



Maddocks

The Franchisor Handbook



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Foreword

We are delighted to publish this first edition of The Franchisor Handbook. The Franchisor Handbook is intended to be a straightforward and informative guide to assist franchisors who have franchised businesses in Australia, or who are considering establishing franchised businesses in Australia. The handbook provides an overview of the core laws applicable to franchising in Australia.

The Franchisor Handbook has been designed to assist franchisors to navigate compliance with Australian franchise law. The Franchisor Handbook builds on the considerable experience and expertise of the Maddocks Consumer Markets & Franchising team. It is drafted in plain language, with useful checklists and practical examples. We have produced The Franchisor Handbook to support our franchisor clients in taking a best practice approach to franchising.

We hope that you will find The Franchisor Handbook to be a valuable resource.

If you or team members have any questions, please contact a member of our Maddocks Consumer Markets & Franchising team. More information about our team can be found at the end of this publication.



Chapter one Franchising in Australia - a snapshot

Franchising is a way of doing business. It is an innovative method of distributing goods and services which brings together a network of businesses operating under a unified brand and following a business format aimed at achieving consistency in the delivery of their goods and services.

Franchising – a way of doing business

The franchise model can be used by established businesses looking to expand and develop their existing business operations, and also by entrepreneurs looking to establish new business ventures.

Franchising can capture a number of different business models. These include:

- **Manufacturer-Retailer:** The retailer, as franchisee, sells the franchisor's product directly to the public.
- **Manufacturer-Wholesaler:** The franchisee, under license, manufactures and distributes the franchisor's product.
- **Wholesaler-Retailer:** The retailer, as franchisee, purchases products for retail sale from a franchisor wholesaler.
- **Retailer-Retailer:** The franchisor markets a service, or a product, under a common name and standardised system, through a network of franchisees. This is the classic business format franchise.

For several years, Australia has held one of the highest levels of franchisors per capita in the world. The franchise sector in Australia performs well and demonstrates continued growth. In recent years, the franchise sector has seen a number of franchise network mergers and consolidations which has driven sustainability and growth in the sector.

Franchising Australia 2016 survey

The Franchising Australia 2016 survey, undertaken by Griffith University's Asia-Pacific Centre for Franchising Excellence and supported by the Franchise Council of Australia, was the 10th installment of this definitive benchmark study of Australian franchising. The survey dates back to 1998 and has been updated every few years since.

4% of small businesses
are franchised
businesses

90% of franchise
systems originated
in Australia

\$146 Billion in total
annual sales
revenues

1,120 franchised brands

472,000 permanent, part-time and
casual employees employed
in the sector

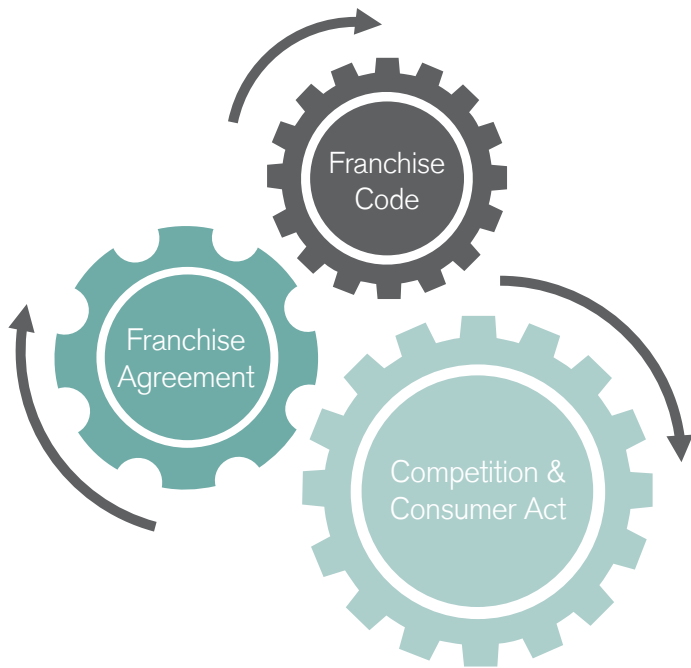
79,000 franchised units

26% of franchisor
brands are in retail
(non-food)

19% of franchisor brands are
in accommodation and
food services

15% of franchisor brands are
in administration and
support services

10% of franchisor brands are in other
services such as personal services,
automotive repairs and IT



The franchise agreement

The corner-stone of any franchise relationship is the contract – the franchise agreement – between the franchisor and the franchisee. The principles of contract law apply to the formation, interpretation and enforcement of the franchise agreement and its terms.

All franchise arrangements should be recorded in a written contract. However, there is no legal requirement that a franchise agreement must be in writing for there to be an enforceable contract between the franchisor and the franchisee. We cover the franchise agreement in [chapter two](#).

Franchise laws

Australia has long-established federal franchise laws and regulations.

