

Effect of the Draft CPA Regulations on Franchise Agreements – Disclosure documents and Unreasonable Contracting Terms

Following on the article published in the February edition of the SA Franchise Warehouse magazine, it is prudent to discuss the contents of Regulations 3 and 56 of the Draft Regulations of the Consumer Protection Act (CPA).

These Regulations specifically deal with the Disclosure Document of a franchise agreement (Regulation 3) and a List of Contracting Terms which are presumed to be not Fair and Reasonable (Regulation 56). At the time of writing, the final Regulations had not been published and this article is therefore based on the latest version of the Draft Regulations. The final Regulations should be published and be in force before 1 April 2011, when the CPA comes into force.

Regulation 3 states that a franchisor must provide a franchisee with a Disclosure Document at least 14 days prior to signing the franchise agreement. The Disclosure Document must contain certain information and must be signed by an authorised officer of the franchisor.

The information which must be disclosed in the document includes key financial information relating to the turnover and net profit of the franchisor, the number of outlets/franchises, a description of the growth of the franchise system over the preceding 12 months and written projections relating to the potential sales, income, gross or net profit and other financial information. The document must also include a statement to the effect that any deposit paid by the franchisee will be paid into a separate bank account, and a statement certifying that there were no significant or material changes in the franchisor's financial position since the date of the officer or auditor's signature.

A formula for the calculation of the maximum selling price of the franchised business (should the franchisee wish to sell its business in future) and the factors and assumptions on which it is based must also be included. Each page of the Disclosure Document must be 'qualified in respect of the content thereof' and must carry a statement to the effect that the projections made in the document do not represent a guarantee or undertaking by the franchisor. The document must also include a certificate by 'a person eligible in law to be an accounting officer of a close corporation, or the auditor of a company, as the case may be' to the effect that the franchisor is solvent and capable of meeting all financial obligations. The financial information provided elsewhere in the document must also be confirmed in this certificate.

Further factors which must be included in the Disclosure Document are a full list of the current franchisees with contact details, an organogram depicting the support system and a copy of the most recent black economic empowerment certificate of the franchisor.

It is not anticipated that these minimum prescribed contents of the Disclosure Document will change significantly in the final version of the Regulations.

Regulation 56 includes a considerable list of terms which are deemed to be unreasonable or unfair if it is included in a consumer agreement. These include a number of clauses which appear in most standard franchise agreements, for example: a disclaimer in the event of death or disability, a clause determining that a consumer must take disputes exclusively to arbitration, shifting the burden of proof, any clause requiring the consumer to pay damages which 'significantly exceeds' the harm suffered, forcing the consumer to indemnify the supplier against liability incurred by it to third parties and a clause which provides that a law other than that of the Republic applies to a consumer agreement.

The Regulation also includes a list of agreements, mostly relating to financial arrangements, to which certain sub regulations do not apply.

During the last round of submissions a number of interested parties raised objections to the ambiguous nature of certain provisions and sub-regulations in Regulation 56. It is therefore anticipated that an amended version of this Regulation will appear in the final Regulations.

As a franchisor or a franchisee it is extremely important to note that, as the matter stands, Regulation 56 does not apply to franchise agreements. The Regulation, at sub-regulation (1) and (3), clearly refers to a so-called 'consumer agreement', which term is defined in the Act as 'an agreement between a supplier and a consumer other than a franchise agreement'.

The reason for this exclusion from the Regulation is not clear. Presumably the drafters felt that franchise agreements were sufficiently regulated by Regulation 2 and 3. Another possibility is that the drafters foresee a franchise industry code being implemented by FASA or a similar body in accordance with Section 82 of the Act.

It is not certain whether the wording will be changed to include franchise agreements in the final regulations. If it does change, most, if not all standard franchise agreements will need to be amended and a franchisor will find it more difficult to manage the franchise business and enforce its rights.

The full draft Regulations can be view at http://www.dti.gov.za/ccrd/cpa_regulations.htm

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