

IBA/IFA 27TH ANNUAL JOINT CONFERENCE

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NEW APPROACHES AND CHALLENGES IN INTERNATIONAL FRANCHISING

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NEWS FROM AROUND THE WORLD:

AUSTRALIAN DEVELOPMENTS

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1. Introduction

This paper considers three main topics:

1. An update on the status of the Australian Franchising Code of Conduct (the *Code*) and the recent amendments to it.
2. An overview of the recent State reviews of franchising legislation and state proposed legislation.
3. A discussion of other relevant legislation, trends and cases in Australia.

2. Recent amendments to the Code

In July 2010, the Code was amended following a report from an Expert Panel into unconscionable conduct and the franchising industry.¹

The amendments were largely welcomed by the franchise industry, many of whom had been concerned that calls by franchisee lobbyists for an obligation of '*good faith*' to be imposed on franchisors would be accepted.

- No obligation of good faith was imposed, largely due to concerns that the Australian case law on good faith is still evolving and a definition of the term may create unintended consequences.
- The inclusion of a good faith clause in franchising laws has been one of the most hotly-debated topics in franchising for the past five years and has been promoted by franchisee advocates as a way of preventing end-of-term disputes where a franchisor decides not to renew the agreement.
- However, the Franchising Council of Australia has stated publicly that it considers good faith already implied in the CCA and so an express addition into the Code is not required.

The following are the substantive amendments were made to the Code in July 2010:

Pre-expiry notice (clause 20A) – a new pre-expiry notice is now to be provided by the franchisor to the franchisee to advise the franchisor's decision in relation to any renewal of the agreement or offer of a new agreement.

Dispute Resolution behaviour (clause 29(8)) – guidance is provided as to the conduct expected of parties in a franchise agreement engaging in the dispute resolutions processes under the Code (e.g., attending and participating at meetings at reasonable times).

Attribution of costs of dispute resolution (clause 31(4)) – Clause 31(2) of the Code had required the parties to be equally liable for costs of mediation, unless they agree to the contrary. The July 2010 amendments clarified the meaning of “costs of mediation” so as to include items such as room hire.

¹ Strengthening Unconscionable Conduct and the Franchising Code of Conduct

Novations (Clause 20) - the Code was clarified to make clear that novations are also regulated by the provisions governing the franchisee-initiated assignment and transfers of the franchise agreement (in relation to the franchisor withholding of consent, etc.).

Changes in scope of the franchise agreement (Clauses 8, 10 and 13) – It is now clearly a breach of the Code if the franchisor extends the scope of the franchise agreement (such as extensions to term, territory or trade marks to be licensed by the franchisee) without the mandatory prior disclosure to the franchisee.

The following disclosure document requirements were added to the template disclosure document (Annexure 1) – which largely implement recommendations for more information to be included.

Unforeseen significant capital expenditure (section 13A):

- The franchisor is obliged to disclose whether, through the franchise agreement, the operations manual or any other means, the franchisee will be required to undertake *'unforeseen significant capital expenditure that was not disclosed by the franchisor before the franchisee entered into the franchise agreement'*.
- The term 'significant capital expenditure' is not yet interpreted by the Courts but the Explanatory Statement accompanying the release of the amended Code noted its Expert Panel report referred to *'shop re-fits, new capital equipment and refurbishment'* and that *industry input had also referred to 'IT infrastructure'*.

Unilateral variation (section 17A) - The franchisor must disclose the circumstances where it unilaterally varied a franchise agreement in the last three financial years.

Attribution of legal costs (section 13B.1) – franchisors must state whether their legal costs incurred in dispute resolution will be required to be paid by the franchisee.

Confidentiality obligations (section 17B) – franchisors must disclose the confidentiality obligations imposed on franchisees.

End of term arrangements (section 17C) – franchisors will be required to disclose information on whether franchisees are entitled to an exit payment (for example, for goodwill) and the arrangements applying at the end of the term of the franchise (such as purchase of remaining stock, first rights of refusal to buy the business or significant capital expenditure). Franchisors must also provide information on whether any significant capital expenditure undertaken by the franchisee during the term of the agreement will be considered in determining the franchisor's end of term arrangements.

Amendment of the franchise agreement when transferring (section 17D) – the franchisor must disclose whether the franchisor will amend the franchisor agreement on any franchisee initiated transfer of novation of the agreement.

Fortunately, the Minister responsible in the Federal Government for overseeing the Code, Senator Sherry, has publicly stated that further changes to the Code in the near future are unlikely and that it is the government's intention to bed down the July 2010 changes.

Senator Sherry has also stated that the Federal government does not intend to further review the Code before 2013.

3. Status of proposed legislation and/or reviews at State level

Other developments are progressing at a state government level in Australia related to franchising legislation. These have the potential to undermine the present uniformity of Australia's single national law regulating the franchise industry as the proposed state based laws are not uniform or consistent with the Code.

3.1 South Australia

In December 2009, a member of the South Australian parliament² introduced his private member's bill³ (the *SA Bill*). The significant aspects of the SA Bill are the following.