The *Competition and Consumer (Industry Codes – Franchising) Regulations 2014* (Cth) (the **Franchise Code or Code**) is the principle piece of legislation that regulates the franchise industry. The Franchise Code is a mandatory code which regulates various aspects of the franchise arrangement, including pre-contractual disclosure, franchise agreement execution, termination and transfers and dispute resolution (among other matters).

The *Competition and Consumer Act 2010* (Cth) (the **CCA**) applies broadly to the conduct of business in Australia. The CCA includes provisions which have particular application to how a franchisor conducts its business, and importantly how it interacts with its franchisees.

The Franchise Code and CCA embody the key franchise laws in Australia.

Together, they regulate various aspects of the franchise relationship, commencing from the first discussions between a franchisor and franchisee through to the end of the franchise relationship. In summary, these laws include:

- Obligations on the franchisor to disclose certain information to a franchisee (before entering into the franchise and during the term of the franchise relationship).
- Certain procedures and requirements that must be followed before entering into a franchise agreement.
- Restrictions on certain contractual terms in the franchise agreement.
- Controls on the franchisor's ability to give (or withhold) its consent to a transfer of a franchised business.
- Controls on the franchisor's ability to terminate a franchise agreement.
- Mechanisms for franchisors and franchisees to resolve disputes.
- Requirements for the establishment and operation of marketing funds.
- Various notification and record keeping obligations.
- An overarching obligation on all franchise parties to act in good faith towards each other.
- Obligations not to engage in misleading or deceptive conduct, or unconscionable conduct.
- Regulation of pricing controls, product purchase requirements, and exclusivity.

Chapters three ([page 14](#)) and five ([page 54](#)) of The Franchisor Handbook explore the application of these laws in more detail.

Other laws

The Franchise Code and CCA are not the only legislation applicable to a franchisor's business. All persons and entities who do business in Australia are subject to and must comply with a multitude of federal, state and territory laws and regulations – this includes franchisors.

Laws that are relevant to franchisors include (by example only):

- Privacy legislation.
- Intellectual property legislation.
- Workplace health and safety legislation.
- Employment and industrial relations legislation.
- Leasing and property legislation.
- Business names legislation.
- Corporations law.
- Taxation legislation.
- Foreign investment legislation.

The application of these laws is beyond the scope of this publication. If you require specific assistance in relation to these areas of law, please contact the Maddocks Consumer Markets & Franchising team who will be able to assist.

Franchisor liability for franchisee contravention of workplace laws

The *Fair Work Act 2009* (**FWA**) is the primary legislation that governs workplace relations in Australia. In September 2017, the Fair Work Amendment (Protecting Vulnerable Workers) Act introduced new 'franchisor liability' laws. The laws included the introduction of franchisor accessory liability for 'serious contraventions' of the FWA by its franchisees. Accordingly, franchisors can now be held liable to the extent that their franchisees don't follow workplace laws.

Franchisors that fall within the definition of a 'responsible franchisor entity' are caught by the legislation. Responsible franchisor entities are caught to the extent that they would 'reasonably be expected to know' that a contravention of the FWA would occur, or would be likely to occur by a franchisee. Actual knowledge of a contravention is not necessary. For this reason, responsible franchisor entities need to be informed about franchisees' employment arrangements, and take appropriate steps to prevent breaches of the FWA by their franchise network.



Chapter two The franchise agreement

The franchise agreement is the legally binding contract between the franchisor and the franchisee. The franchise agreement sets out the commercial terms of the franchise arrangement and the rights and obligations of both parties.

The franchise agreement

All franchise arrangements should be recorded in a written contract. However, there is no legal requirement that the franchise agreement must be in writing for there to be an enforceable contract. The Code confirms that a contract between a franchisor and franchisee may be verbal, partly written and partly verbal, or implied from the conduct of the parties.¹

To avoid misunderstandings and disputes in relation to the terms of the franchise arrangement, it is important that all key terms and any applicable special conditions are recorded in writing in a franchise agreement.

Franchise agreement terms

A 'term' is any clause or provision in a contract. The two main issues which arise in relation to contractual terms are:

Identification > what are the terms of the contract?

Construction > what is the legal effect of each term?

Terms may be express (i.e. agreed in writing or verbally) or implied (i.e. implied from presumed intent or conduct).

The terms of a franchise agreement vary from franchise system to franchise system. The Code does not set out or provide 'standard' or 'template' franchise agreement terms. However, the Franchise Code does include regulations which are relevant to, or restrict, the terms that may be included in a franchise agreement.²

Disputes in relation to the interpretation of contractual terms can give rise to litigation, the outcome of which can be difficult to predict. For this reason, it is important that the contractual terms of a franchise agreement are clear, unambiguous and reflect the commercial arrangement between the parties.

Unfair contract terms laws³ further necessitates the need for contract terms to be fair and transparent – this includes being expressed in plain language and presented clearly.

Examples of terms found in most franchise agreements are set out in the table on the [next page](#).



The franchise agreement must set out the key commercial terms in a clear, unambiguous manner and reflect the commercial arrangement that has been agreed between the franchise parties.

