



Franchise Law Alert™

Recent developments in franchise law

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New franchise legislation in South Africa

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South Africa's Consumer Protection Bill changes the legal landscape for franchising in South Africa.

Although still in draft form, the Franchise Association of South Africa (FASA) expects South Africa's Consumer Protection Bill to be signed into law within the next few months. The bill codifies many franchise practices that have been advocated by FASA since the early 1990s and expands on existing provisions of South Africa's Competition Act, 1998.

Consumer Bill of Rights

Under the bill, franchisees are explicitly included as "consumers." They are also given a number of consumer rights, including the right to equality, privacy, choice, information, disclosure, fair and responsible marketing, honest dealing, fair agreements, fair value, good quality, safety, and supplier accountability. In addition, franchisees are protected against undue influence or pressure; unfair tactics; and false, misleading, or deceptive representations concerning material facts.

Franchise agreements

A new definition of a franchise agreement includes an agreement where a franchisor grants to a franchisee for consideration a right to carry on business under a system or marketing plan substantially determined or controlled by the franchisor. In addition, the franchisee's business is substantially or materially associated with advertising schemes or programs or with the trademarks of the franchisor, or any combination of these that are licensed to the franchisees.

A franchisee may cancel a franchise agreement without cost within 10 business days after signing the franchise agreement by giving notice to the franchisor.

Right to disclosures

Providing franchisees with the right to disclosure was a driving force behind the inclusion of franchisees in the bill because South Africa's Department of Trade and Industry ("DTI") found that many franchisees had been devastated financially after investing their life savings into a franchise that was sold to them on the premise that it would be far more profitable than it ever

actually would be. Under the bill, franchisors will be required to disclose certain information to prospective franchisees, as provided in regulations to be promulgated by DTI.

Tying of products

Currently, franchisees in South Africa have limited protection against unfair practices by franchisors under that country's Competition Act, particularly in relation to the tying or bundling of unrelated products by a dominant franchisor or when it comes to exclusive dealing. Exclusive dealing occurs when a dominant firm requires or induces a supplier or customer not to deal with a competitor. Complaints stemming from these activities are, however, difficult to prove and the franchisor in question has to be dominant or have market share.

The bill has taken the foregoing prohibitions in South Africa's Competition Act and applied them regardless of whether the franchisor is dominant. The new law prohibits bundling or tying of products by a franchisor, unless the franchisor can show either (i) that the bundling results in economic benefits for consumers or (ii) that the convenience of bundling outweighs any restriction on consumer choice. Alternatively, the bundled goods or services must be offered separately and at individual prices.

The bill guards the right to consumer choice by generally providing that franchisors must not require, as a supply condition or as a condition of entering into an agreement, that the franchisee purchase goods or services from the franchisor or from any other designated supplier. It is a valid defense to show that products or services that the franchisee was required to purchase are reasonably related to the branded products or services that are the subject of the franchise agreement. It remains to be seen how closely linked to the brand 'reasonably related' will need to be to excuse such a requirement by a franchisor. As a result, many franchisors will no longer be able to be the sole supplier of goods and services to a franchisee, unless it can be shown that the products and services are "reasonably related" to the brand.

Franchisors should take care to ensure that products and services essential to the protection of their brand are explicitly listed in their franchise agreements to reduce any later issues regarding interpretation. In other words, the bill suggests that franchise agreements provide for core and non-core products. Core products or services would be the primary, unique products related to the brand.

Conclusion

Franchising in South Africa has gained increasing popularity in recent years and has emerged as one of the key vehicles through which companies choose to expand their operations. Given the changes proposed in the Consumer Protection Bill, franchisors will need to audit their franchise agreements and practices to ensure that they are compliant. The bill will become effective 18 months after signature by South Africa's state president.

We welcome your questions and comments. If you need assistance on any matter, please call or e-mail Kendal H. Tyre (ktyre@nixonpeabody.com or 202-585-8368) or Andrew P. Loewinger (aloewinger@nixonpeabody.com or 202-585-8855).