Franchise agreements

Does the Consumer Protection Act 68 of 2008 point in the right direction?

When the Consumer Protection Act 68 of 2008 (CPA) was introduced in 2011 it was welcomed as an overdue step in the regulation of franchise agreements. The perception was that this legislation was going to stimulate the franchise agreement business model by levelling the playing field between franchisors and franchisees. However, almost two years later, the practical consequences of this Act are beginning to provide frustrating results for those wishing to enter into such agreements.

The primary reason for this frustration appears to be the overbearing nature of the legislation and the regulations thereunder on the parties wishing to enter into agreements on their own terms. With particular reference to the disclosure schedule requirement, the purpose of this article is to show that not only are these regulations impractical, but there also seems to be little theoretical justification for their inclusion under the CPA.
Theoretical background

Under the common law there used to be a perception that franchisors dictated terms to agreements they entered into and that the franchisee had a choice of either agreeing to those terms or looking for opportunities elsewhere. This perceived lack of bargaining power seemed to mark franchise agreements as ideal candidates to be included under the CPA. Issues that arose in the consumer context before the introduction of the CPA were extensive, but primarily involved:

- the issue of bargaining power disparity between suppliers and consumers;
- the need to provide protection for consumers in everyday contracts that they enter into in good faith; and
- the public’s lack of understanding of legal and the terms and conditions that were written in such language, combined with the fact that legal services in South Africa were prohibitively expensive.

Clearly, in the context of consumers, it was imperative to introduce legislation that could prevent suppliers from taking advantage of these situations. However, it seems as though the legislature equated the perceived lack of bargaining power of franchisees with the consumers’ inherently vulnerable position and included them under this protection. Not only this, but the protection of franchisees is in certain respects even more extensive.

If this was the reasoning behind the legislature’s stance, it would appear flawed for a number of reasons. Although the protection of the franchisee was a necessary and beneficial step, the ‘one-size-fits-all’ approach that the legislature adopted has provided certain difficulties.

First, in everyday contracts a consumer does not have access to legal representation nor should they have to. Secondly, consumer contracts are generally not strategic business decisions and the economic cost of spending hours ensuring that the terms and conditions of the contract are not unfairly prejudicial, generally outweighs any benefit that might occur in doing so. More simply put, in a consumer context most contracts are reliant on a certain amount of good faith to remain economically efficient. The CPA therefore performs an important economic function in allowing consumers to enter into transactions freely on a bona fide basis knowing that they are protected from opportunistic suppliers.

The legislature has, however, correctly identified a number of situations where consumers should not be protected. They have undertaken this in two significant ways: First by excluding private sales between consumers and, secondly, by restricting the CPA’s ambit to consumer contracts.

Practical issues

Understandably, issues with the theoretical justification of franchise agreements’ inclusion in the CPA have translated into practical difficulties. One such example is the disclosure schedule that franchisors are compelled to produce. Regulation 3 provides a detailed list of information that a franchisor must provide in order to be compliant with the CPA.

Importantly, it must be noted that these disclosures are not merely a default position or guideline but are compulsory as reg 3(1) clearly states:

‘Every franchisor must provide a prospective franchisee with a disclosure document ….’

There are two primary issues with the legislature forcing franchisors to provide detailed disclosures. The first is the economic cost of compliance and the second is that franchisors are in practice not always able to supply the information required. Both of these concerns provide very real hurdles for parties to overcome in order to enter into franchise agreements that are compliant with the CPA.

The disclosure document requirement does not result in the levelling of the relative bargaining power between the parties, but rather makes entering into franchise agreements more expensive for all parties concerned. The financial cost, combined with the time delay and the opportunity cost associated providing such information, will inevitably be spread between the parties or, if the legislature is correct in its assumption of unequal bargaining power, be transferred to the franchisee.

This is not to say that there is no benefit derived from this additional expenditure. The fact that franchisors have to provide this disclosure schedule means that all parties have more information available to them before entering into the agreement. The availability of more information decreases the unknown variables and thus decreases the risk associated with entering into the agreement. However, a strong argument can be made that, if there is no great discrepancy in bargaining power, parties should be able to regulate the allocation of risk as they please.

Apart from increasing the economic cost of the transaction, the second major problem arising from the compulsory disclosure schedule is the fact that franchisees are not always in a position to provide this information. This is especially true for foreign franchisors who have struggled to meet reg 3(1)(d), which states there must be ‘written projections in respect of levels of potential sales, income, gross or net profits or other finan-
cial projections for the franchised business or franchises of a similar nature with particulars of the assumptions upon which these representations are made.

One can immediately see how this would be problematic for a foreign franchisor wishing to expand into the South African market. They may have an understanding of the prevailing market conditions and the track record of a franchise’s performance in other countries, but it would take a significant amount of guesswork to be able to predict the potential sales, income or profits that the franchise could expect. However, to warrant as much would be excessively arduous. It is clear that in this situation it is not possible for the regulations to be complied with.

The current position and alternatives
These two issues currently pose a number of difficulties for parties wishing to enter into franchise agreements and there is uncertainty as to the options available to franchisees and franchisors to overcome them. Simply put, are these requirements compulsory or, alternatively, can they be waived?

On the reading of reg 3 with s 51 of the CPA it would seem that it is not possible to waive these requirements. Regulation 3 clearly states that the disclosure schedule must provide certain disclosures, while s 51 prohibits suppliers from contracting out of their obligations and the rights of the consumer created under the CPA.

Provided the legislature is correct in its assumption of the existence of unequal bargaining power between franchisors and franchisees, this position is congruent with the underlying theoretical justification of including franchise agreements in the CPA. If franchisees were able to waive their rights to certain required information, the reason for the inclusion of franchise agreements under the CPA would be defeated, because the franchisors would merely use their superior bar-

ning power to force franchisees to waive their rights to any information that they did not want to supply. Thus, it seems as though it must be accepted that these disclosures may not be waived.

This accentuates the difficulties faced by foreign franchisors. These franchisors are unable to supply the requisite information due to no fault of their own, but at the same time they are unable to get the potential franchisee to waive its rights to the undisclosed information. The position in our law currently seems to be that foreign franchisors have to either provide forecasts or predictions reliant on nonexistent or unreliable information, or choose not to enter the South African market. This is hardly a wise position for a country attempting to promote the franchise business model and encourage foreign investment.

Conclusion
Theoretically franchise arrangements differ in fundamental ways to the types of transactions that the CPA envisages in a consumer context and it is these divergences that give rise to a number of difficulties when parties attempt to enter into franchise agreements in compliance with the CPA. The inclusion of franchise agreements in the CPA is a well-intentioned attempt by the legislature to promote the franchise business model in a manner that introduces fairness and equity between the parties. However, the effect of this inclusion has created a commercial reality of impracticalities and uncertainty. In conclusion, the intention of this article is to expose certain areas of regulation under the CPA that have provided practical difficulties and to highlight the need to re-evaluate the merits of certain regulations from a more practical and commercially efficient manner.

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