1. *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth) cl 5. The Code definition for 'franchise agreement' includes agreements that are written, oral, or may be implied
2. [See chapter three \(page 14\)](#) for further information on Code provisions which are relevant to or restrict the terms which may be contained in a franchise agreement
3. *Competition and Consumer Act 2010* (Cth) sch 2 ('The Australian Consumer Law') cls 22-23

Franchise agreement terms

Pre-conditions to the Franchise Grant	<p>Common pre-conditions include satisfactory completion of training by the franchisee's manager and key personnel, and completion of store fit-out.</p> <p>Failure to meet a contract pre-condition may give rise to termination of the franchise agreement. However franchisors need to ensure that the right to terminate in these circumstances is consistent with the Code.⁴</p>
Franchise Grant	<p>The franchise grant should carefully set out the scope and extent of the franchisee's right to conduct the franchised business.</p>
Exclusive Rights	<p>There is no obligation to grant a franchisee 'exclusive' rights. However some franchises grant franchisees the right to operate a franchised business within an 'exclusive' territory to the exclusion of other franchisees and the franchisor.</p> <p>The extent of any exclusivity that is granted, and the rights retained by the franchisor over the territory, must be carefully drafted.</p> <p>Before granting exclusive rights, franchisors should give consideration to the to growth of the network, changes in customer demand and changes to the business model. Exclusive rights can restrict a franchisor's ability to address these changes in the future.</p>
Term (Duration) of the Franchise	<p>It is important that the 'term' (which in this context, refers to duration) of the franchise agreement be specified. Many franchise agreements have a contract term of three years or five years, although there is no set franchise term in the Code.</p> <p>Holding over clauses (with a right to terminate on notice) should be included to deal with a possible scenario where the franchisee continues to operate its franchise once the term of the franchise agreement has expired. Franchisors also need to be aware of their end of term Code notification obligations.⁵</p>
Further/Renewal Term	<p>There is no requirement for a franchisee to have an automatic right or option to renew or extend the franchise arrangement at the end of the term. However, many franchise agreements include an option for a renewal or further term.</p> <p>The franchise agreement should carefully set out the process for, and any conditions that attach to, the renewal option.</p> <p>Common conditions include that the franchisee is not in breach of the franchise agreement, a premises lease is secured for the duration of the renewal term, a store fit-out refresh is completed, and fees owed in relation to the franchise are paid.</p>
Fees and Payments	<p>The franchise agreement should specify the fees that the franchisee must pay to the franchisor, including when payment is due, how payment is to be made and any automatic or periodic increases to the fees.</p> <p>Fees typically include an upfront fee, on-going franchise fees (commonly referred to as royalties), on-going marketing levies, as well as training fees, IT fees, and service fees.</p> <p>The fees can be fixed dollar amounts, a percentage of franchisee business revenue (which is how royalties are often calculated), or a combination of both.</p>
Intellectual Property	<p>A franchise system's intellectual property (including trademarks, trading names, logos, branding, websites, operations guides and manuals, and confidential information) is the cornerstone of the franchise. The franchise agreement must contain appropriate clauses dealing with the license and protection of the franchise system's intellectual property.</p>
Operations Manual	<p>An operations manual or handbook is common to many franchise systems. It sets out the requirements for the day to day operation of the franchise business, including setting rules, standards and specifications.</p> <p>The franchise agreement usually includes a strict obligation on the franchisee to comply with the operations manual.</p> <p>It also usually includes provisions describing how the operations manual may be amended and updated by the franchisor over time.</p>

4. Competition and Consumer (Industry Codes – Franchising) Regulation 2014 (Cth) div 5

5. Ibid cl 18, annex 1 item 18

Franchise agreement terms (continued)

