behaviors. Watch for these legislative changes to become effective in early 2010.

B. Brazil

The Brazilian House of Representatives continued examining in 2009 an important bill that was introduced in 2008. The Brazil Franchise Law currently requires franchisors to provide certain pre-sale disclosures. Legislative Bill No. 4.319/2008 would amend the Franchise Law to require that, before offering franchises in Brazil, franchisors must have had at least 12 months of market experience. Like China's 2+1 Rule (see below), the market experience requirement could be satisfied by operations outside the country and by entities related to the franchisor.

Another important bill was introduced in the House of Representatives in 2009 and is making its way through the legislative process. If adopted, this bill (Legislative Bill No. 6080/2009) would prohibit a franchisor who leases, then subleases, real estate to its franchisees from charging the sub-tenant/franchisee any rental higher than that which is provided under the head lease. While it would prevent franchisors from charging inappropriate up-charges under subleases, the bill would have the unintended consequence of restricting the franchisor's ability to recapture, through rental payments,



leasehold improvements that it might make to the premises to make them usable in the context of the franchise system.

The Brazilian Franchise Association, with the guidance and assistance of its national legal counsel, Luiz Henrique of the Danneman Siemsen firm, has been actively involved as these bills make their way through the House of Representatives. Either measure, if adopted, could have a significant impact on franchising in Brazil during 2010.

C. Canada

Legislative developments during 2009 in two provinces bear watching in 2010.

(1) In Manitoba, the government moved closer to adopting a pre-sale disclosure law and regulations governing the franchisor-franchisee relationship (particularly, termination and encroachment). Expect Manitoba next year to join the ranks of Ontario, Alberta and Prince Edward Island in requiring franchisors to have and use pre-sale disclosure documents.

(2) In New Brunswick, the government finally proposed regulations under the province's Franchises Act that was adopted in 2007 (while the Act was adopted in 2007, it has never become effective pending adoption of the implementing regulations). As proposed, the regulations would require that franchisors provide prospective franchisees with pre-sale disclosures similar to those already required by the provinces of Alberta, Ontario and Prince Edward Island. But one of the key differences in the proposed New Brunswick regulations is the requirement that the parties submit to informal dispute resolution processes. The franchisor or franchisee would be allowed to issue to the other party a notice describing the nature of the dispute and the desired resolution. Then, the parties would have 15 days to attempt to resolve the dispute, failing which, either party could issue a notice to mediate. The proposed regulations expressly provide, however, that delivery of either a notice of dispute or notice to mediate does not preclude a party to the franchise agreement from taking any other measure in relation to the subject matter of the dispute. The New Brunswick government is likely to publish the final regulations in early 2010 and, if adopted, the regulations and the Act would come into force together following a 3-6 month notice period to allow franchisors to come into compliance.

There were also several court decisions involving franchising that are of note. In particular, lawsuits initiated as putative class actions became more prevalent as cash-strapped franchisees

attempted to share legal costs in their efforts to seek redress from alleged abuses by their franchisors. The courts have certified classes in several of these cases. And, in a recent case, the Ontario Superior Court of Justice called into question the validity of release provisions that are typically found in franchise agreements.

In a case filed by a Midas franchisee, the franchisor, relying on a provision in its franchise agreement which is fairly standard in most franchise agreements, demanded that the franchisee (who was also a member of the class in a pending class action against the franchisor) sign a general release of claims against the franchisor as a condition of renewing the franchise agreement. The release would obviously have knocked the franchisee out of the pending class action. The court found that the release required under the franchisor's standard form franchise agreement (as opposed to a release that was being granted in connection with the settlement of an existing claim) would violate the franchisee's right to associate, which is protected in Ontario by statute (Section 4(1) of the Arthur Wishart Act). In the court's view, not only was the standard release provision invalid, but its existence could give rise to a claim for damages against the franchisor for attempting to interfere with the franchisee's statutory right to associate. And, importantly, the court extended the reach and protections of the Arthur Wishart Act to Midas franchisees operating outside of Ontario because the franchise agreements selected Ontario law as the governing law (query whether the court would have decided differently had the franchise agreements outside of Ontario included appropriate carve-outs for the Act's application only where the jurisdictional requirements of the Act are independently satisfied).