- Mandate the Federal Franchising Code of Conduct as a South Australian mandated law.
- Additional regulations such as the requirement to act in good faith.
- Establish a Commissioner of Franchising.
- Mandate compulsory inspection of documents.
- Introduced fines and penalties (up to \$AUD100,000) for franchisors who fail to comply with the state franchise laws.

The SA Bill was motivated by a perceived failure of the Federal government to mandate into the Code an obligation of good faith. The SA Bill subsequently lapsed before the South Australia state election in 2010 but the returned South Australian government announced it would be progressing its own legislation to "protect" franchisees.

A steering committee⁴ has been formed to draft the laws to create a Small Business Commissioner and regulate franchising. New draft legislation is not yet released and the committee conducting the inquiry has recently had a number of new appointees following a state government cabinet reshuffle. It is unknown if this will affect the inquiry's timeframe for its final report as no more public announcements have been made about the progress of the inquiry or the timetable set for its completion.

The post-election developments indicate a broader approach (such as introducing a Small Business Commissioner rather than a Franchising Commissioner). Whilst the government is unlikely to replicate entirely the SA Bill, it has promised a laws against unconscionable conduct and unfair contract terms and a requirement for good faith and fair dealing for parties in franchise negotiations.

² Tony Piccolo.

³ Formally the Franchising (South Australia) Bill 2009 (SA).

⁴ The South Australia Economic and Finance Committee.

In early April 2011, the South Australian state government released a draft bill for the creation of a Small Business Commissioner, who will have some oversight for franchising issues.

3.2 *Western Australia*

In October 2010, a Western Australian Member of Parliament, Peter Abetz, introduced the *Franchising Bill 2010* (WA) (*WA Bill*) which is designed to strengthen regulation of the franchising industry in that state.

The WA Bill is now referred to a parliamentary committee for review⁵ and submissions were due in January 2011. The terms of reference for the WA Bill inquiry include considering consistency with the Code and the cost impact of the WA Bill. Hearings were conducted in Perth in early April 2011 and prominent Western Australian KFC franchisee and Hungry Jack's parent company Competitive Foods and the Franchise Council of Australia have appeared. The inquiry's final report is due no later than **26 May 2011**.

The WA Bill goes further than legislation previously proposed by the SA Bill by including the following:

- The requirement to renew agreements – by a provision to enforce the renewal of franchise agreements at the end of a term even if the franchisor would not otherwise offer a renewal.
- A six year statute of limitations for any claims in breach of the proposed WA laws.
- A defined good faith clause.
- A provision for third parties to franchise agreements to seek damages against a franchisor.
- Third parties to be exposed to civil penalties if they have *'been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by another person'* under the WA Bill. Penalties include fines of up to \$AUD10,000 for individuals or up to \$AUD100,000 for a company.
- A statutory cause of action to any person who retrospectively suffers harm as a result of a contravention of the WA Bill, which may have the potential to increase personal injury claims.

The Western Australian opposition announced its support for the WA Bill and has previously challenged the state government to waive its normal three week period before debating the WA Bill so it could be introduced quickly.

The WA Bill has divided the industry. Of the 114 submissions made to the Western Australia inquiry, 99 opposed the WA Bill.

⁵ The Western Australia Economics and Industry Committee.

- It has the support of the Retail Traders' Association, which believes the WA Bill will protect franchisees from being unfairly treated by franchisors.
- The Franchise Council of Australia is against it.
- Some franchisors have announced they will relocate out of WA if the state introduces the proposed legislation, on the basis that they would be disadvantaged in their home market against competitors based on the east coast.

The Federal government's response described the WA Bill as 'radical'. The Federal government's stance to date is to oppose all proposed state based franchising legislation.

3.3 *Queensland*

In December 2010, a Queensland opposition member of Parliament, David Gibson, flagged his intention to also introduce a private members bill dealing with franchise disputes, making Queensland the third state to debate such a law.

His announcement stated that his proposed laws would include penalties of up to \$AUD 100,000 for breaches, a statutory definition of good faith, and would provide for the Queensland Civil and Administrative Tribunal to provide low cost, timely dispute resolution services.

The Queensland proposal has been welcomed by some on the basis that a more cost-effective and accessible dispute resolution forum would be desirable.

New draft legislation is not yet released.

3.4 *New South Wales*

While in opposition, the Liberal Party of New South Wales indicated that it would, if elected, consider similar state based laws as South Australia for New South Wales.

The Liberal Party was elected on 26 March 2011, but at the date of writing this paper, no further announcements in regard to franchising have been made.

3.5 *Federal government opposition to state based legislation*

Federal Small Business Minister, Senator Sherry, has stated the Federal government is opposed to state-based franchise legislation on the basis that recent changes to the Code need time to be evaluated and franchising requires a uniform, national system.

Senator Sherry's statements have also pointed out that new regulations that apply to some states but that will affect businesses operating across state borders are not helpful.