Training	<p>Training (initial and ongoing) is often critical to the franchise. The franchise agreement should deal with the franchisor's obligation to provide, and franchisee's obligation to attend and complete, training.</p> <p>The franchise agreement should also cover training costs and responsibility to pay ancillary costs associated with attending training (for example, travel and accommodation costs).</p>
Premises	<p>The franchise agreement should specify the franchisee's obligations in connection with the premises (or mobile vehicle/home office) that will be used to conduct the franchised business, including installing fit-out, equipment and signage, and relocation.</p>
Sourcing and Selling Product	<p>For a product based franchised business, the franchise agreement should include controls on what products the franchisee may sell. An approved product list or menu may be specified or referred to in the franchise agreement. The franchisor may also want to nominate suppliers (which may include the franchisor) from whom the franchisee must acquire approved products.⁶</p>
Providing Services	<p>For a service based franchised business, the franchise agreement should include controls on the services that the franchisee may supply.</p>
Customer Relations	<p>The franchise agreement should describe the franchisee's responsibilities to customers / clients, including dealing with and reporting customer complaints.</p>
Business Obligations	<p>The franchisee's general business obligations, including obligations to comply with all laws, and obtain all business permits and licences that are required to operate the franchised business, should be set out in the franchise agreement.</p>
Reporting and Accounting	<p>The franchisee's reporting obligations to the franchisor, as well as the franchisor's inspection and audit rights, should be set out in the franchise agreement.</p>
Advertising and Promotions	<p>The franchisee's obligation to conduct promotions and undertake advertising and contribute to any central marketing fund should be set out in the franchise agreement. This may include an obligation to seek approval from the franchisor prior to undertaking certain marketing activities.</p>
Franchise Transfers	<p>Procedures for assignment or transfer of the franchise and the franchised business should be set out in the franchise agreement. These provisions are most commonly relevant when a franchisee wishes to sell their franchised business to a buyer.</p> <p>The terms of the franchise agreement that deal with franchise transfers must be consistent with the provisions of the Code.⁷</p>
Termination	<p>Like any contract, all franchise agreements must come to an end. The franchise agreement should include clear terms as to when the contract will expire. It should also contain clear terms specifying the grounds on which the contract may be terminated prior to expiry of the term. The franchise agreement should include the process that must be followed to terminate the franchise agreement, and consequences of expiration or early termination of the franchise agreement.</p> <p>The terms of the franchise agreement that deal with termination of franchise agreements must be consistent with the provisions of the Code.⁸</p>
Dispute Resolution	<p>The franchise agreement should set out procedures for resolution of disputes between the parties which must be consistent with the provisions of the Code.⁹</p>
Restrictive Covenants	<p>The franchise agreement may specify covenants restricting the franchisee's ability to operate or be involved in a competing business, both during the term of and on expiration of the franchise agreement.</p> <p>The Code includes restrictions on the enforcement of end of term restraints.¹⁰</p>
Governing Law	<p>The franchise agreement must not require a party to commence an action outside of Australia or the State/Territory in which the franchised business is based.¹¹</p>

6. See [chapter five](#) of this Franchisor Handbook for the application of the CCA to product controls

7. *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth) pt 3 div 4

8. *Ibid* pt 3 div 5

9. *Ibid* pt 4

10. *Ibid* cl 23

11. *Ibid* cl 21

The franchisee

It is vital that the legal entity or person that executes the franchise agreement as 'franchisee' will be the actual owner and operator of the franchised business. If this is not the case, then it will be difficult for the franchisor to enforce the contract terms or take legal action under the franchise agreement against the true owner and operator of the business. More often than not, franchised businesses are owned and operated via proprietary limited companies.

Where the franchisee is a company, it is prudent to ask the directors (and if appropriate, the shareholders) of the company to provide personal covenants guaranteeing the franchisee's performance and obligations under the franchise agreement. Validly executed personal guarantees can be used by the franchisor to enforce the obligations of the franchisee against the guarantors personally.

To help you properly identify a franchisee company, you should take the following steps.

- | | |
|---|-----------------------------------------------------------------------------------------------------------------------|
| 1 | Obtain a current company extract from ASIC. |
| 2 | Check that the company is a current registered entity. |
| 3 | Verify that the registered directors and shareholders of the company are the persons that you have been dealing with. |
| 4 | Check that the company has filed all necessary forms and documents with ASIC. |
| 5 | Check whether there are any charges recorded over the assets of the company, and investigate any anomalies. |

Execution of the franchise agreement

To be legally enforceable, the franchise agreement should be executed (signed) by all parties including the franchisor, the franchisee and, where applicable, any persons named as franchisee representatives, principals or guarantors. Failure to correctly sign the franchise agreement can lead to contractual uncertainty. It can give rise to disputes in relation to what the agreed contract terms are and who is bound by them. It can also lead to a finding that there is no valid and enforceable franchise agreement at all.

Is there a standard duration (term) for a franchise agreement?

Franchise relationships are usually for a defined duration – that is they remain on foot for a set number of years, or for a period with a specified end date. The Code does not prescribe a minimum or maximum period for a 'term', nor does it require a franchisor to offer a further or renewal term at the end of the initial term. However, the Code does include important obligations on a franchisor to notify a franchisee of its intention to extend, or not to extend, the term of the franchise on its expiration.

A typical franchise term is three years or five years. Some franchise agreements include an option for a further term, again, typically for 3 or 5 years. Some franchises link the term of the franchise agreement to the term of the lease for the business premises. Others consider the capital expenditure that the franchisee will expend in establishing and operating the franchised business, and include a term that is commensurate with such expenditure. Any option for a further or renewal term is usually written into the franchise agreement and is expressed to be subject to certain conditions.



Application of the general principles of contract law

A franchise agreement is like any other commercial or business contract. The general principles of contract law apply to the formation, interpretation and enforcement of the franchise agreement. The decisions of the Australian courts have affected the circumstances where legal action can be taken regarding contracts, and recognise that certain factors can change contractual obligations. For example, where:

- there is 'unconscionable dealings';
- one party is at a 'special disadvantage'; or
- a party exercises 'undue influence';

the courts will commonly declare the relevant contract void or voidable. Remedies available include damages, orders for specific performance and injunctions. Contract law principles and associated remedies are beyond the scope of this publication, however Maddocks can advise you on these matters.

