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This note summarises the law and FASA's practice in this regard, for the guidance of franchisors and franchisees.

Section 5(6), read with section 5(7) of the Consumer Protection Act (CPA), provides that the CPA applies to a franchise agreement, and also to:

- a solicitation of office to enter into a franchise agreement;
- an offer by a potential franchisor to enter into a franchise agreement with a potential franchisee; and
- an agreement supplementary to a franchise agreement,

all of which are deemed by the Act to be transactions between a supplier and consumer within the meaning of the CPA.

Where no franchise agreements has been signed

FASA's Code of Ethics provides for deposits paid in anticipation of the conclusion of a franchise agreement in the following terms:

"Where a Franchisor Member receives any monies from any prospective franchisee in contemplation of the conclusion of a Franchise Agreement...and, whether at the instance of the Franchisor Member or the prospective Franchisee, negotiations in connection with such contemplated agreement are terminated without an agreement being concluded:

- The Franchisor Member shall refund the amount it has received forthwith, and not later than 30 (thirty) days after having received a written request from the prospective Franchisee; and
- The Franchisor may not retain any part of the amount it has received, save to cover reasonable out-of-pocket expenses that it has incurred in contemplation of the conclusion of a franchise agreement..."

The CPA contains various provisions relating to payment of deposits.

None of these expressly prohibits a franchisor from retaining a deposit paid in anticipation of entering into a franchise agreement. However:

- Section 65(2) prohibits the franchisor from merging a deposit with his own funds and obliges him to treat it as a separate fund that is not his;
- A provision that entitles the franchisor to retain a deposit would be prohibited in terms of section 51(1), except to the extent that the CPA permits it.
- Section 48(1) prohibits a supplier (including a franchisor) must not offer or enter into an agreement to supply any goods or services on terms that are "unfair, unreasonable or unjust", and may not require a consumer (including a franchisee) to waive any right, assume any obligation, or waive any liability of the supplier, on terms that are unfair, unreasonable or unjust. Section 48(2) of the CPA provides that, a transaction or term of a transaction is unfair, unreasonable or unjust if it is excessively one-sided in favour of any person other than the consumer or so adverse to the consumer as to be inequitable. According to the regulations in terms of the CPA, a term in a "consumer agreement" (which includes a franchise agreement) is presumed to be unfair (and is therefore prohibited in terms of sections 48(1) and 48(2)) if it allows the supplier/franchisor to retain a payment by the consumer/franchisee where the consumer/franchisee fails to conclude or perform the agreement, without giving the consumer/franchisee the right to be compensated in the same amount if the supplier/franchisor fails to conclude or perform the agreement.

Having regard to all of these provisions, a term in an agreement that a deposit paid by a prospective franchisee is non-refundable, would seem to fall within the purview of this regulation. It is, therefore, presumed to be unfair and, in terms of section 48(2), may not be included in a consumer agreement, unless it is at least related to some services rendered by the franchisor and represents a fair charge for the services concerned. Details of the services and the way in which the charge is calculated, should be clearly stipulated, to minimise the likelihood of disputes in this regard.

Where a franchise agreements has been signed

The CPA requires that a franchise agreement must be in writing and signed by or on behalf of the franchisee and must include any "prescribed information". In regard to deposits the regulations stipulate that a franchise agreement must contain. :

- "confirmation that any deposits paid by the prospective franchisee will be deposited into a separate bank account and a description of how these deposits will be dealt with".
- full particulars of any initial fee payable to the franchisor on the signing of the franchise agreement, and the purpose for which it is to be applied.

Section 7(2) of the CPA provides that the franchisee may cancel the agreement "without cost or penalty" at any time within a period of 10 (ten) business days after signature of the agreement (the so-called "cooling off period"). A clause in a franchise agreement that provides, without qualification, that the whole of a deposit or initial fee will be non refundable will be unenforceable as it would amount to a cost or penalty levied on the franchisee, unless the clause limits the franchisor to withholding so much of the deposit as equates to the value of any services that the franchisor may have rendered, or costs he reasonably incurred, in connection with the agreement and in anticipation of a long-term relationship. These services and costs might include advice on site selection, negotiations with suppliers and credit providers, etc.

In terms of section 64(1) of the CPA, if a consumer agrees or is required, in terms of any agreement, to pay any amount in respect of services to be provided at a date more than 25 business days after the payment is made, the amount paid remains the property of the consumer until the supplier makes a charge against it. By definition, a deposit or initial fee paid in terms of a franchise agreement, at the time of signature, will relate to services to be rendered after the date of signature of the agreement. If any of those services are to be rendered more than 25 (twenty five) days after the signature date, section 64(1) will prohibit the franchisor from levying any charge against the deposit until the service are in fact rendered.

Cancellation after the cooling off period

A franchise agreement may be cancelled is after the ten day cooling off period has expired, if:

- the agreement itself is invalid, or
- where one of the parties has been induced to enter into it by a misrepresentation by the other, or
- where one of the parties has committed a material breach of the agreement.

If a franchise agreement contravenes, or does not comply with, the requirements of the CPA or the regulations, including the stipulations of the regulations in respect of deposits and initial payments, the agreement will be invalid, either in total or to the extent of the contravention. In addition, the provisions of sections 48(1), 51(1) and 65(2), dealt with above, will apply in the

same way as where no agreement is concluded, or where the agreement is cancelled during the cooling off period. In other words, a franchise agreement may not provide, without qualification, for payment of a non-refundable deposit.

Practical solutions

FASA appreciates that neither party wants to be committed to a franchise relationship before doing its homework, and assessing the viability of the prospective business. The franchisor is entitled to require a deposit in anticipation of these expenses, both in connection with the initial investigations and in assisting the franchisee in setting up his business. On the other hand, the franchisee should not be expected to forfeit a large sum of money in anticipation of services he may never receive.

FASA recommends, in order for both parties protect themselves against these risks, that:

- the contractual documents (both the franchise agreement and any preliminary ancillary agreements) are drafted so as clearly to set out the intentions and expectations of both parties. Importantly, the agreements should set out clearly for what purposes any deposits or initial fees are to be used.
- Ideally, the agreement should be signed, and the "cooling off period" should be allowed to expire, before the franchisor incurs any expenses for which he expects to be reimbursed.
- Where this is not practically possible the agreement should be made conditional upon the completion of the preliminary research and formalities and the obtaining of necessary finance, or a "pre franchise agreement" can be concluded. The franchise or pre-franchise agreement should stipulate:
 - That a deposit will be paid and the amount to be paid;
 - The processes that will be undertaken by the franchisor and the matters in regard to which the franchisor will have to satisfy itself before the franchise agreement becomes unconditional, or before a franchise agreement is signed;
 - The costs that the franchisor will incur in this process, or at least how they will be calculated; and
 - An acknowledgement by the franchisee that, if the agreement is not concluded or if it is cancelled by the franchisee during the cooling off period, the agreed amount of the expenses incurred by the franchisor will be deducted from the deposit when it is refunded.

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