4. Other relevant legislation, trends and cases

4.1 *Competition and Consumer Act 2010 (Cth)*

In 2010, there were a number of changes to the *Trade Practices Act 1974* (Cth) as the new Australian Consumer Law (**ACL**) reforms were progressively implemented. The final tranche came into force on 1 January 2011. The ACL reforms will require businesses to review the way they interact with consumers. Key changes include the following:

- The *Trade Practices Act 1974* (Cth) was renamed the *Competition and Consumer Act 2010* (Cth) (**CCA**).
- There is a new system of statutory consumer guarantees.
- There are new prohibitions on false and misleading representations in relation to testimonials and consumer guarantees.
- There is a new regime prohibiting unfair contract terms in standard form consumer contracts.
- There is a new single national product safety regime;
- Additional investigative and enforcement powers have been given to the regulator, the Australian Competition and Consumer Commission (**ACCC**).

The ACL is intended to provide uniform national consumer law provisions. Existing prohibitions against misleading conduct, unconscionable conduct and false and misleading representations have been relocated to the ACL but are largely unchanged in substance.

4.2 *Recent cases of note related to franchising in Australia*

Two recent cases in 2010 illustrate the difficulty for trade mark licensors and parties to distribution agreements in Australia to avoid getting caught by the Franchising Code of Conduct legislation.

(i) *Alpha Centauri case – payments*

The New South Wales Court of Appeal case, *Alpha Centauri Enterprises Pty Ltd v Mortgage House of Australia Pty Ltd* [2010], NSWCA 188, recently considered the “payment for goods and services” exception under the Code clause s4(1)(d)(v) in a case involving litigation about a mortgage broking agreement.

The Court decided that if *no limit* was placed on the franchisor's price for any particular good or service under the agreement in the franchise agreement, then the provision for payment for those goods could not fall within the Code exceptions exempting agreements which only involve payment for goods and services “*at the usual wholesale price*”.

Consequently, parties who rely on this exemption to avoid the Code regulating their distribution agreement or trade mark licence have been, since the case, required to carefully consider expressly stating a wholesale price limit on their prices for goods or services supplied under the agreement.

The Court in the *Alpha Centauri* case also decided that any provision in an agreement which obliged a payment only in certain circumstances may also fall within the meaning of a

“*payment for goods and services*” even if the circumstances which trigger the payment obligation never arise. The situation in *Alpha Centauri* was the licensee's obligation to pay the licensor a fee on a transfer or assignment of the licence. That was held to be a payment obligation which did not fall within any of the payment criteria exemptions in the Code. As a result, the trade mark licence was held to be a franchise agreement.

(ii) Rafferty case – 'system or marketing plan'

A Federal Court case, *Rafferty v Time 2000 West Pty Ltd* (No 4), 2010 FCA 725, is another which recently considered the Code 'franchise agreement' criteria for “system or marketing plan substantially determined, controlled or suggested by franchisor or associate of franchisor” (Code clause 4(1)(b)).

The Rafferty case involved a joint venture arrangement where the parties did not describe themselves as parties to a franchise agreement.

The case endorsed Tracey J's earlier “non-exhaustive” list of 16 “helpful indicators” of a system or marketing plan which were given in the 2007 decision, *ACCC v Kyloe Pty Ltd* [2007] ATPR 42-194. Those indicators of a “system or marketing plan” were the following:

- detailed compensation and bonus structures for selling products;
- centralised book & record keeping computer operations;
- schemes for appointment of distributors;
- assistance with 'opportunity' meetings;
- comprehensive advertising and promotional programs;
- rights to screen/approve promotional materials;
- prohibitions on repackaging of products;
- suggestions for retail prices for products;
- marketing areas;
- sales quotas;
- rights to approve sales personnel employed by sub-distributor;
- mandatory sales training regimes;
- supplying quotation sheets, other sales forms to sub-distributors;
- supplying prescribed invoices;
- obligations on sub-distributor to gather information from customers for head distributor; and
- restrictions on sub-distributor selling products without consulting head distributor.

However, Rafferty extended *Kyloe* further by deciding that a mere power by the trade mark licensor to impose a system or marketing plan will suffice. The Court also stated that not all of the *Kyloe* factors need be present and some may be entitled to more weight than others. The Court did not elaborate further on the weighting assessment.

Many trade mark licences and distribution agreements contain some of these type of marketing provisions. The case serves as a reminder to trade mark licensors and distributors that the Australian courts will look closely at any trade mark licence, distribution agreement or other agreement to determine whether that agreement may be a 'franchise agreement' within the meaning of the Code. The lesson for trade mark licensors and distributors is to consider carefully the application of the Code to any agreement, to avoid inadvertently breaching the Code.

5. Wrap Up

In conclusion:

1. There are interesting developments in Australia – both at the legislative level and evolving from case law – which affect the franchising industry.
2. Although the Code is unlikely to be amended before 2013, the state based developments will need to be closely monitored. Australia is at risk of undermining its national uniform approach to regulation of the franchising industry.
3. Another development to have in mind is the continued evolution of Australia's laws regulating dealings with consumers.
4. Finally, it is prudent, given recent case law, for companies intending to distribute products in Australia pursuant to a distribution agreement, trade mark licence or franchise agreement, to consider the application of the Code to the proposed agreements.