The Code and the CCA provide a statutory regime that can operate to extend and/or modify general contract law principles. These laws are relevant to the interpretation and enforcement of the contractual terms of a franchise agreement, and the remedies that are available in the event of a contract dispute. The next chapters of The Franchisor Handbook explore these laws in more detail.

When will a 'memorandum of understanding' be an enforceable franchise agreement?

A 'Memorandum of Understanding' (**MOU**) can be used to document preliminary discussions between a franchisor and franchisee, especially for international, master or multi-unit franchises. MOUs are generally not intended to be legally binding, and usually contemplate that the parties will enter into a more formal contract (franchise agreement) at a later point.

However, if the MOU satisfies the elements for a legally binding contract, then it will be enforceable as a contract. Furthermore, if the MOU gives rise to a franchise agreement, or is drafted as an agreement to enter into a franchise agreement, then the pre-contractual disclosure obligations specified in the Code will apply.¹²

If the parties to a MOU do not intend for the MOU to be a legally binding franchise agreement (or agreement to enter into a franchise agreement), then this needs to be clearly stated in the MOU.

Do I have a contractually enforceable franchise agreement?

- ✓ Check that the franchisee entity exists! It is vital that legal due diligence is undertaken to ensure that the proposed franchisee entity is in fact a properly constituted legal entity. ACNs and ABNs must be verified, companies must be registered and directorships and shareholdings confirmed.
- ✓ Complete all of the unique details for the franchise (these details are usually set out in a schedule to the franchise agreement).
- ✓ Where applicable, attach the territory map and properly outline the allocated territory on the map.
- ✓ Note whether fees and payments are GST exclusive or inclusive.
- ✓ Correctly define the restraint areas and restraint periods.
- ✓ Ensure that all special conditions that may apply to the arrangement are set out in the franchise agreement.
- ✓ Date the franchise agreement. It is crucial that the franchise agreement is dated, especially where the term of the franchise is linked to the date of the franchise agreement.
- ✓ Check whether the franchise agreement has been properly executed by the parties, and witnessed where appropriate. A franchisor should always verify that the persons who sign the franchise agreement have full authority to bind the legal entity on whose behalf they are signing.
- ✓ Ensure that the franchisee executes all other related documents (for example, property licences, equipment leases and software licences).

12. Ibid cl 9(1)(d)



Chapter three The Franchise Code of Conduct

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The Franchise Code of Conduct is the principal legislation that regulates all franchise arrangements in Australia.

The Code is a prescribed industry code. It has the force of law and is binding on franchisors and franchisees. The Code applies to domestic Australian-owned franchisors who grant franchises in Australia. It also applies to international franchisors that grant master franchises and/or unit franchises within Australia. The purpose of the Code is to regulate the conduct of franchising participants (including franchisors, franchisees and prospective franchisees) towards one another.

The Code is a mandatory industry code. All franchisors must comply with the Code. A franchisor cannot ask a franchisee to waive the franchisor's obligation to comply with the Code, nor can a franchisor include a clause in the franchise agreement which states that the Code does not apply.

The history of franchise regulation in Australia

The Code was first introduced as a mandatory industry code in 1998.

Over the years the Federal Government has introduced a number of amendments to the Code. In November 2014 the Federal Government introduced wide ranging amendments to the Code, to implement recommendations made in The Wein Review of the Franchising Code of Conduct – 2013.

The current Franchise Code was introduced following the Wein Review. The current Franchise Code (which commenced 1 January 2015) applies to:

- Franchise conduct engaged in at any time from 1 January 2015 onwards.
- All franchise agreements which are entered into from 1 January 2015 onwards.
- Any franchise agreements which are varied, renewed or transferred after 1 January 2015.

If you are unsure of the extent to which the current Code may apply to an older (pre-1 January 2015) franchise agreement, you should seek legal advice. This handbook covers the application of the current Franchise Code.

Application of the Code to 'Franchise Agreements'

The Code applies to all 'franchise agreements'. The Code's definition of what will constitute a 'franchise agreement' is very wide. It captures a range of agreements, from full business format franchise agreements to simple brand licence agreements. Whether an agreement is a 'franchise agreement' is a question of substance, not form. The fact that the agreement is called something other than a 'franchise agreement' will not mean that the Code does not apply to that agreement. A franchisor cannot avoid the application of the Code by calling the agreement a 'licence agreement' or a 'brand agreement'.

What is the definition for 'franchise agreement'?

Clause 5 of the Code sets out a lengthy definition of a 'franchise agreement'. The elements are:

- An agreement (written, verbal and/or implied).
- A person (the franchisor) grants another person (the franchisee) the right to carry on a business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined or controlled by the franchisor (or an associate of the franchisor).
- The operation of the business is substantially or materially associated with a trade mark owned or specified by the franchisor (or an associate of the franchisor).
- The franchisee pays the franchisor an amount (including (without limitation) an initial capital investment fee, a payment for goods or services, a fee based on a percentage of income or a training fee).

