

Provisions in CPA applicable to franchise agreements

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13 Oct 2014

The Consumer Protection Act, 68 of 2008, (CPA) has been in effect since it was signed into law on 24 April 2011 and accordingly has now been in operation for a period of three years.



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The CPA will apply to all franchise agreements as none of the threshold limitations contained in the CPA find application to franchise agreements. The rights of the franchisee in terms of any franchise agreement are included in the definition of 'services' and the franchisee included in the definition of 'consumer' in terms of section 1 of the CPA.

Because the definition of a 'Franchise Agreement' in the CPA has been so widely defined, it would be prudent to consult an appropriately qualified consumer law practitioner prior to concluding any licensing or distribution agreement to see if such agreement would fall within the aforesaid definition.

While a number of provisions of the CPA will generally find application to the franchise relationship, there are a number of provisions directed specifically at franchise agreements, which shall be canvassed below.

Right to cancel agreement

All franchise agreements must be in plain and understandable English, must be reduced to writing and must be signed by or on behalf of the franchisee. The principle right of the franchisee, to cancel the franchise agreement without cost or penalty within ten business days after signing the franchise agreement, by giving written notice thereof to the franchisor must, in accordance with the provisions of Regulation 2(2)(a), be set out on the top of every franchise agreement exactly as set out in section 7, and must specifically refer the franchisee to the proposed section.

The above right is a massive protection for the franchisee as the franchisor would ordinarily incur certain costs, which costs are not insignificant, on setting up a new franchisee, which costs are unrecoverable should the franchisee elect to

cancel the agreement, for any reason, during the first ten business days after signature thereof.

Because of the vast number of regulations contained in Regulation 2 that must be present in all franchise agreements, we shall endeavour to address those that are of specific importance, however, this should not be read to mean that the other regulations should be disregarded. It is always best to consult your legal practitioner regarding full compliance with this regulation.

There are three general clauses that must be present in all franchise agreements that prevent:

1. Unreasonable or over-valuation of fees, prices or other direct or indirect consideration.
2. Conduct which is unnecessary or unreasonable in relation to the risks to be incurred by one party.
3. Conduct that is not reasonably necessary for the protections of the legitimate business interests of the franchisor, franchisee or franchise system.

The franchise agreement must contain a specific clause that informs the franchisor that it is not entitled to any undisclosed benefit (whether direct or indirect) or compensation from suppliers to its franchisees or the franchise system, unless this is disclosed in writing with an explanation of how it will be applied.

Very importantly, any provision contained in the franchise agreement that conflicts with Regulation 2 is void to the extent of such conflict.

There are then certain clauses that must be included in all franchise agreement, which include inter alia:

1. All obligations of both franchisor and franchisee.
2. All direct and indirect consideration payable by the franchisee to the franchisor.
3. Any territorial rights granted to the franchisee.
4. The name and description of the types of goods or services which the franchisee is entitled to provide, produce or sell.
5. The conditions under which the franchisee or his/her/its estate may transfer or assign the rights and obligations under the franchise.
6. Particulars of the initial training and assistance provided by the franchisor together with any ongoing training that is provided for the duration of the franchise agreement together with a statement that the particulars of such training will be provided to the franchisee as and when necessary.
7. Duration and terms of renewal.
8. If there is a provision in the franchise agreement that the franchisee must contribute towards an advertising, marketing or similar fund, there must be clauses setting out:
 - the amount, or if expressed as a percentage, the method of calculation of such contribution;
 - that within six months of the conclusion of the financial year, the franchisor will provide a copy of the financial statement reflecting such funds receipts and expenses for such financial year;
 - that the funds may not be spent on advertising and marketing of the franchisor's franchises for sale;
 - that any amount deposited into the fund will be deposited in a separate bank account and used only for purposes of the fund;
 - a certificate from the auditor or the accountant as the case may be confirming that the accounts have been prepared and that they are correct;
 - any contribution made by the franchisor to the fund; and
 - a statement that the franchisor and any associated franchised businesses do not enjoy any benefit not afforded to independent franchisees.
9. Full details of the franchisors directors and officers.
10. Confirmation that all deposits from the franchisee will be paid into a separate account with a description of how the deposits will be dealt with.