D. People's Republic of China

China's 2007 Franchise Regulations require that, before engaging in franchising in China, the franchisor must have operated at least 2 company-owned units for at least 1 year (the so-called "2+1 Rule"). This rule has made it difficult for some franchisors to enter the market. Recently, there has been debate around whether the 2+1 Rule is a mandatory or an administrative requirement. The importance of that distinction is that, if it's a mandatory requirement, the franchise agreement would be null and void if the franchisor didn't comply with the rule. But if it's administrative, the franchisor might be subject to a fine, but the franchise agreement would still be valid. In April 2009, a Beijing court added to the debate by disagreeing with earlier decisions by other courts that had held the 2+1 Rule to be mandatory and, instead, holding held that the requirements of the 2+1 Rule were



administrative. The debate will continue and, hopefully, lead to an easing of the restrictions that are currently making it difficult for some franchisors to get in to China.

E. Japan

On June 22, 2009, following a very public months-long investigation, Japan's Fair Trade Commission found that Seven-Eleven Japan Co., Ltd., Japan's largest convenience store franchisor, abused its dominant position by, informally through field representatives, threatening action against franchisees who discounted prices on perishable foods. The practice caused the franchisees significant financial losses resulting from having to discard perishable foods that they could not sell prior to expiration dates (presumably they could have moved the inventory if they could have reduced the prices just prior to expiration). Finding the franchisor's practice to be an unfair trade practice which resulted in a violation of Japan's Anti-Monopoly Act, the Fair Trade Commission issued a cease and desist order requiring the franchisor to stop the practice. The order required, among other things, that the company take certain measures to ensure that its field representatives were not continuing to threaten franchisees in this manner.

F. South Africa

In April 2009, the President of South Africa signed the Consumer Protection Act, 2008, which will become generally effective in October 2010 and will provide sweeping protections for South African consumers. Importantly for franchisors, franchisees are defined as "consumers" who are entitled to the protections of the Act. The offer of a franchise to a prospective franchisee, the franchise agreement itself, and the supply of goods or services to a franchisee in respect of the franchise agreement are all deemed to be transactions between a supplier and a consumer and are within the purview of the Act. Franchise agreements will have to be in writing (not an issue for most franchisors), and the franchisee will be allowed to cancel the agreement, without cost or penalty, by giving the franchisor written notice within 10 business days after signing. While the Act generally prohibits tying or bundling arrangements (that is, requiring the consumer, as a condition of purchasing one product, to purchase other products), it provides an exception for franchisors where the tied goods or services are "reasonably related to the branded products or services that are the subject of the franchise agreement." The Act also appears to give the Minister the ability to develop requirements which would include certain mandated disclosures within the body of the franchise agreement itself. While that seems unlikely, franchisors will

clearly be required to provide certain pre-sale disclosures to prospective franchisees. It is expected that the government will develop regulations relating to the form and substance of these disclosures by April 2010.

G. United Kingdom

Although the UK has no franchise-specific legislation, the greater propensity of courts to give weight to technical bulletins issued by the British Franchise Association, even when considering the actions of franchisors who are not members of the BFA, makes these bulletins noteworthy. During 2009, the BFA issued bulletins which:

(1) accepted the use by franchisors of minimum performance standards, but provided that the "minimum" cannot be greater than 70% of the franchisor's reasonable expectation for its system and, further, that a franchisee's failure to satisfy the minimum performance standards cannot be grounds for immediate termination;

(2) required franchisors to disclose the existence of supplier rebates; and

(3) prohibited franchisors from imposing confidentiality obligations on their franchisees that would restrict the franchisees' ability to discuss with the BFA disputes with franchisors.

Conclusion:

While 2009 was an active year for the regulation of franchising outside the US, much of what happened in 2009 laid the foundation for things to come in 2010. We hope you had a successful international development program in 2009. If you have any questions about these or other 2009 developments, please don't hesitate to contact us. Meanwhile, we hope to report further developments as we learn of them.

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