For the agreement to be a 'franchise agreement', each of these elements must be satisfied.

*Reference should be made to Clause 5 of the Code for the complete definition of a 'franchise agreement'.



The Franchise Code is mandatory legislation, applying to both franchisors and franchisees.

Is the agreement a franchise agreement?

key considerations:

- Is there a licence to use a brand?
- Is there a system or marketing plan to be followed?
- Is there payment of an amount by the franchisee to the franchisor?

In many cases the question of whether an agreement is a 'franchise agreement' will turn on whether there is a system or marketing plan specified by the franchisor. There is no definition of 'system' or 'marketing plan' in the Code. However, it has been held that a 'system' is 'a set of principles or procedures according to which the business is operated or an organised scheme or method pursuant to which the business is operated'. A marketing plan is a 'detailed proposal for achieving the promotion or advertising of the licensor's products'.¹³

Example

A licensor and licensee enter into an Intellectual Property Licence Agreement. The Agreement includes the grant of a licence to the licensee to carry on its business using the licensor's trademark. A monthly licence fee applies.

The Agreement includes a clause that the licensee must comply with the licensor's 'branding and operations manual'. The branding and operations manual includes procedures for the operation of the business, sufficient to constitute a 'system or marketing plan substantially determined, controlled or suggested' by the licensor.

There is a risk that the Agreement is a 'franchise agreement' regulated by the Code.

In its 2014-15 Annual Report, the Australian Competition and Consumer Commission (**ACCC**) noted that in the past, it has received complaints about businesses operating franchise systems under the guise of a licensing or distributorship arrangement in a deliberate attempt to bypass the Code.¹⁴ Historically, the Code lacked penalties meaning that there was little to deter these operators. However, on 1 January 2015, penalty provisions were introduced into the Code to specifically address this issue.

Case study

IP licence agreement was a franchise agreement¹⁵

What happened:

The ContactPlus Group sold licenses to licensees to use its software and licensed marketing database to operate recruitment and employee services businesses. An upfront licence fee of \$60,000 applied.

Following complaints from licensees, the ACCC commenced proceedings against ContactPlus. It sought a declaration that the ContactPlus licence agreement was a franchise agreement for the purposes of the Code, and ContactPlus' conduct in selling and in some cases terminating licence agreements had breached the Code.

The outcome:

The Federal Court declared that the licence agreement was a franchise agreement regulated by the Code. The fact that the agreement was referred to as a 'licence agreement' and not a 'franchise agreement' did not take the agreement outside of the ambit of the Code. The licence agreement satisfied all four elements for a franchise agreement specified in the Code.

The Federal Court declared that ContactPlus had breached the Code by:

- Failing to provide disclosure documents.
- Failing to obtain written advice statements from licensees.
- Terminating licence agreements without reasonable notice.
- Failing to provide for a compliant handling procedure in the licence agreement as required by the Code.

The Court also found that ContactPlus has made various misrepresentations in relation to the upfront fee and exclusivity of the licence rights grants to licensees. The Court declared that the \$60,000 up front licence fees were not enforceable.

(Note that at the time of proceedings ContactPlus was in liquidation, and the Courts declarations and orders were not opposed.)

13. *Apple Computer Australia Pty Ltd v Mckrisis* [2003] NSWSC 126

14. Australian Competition and Consumer Commission, Annual Report 2014-15 (30 October 2015) https://www.accc.gov.au/system/files/979_Annual%20Report_2014-15_web_FA_1_0.pdf

15. *Australian Consumer and Competition Commission v Contact Plus Group Pty Ltd* (in liq) [2006] FCA 396

Case study

Heads of agreement was a franchise agreement¹⁶

What happened:

The Donovan Parties were the owners of certain intellectual property in relation to Modular Accommodation Units (**MAUs**). The Rafferty Parties paid moneys to the Donovan Parties for certain rights to manufacture and distribute the MAUs in Western Australia and the Northern Territory.

The commercial arrangement between the parties was documented by various agreements including a Heads of Agreement and Rights Agreement. The Donovan Parties did not comply with the Code (including providing a disclosure document) despite being made aware that the arrangements with the Rafferty Parties could fall within the ambit of the Code.

The Court's decision: The Full Federal Court held that the Heads of Agreement and the Rights Agreement together comprised a franchise agreement.

The outcome:

The Full Federal Court held that the Heads of Agreement and the Rights Agreement together comprised a franchise agreement within the meaning of the Code. In doing so, the Court took a substance over form approach, and focused on the likely effect of the agreements in practical terms.

In particular, the Court looked at whether there was a 'system or marketing plan' for the purpose of clause 4(1)(b) of the Code and found the following factors to be relevant:

- specific requirements for accounting and record keeping;
- reservation by the Donovan Parties of a right to audit books of account and other records;
- inability of the Rafferty Parties to supply goods or services without the approval of the Donovan Parties;
- requirements for signage, merchandising, promotional or advertising materials to be approved by the Donovan Parties;
- a right of the Donovan Parties to approve sales staff, bonus structures, reporting procedures and training for the Rafferty Parties' staff; and
- stipulation of retail prices and sales quotas.