11. A description of any trademarks and intellectual property owned by the franchisor or licensed to the franchisor which is, or will be used in the franchise, and the conditions under which they may be used.

12. Particulars of any restrictions imposed on the franchisee.

13. The full particulars of the financial obligations of the franchisee in terms of the franchise agreement including:

- the initial fee payable on signature;
- funds required to establish the business;
- initial working capital;
- total investment required;
- a clear statement setting out what costs are included in the purchase price;
- amount of funding available from the franchisor if any; and any minimum amounts that the franchisee must contribute towards the fund before being entitled to borrow from such fund;
- royalties (specifically detailing how they are calculated and paid); and
- other amounts payable.

Regulation 3 deals principally with the documents that a franchisor must provide to any prospective franchisee. Every potential franchisee has a right to receive a disclosure document from a franchisor at least 14 days prior to the signing of a franchise agreement, which at an absolute minimum must contain:

- the number of individual outlets franchised by the franchisor;
- growth of franchisor's turnover, net profit and the number of individual outlets franchised by the franchisor for the financial year immediately preceding the date on which the prospectus is given to the prospective franchisee;
- a statement confirming that there have been no significant or material changes in the franchisor's financial position since the date of the last auditor's certificate and that the franchisor has reasonable grounds to believe that it will be able to pay its debts as and when they fall due; and
- written projections in respect of levels of potential sales, income, gross or net profits or other financial projections for the franchised business or franchises of a similar nature with particulars of the assumptions upon which the representations are made.

The disclosure document contemplated above must be accompanied by a number of other documents which include:

1. A certificate from the franchisor's auditor/accounting officer certifying that:

- the business of the franchisor is a going concern;
- to the best of the auditor's knowledge, the franchisor is capable of meeting its financial obligations in the ordinary course of business as they fall due, and that the franchisor is able to meet its current and contingent liabilities;
- the franchisor's audited annual financial statements for the most recently expired financial year have been drawn up in accordance with all applicable laws, specifically the Companies Act 71 of 2008, in accordance with South African generally accepted accounting standards and on the basis of accounting policies consistent with prior years and that such financials fairly reflect the financial position, affairs, operations and results of the franchisor at that date and for the period to which they relate.

2. A list of current franchisees and outlets owned by the franchisor including various details about the franchisees and outlets.

3. An organogram depicting the support system in place for franchisees.

Because a franchisee is specifically defined as a 'consumer' in terms of section 1 of the CPA there are a number of provisions that will be applicable and will further regulate the relationship and agreement between the franchisor and the franchisee even though those sections may not specifically refer to a franchise or franchise agreement, some examples of which are set out below.

Section 13 of the CPA provides that the franchisor cannot dictate that all goods and services, or any for that matter, must

be purchased from or at the discretion of franchisor, unless such good or services are reasonably related to the branded products or services that are the subject of the franchise agreement.

Unsolicited goods

Franchisors must be wary of the provisions of section 21 in relation to the supply of unsolicited goods and services, specifically they must ensure that if an agreement exists with the franchisee for the delivery and sale of a certain type of goods at specific intervals, if the franchisor were to deliver different goods or services without amending the agreement, or an increased quantity of such goods then such goods or services could be construed as unsolicited goods or services, and therein risk non-payment for such goods.

Where goods must be bought either from the franchisor or alternatively as prescribed through the franchise system, the franchisor must be specifically cognisant of section 55 of the CPA dealing with the franchisee's right to receive safe and good quality goods which are free of defects and suitable for the purpose for which they were generally intended.

There are a vast number of provisions in the CPA that apply not only to the franchise agreement but the whole franchise relationship and thus it is highly recommended that both franchisors and franchisees contact a suitably qualified consumer law practitioner to discuss any existing or proposed franchise agreement, to ensure full compliance with the CPA.

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