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Franchisors beware

By Lucinde Rhoodie

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It has now been two years since the Consumer Protection Act, No. 68 of 2008, ("the CPA") has come into force and still the impact thereof has not fully been appreciated by franchisors.

Leaving aside for the moment the substantive provisions of the CPA that protect franchisees against unfair contract terms and product liability, there are fundamental consequences of the CPA that are often overlooked.

Franchisors who entered into franchise agreements prior to the general effective date of the CPA, 1 April 2011, sighed with relief thinking that they have escaped the consequences of the CPA. Unfortunately, franchisors with franchise agreements subject to an option or right to renew, are mistaken. Regulation 2(4) promulgated in terms of the CPA provides that, "A franchise agreement which is renewed after the general effective date is a new franchise agreement for the purposes of sub-regulations (2) and (3)". Accordingly, as soon as a right or option to renew is exercised the pre-existing franchise agreement is subject to the provisions of the CPA.

So what does this mean?

One of the direct consequences is the applicability of regulation 2(2)(a), which provides that every franchise agreement must contain the exact text of section 7(2) of the CPA at the top of the first page of the franchise agreement, together with a reference to the section and the CPA. Section 7(2) provides that a franchisee may cancel a franchise agreement without cost or penalty within 10 business days after signing such agreement, by giving written notice to the franchisor.

So what is expected of franchisors in circumstances like this? It is expected that a new agreement (actual document) must be entered into reflecting the wording of section 7(2) on the front page or not?

In answering this question one must consider what the consequences are of not doing so. Regulation 2(e) provides that any term in a franchise agreement to which the regulations apply which is in conflict with the regulation is void to the extent of such conflict.

A failure to have the wording of section 7(2) appear on the front page could be regarded as fundamental non-compliance with the regulations causing the franchise agreement to be void, at least from the commencement of the renewal period.

The parties are often, if not mostly, unaware of this potential consequence and continues with their franchisor / franchisee relationship, albeit in terms of a void agreement.

When, for example, in such circumstance where the franchise agreement is, unbeknown to the parties, void there is a breach by the franchisee of a provision of the franchise agreement, the franchisor will not in law have a damages claim as a result of such breach, as there is no agreement in force.

Restraint of trade clauses

For instance, in today's commercial sphere, the majority of franchise agreements contain restraint of trade clauses. This is necessary to protect a franchisor's intellectual property.

If the franchise agreement is void - the franchisor will not be able to enforce any of the terms of the restraint of trade clause against the franchisee. This will leave the franchisor in a very vulnerable position.

So what is the answer? Unfortunately, to date the courts have not dealt with these regulations. Until such time as the courts deal with the meaning and effect of regulation 2(2)(a) and 2(4), it will be prudent for franchisors to insist that a new document, even if in the form of an addendum be signed upon renewal of a pre-existing franchise agreement displaying the required wording of section 7(2) as read with regulation 2(2)(a).

This will also afford the franchisor the opportunity to include in the addendum all the other terms which may be necessary to align the franchise agreement with the provisions of the CPA.

Franchisors therefore beware - the mere fact that your franchise agreement was entered into before the commencement of the CPA does not necessarily exempt you from complying with the provisions thereof.

ABOUT LUCINDE RHOODIE

Lucinde Rhoodie is a director in Cliffe Dekker Hofmeyr's Dispute Resolution practice. She is also a member of the Insolvency unit. She focuses mainly on High Court commercial litigation matters including insolvency and business rescue, Companies Act litigation, commercial and residential property disputes, sectional title disputes and general litigation (contracts).

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