The Court also identified the following criteria for ascertaining whether a system is 'substantially determined, controlled or suggested by the franchisor':

- the extent to which the franchisee's business involves selling the franchisor's goods or services;
- the degree to which the franchisor assumes responsibility for centralised management or standards of quality;
- whether the franchisor dictates any mandatory obligations with respect to advertising or marketing; and
- the degree to which the franchisor controls the franchisee's business having regard to advertising and financial support, auditing books and financial reporting requirements, staff and sales quota, training and the like.

The Court held that a heads of agreement may be an agreement to enter into a franchise agreement. If so, the obligations under the Code will apply, even if the proposed franchisee entity has not yet been incorporated and there is no franchise system yet in place.

Application of the Code to master franchising

The Code's definition of a 'franchise agreement'¹⁷ includes a master franchise agreement. A master franchise is a system under which the franchisor grants to a master franchisee the right to grant unit franchises to sub-franchisees or to participate in a unit franchise.

The Code applies to master franchise agreements in essentially the same way as it applies to unit franchise agreements. A master franchisor must comply with the Code when granting a master franchise to a master franchisee. A master franchisee must comply with the Code when granting a unit franchise to a sub-franchisee.

The Code disclosure document includes a specific requirement to disclose certain information in relation to any master franchise arrangement.

Application of the code to other agreements

The Code applies to motor vehicle dealership agreements even if the motor dealership agreement does not meet the definition for a 'franchise agreement'.¹⁸ The Code sets out certain types of agreements which (in itself) do not constitute a franchise agreement. The excluded agreements are:

- Those giving rise to an employer/employee relationship.
- Partnership relationship.
- Landlord and tenant relationship.
- Mortgagor and mortgagee relationship.
- Lender or borrower relationship.
- A cooperative (registered under cooperatives legislation).¹⁹

Exempt agreements

Certain franchise agreements are exempt from the Code. Exempt agreements are:

- Franchise agreements to which another mandatory industry code applies.²⁰
- Franchise agreements where the franchisee has supplied substantially the same goods or services for at least two years before entering into the franchise agreement and the supply under the franchise will be no more than 20% of the franchisee's gross turnover.²¹



The Code has a wide definition of 'franchise agreement', which captures a range of agreements that concern the distribution of goods or services in Australia.

16. *Rafferty v Madgwicks* [2012] FCAFC 37

17. Competition and Consumer (Industry Codes – Franchising) Regulation 2014 (Cth) cl 4 (definitions of 'franchisor', 'sub-franchisor' and 'master franchise')

18. *Ibid* cl 5(2)(c)

19. *Ibid* cl 5(3)

20. *Ibid* cl 3(2)(a)

21. *Ibid* cl 3(2)(b)

Overview of the franchisor's Code obligations

The Code regulates the franchise relationship from start to end, including pre-contractual discussions through to termination of the franchise and post termination obligations. It regulates how a franchisor communicates and deals with its franchisees and also prospective franchisees.

Compliance with the Code must be a legal priority for franchisors. Set out in the below table is a high level summary of key obligations and requirements under the Code.

Will franchisor compliance with franchise regulation in another jurisdiction be sufficient for compliance with the Code?

The short answer is no. The Code is similar to comprehensive franchise legislation that can be found in overseas jurisdictions – for example in the United States. However, Australia has its own set of obligations and requirements embodied in the Code, and compliance with franchise regulation in another jurisdiction will not ensure compliance with the Australian Code.

Key code obligations

Obligation to Act in Good Faith (Clause 6)	Each party (the franchisor and the franchisee) to a franchise agreement must act in good faith towards the other party. The obligation to act in good faith extends to pre-agreement negotiations and disputes and cannot be contractually limited or excluded by the parties.
Maintain a Disclosure Document (Clause 8)	A franchisor must create and maintain a current disclosure document. The disclosure document must comply with the format set out in the Code (Annexure 1) and include all information required to be disclosed.
Updating the Disclosure Document (Clause 8(6))	A franchisor must update its disclosure document annually within 4 months of the end of each financial year (i.e. for most franchise systems with a financial year ending 30 June, the update must be completed by 31 October each year).
Providing the Disclosure Document (Clause 9 and 16)	The franchisor must provide a copy of its current disclosure document (and other documents) to a franchisee in the following circumstances: <ul style="list-style-type: none"> To a prospective franchisee at least 14 days prior to the prospective franchisee signing the franchise agreement (or making a non-refundable payment). To an existing franchisee at the time of renewal or extension of an existing franchise agreement. The disclosure document must be given to the franchisee at least 14 days prior to renewal / extension. To an existing franchisee where there is a change in the scope or term of the franchise. The disclosure document must be given to the franchisee at least 14 days prior to the change of the scope or term. To a prospective franchisee who is purchasing a franchised business from an existing franchisee. The disclosure document must be given to the prospective franchisee at least 14 days prior to the prospective franchisee signing the franchise agreement (or making a non-refundable payment). To any franchisee who requests a copy of the disclosure document. The disclosure document must be given to the franchisee within 14 days of a written request. A franchisee can only make such a request once in a 12 month period.
Opportunity to Review (Clause 10)	A franchisor must give all prospective franchisees a reasonable opportunity to review and understand the disclosure document and the Code. A franchisor must obtain a signed statement from the franchisee that it has been given this opportunity.
Independent Advice (Clause 10)	A franchisor must advise all franchisees to obtain their own independent legal, accounting and / or business advice before entering into the franchise agreement. A franchisor must obtain a signed statement from the franchisee that it has obtained such advice (or elected not to obtain such advice).
Information Statement (Clause 11)	A franchisor must give a copy of the prescribed information statement (set out in Annexure 2 to the Code) to each prospective franchisee as soon as practicable after the prospective franchisee applies or expresses an interest to acquire a franchised business.
Lease Information (Clause 13)	A franchisor (or any associate of the franchisor such as a director, related company or supplier) that leases premises to a franchisee must provide certain lease information to the franchisee.

Key code obligations (continued)

Marketing and Co-operative Funds (Clause 15)	A franchisor must comply with specific requirements in relation to the preparation and audit of annual financial statements for any marketing or co-operative fund to which its franchisees contribute. Copies of such statements must also be provided to franchisees.
Additional Disclosure of Materially Relevant Facts (Clause 17)	A franchisor must disclose materially relevant matters (such as a change in majority ownership or control of the franchisor or certain legal proceedings) no later than 14 days of the franchisor becoming aware of the matter.
End of term arrangements (Clause 18)	A franchisor must notify a franchisee of whether the franchisor intends to end the franchise agreement or enter into a new franchise agreement at least 6 months prior to the end of the term of the franchise agreement.
Record Keeping (Clause 19)	A franchisor must keep all written notices etc. from franchisees and all documents which support statements and claims that are made in the franchisor's disclosure document, for at least 6 years.
Release From Liability (Clause 20)	A franchise agreement must not contain, or require a franchisee to sign, a general release of the franchisor from liability towards the franchisee.
Jurisdiction for Settling Disputes (Clause 21)	A franchise agreement must not contain a clause which requires an action or mediation to be held in any State or Territory outside of which the franchised business is located.
Effect of Restraint of Trade (Clause 23)	A restraint of trade clause in a franchise agreement has no effect after the agreement expires at the end of term, unless certain conditions (including payment of compensation) apply.
Transfer of a Franchise Agreement (Clause 24 and 25)	A franchisor must not unreasonably withhold consent to a transfer of a franchise agreement.
Cooling-off (Clause 26)	A franchisee has a 7 day cooling off period during which it may terminate the franchise agreement where it complies with the provisions set out in the Code.
Termination (Clause 27, 28, 29)	A franchisor may only terminate a franchise agreement where it complies with the provisions set out in the Code.
Capital Expenditure (Clause 30)	A franchisor cannot require a franchisee to undertake significant capital expenditure during the term of the franchise, unless certain conditions apply.
Marketing and Advertising Fees (Clause 31)	A franchisor must maintain a separate bank account for marketing/advertising fees it receives from franchisees. The Code also regulates the way in which marketing/advertising fees may be used.
Franchisee Associations (Clause 33)	A franchisor must not prevent its franchisees from forming an association or associating with other franchisees for a lawful purpose.
Resolving Disputes (Clause 34 and 35)	Any disputes between a franchisor and franchisee must be notified and resolved in accordance with the Code's procedures.



The Franchise Code contains extensive obligations and requirements for granting franchises and managing a franchise network.

The franchisor's obligation to 'disclose' information to franchisees

The Code imposes very important obligations on a franchisor to provide, or disclose, certain information to prospective franchisees and current franchisees. In a 2006 press release, the then ACCC Chairman, Mr Graeme Samuel, stated that:

*'Franchising is a significant sector of the economy and often involves significant investment by individuals both in the purchase and establishment of a franchise opportunity. The code provides for informed decision making prior to the purchase of a franchise and should ensure rights and obligations, expenses and income considerations are well understood and communicated.'*²²

Disclosure checklist

- ✓ Information statement – a franchisor must provide an information statement to a prospective franchisee as soon as practicable after the prospective franchisee applies or expresses an interest to acquire a franchised business.
- ✓ Disclosure document – a franchisor must prepare and provide a disclosure document to a prospective franchisee prior to entering into a franchise agreement (or renewing, extending the term or scope, or on transfer of an existing franchise agreement).
- ✓ Lease / property documents – a franchisor must disclose certain information in relation to the lease or occupancy rights to the premises out of which the franchise will be operated.
- ✓ Other agreements – a franchisor must provide copies of other agreements which are to be entered into as part of the franchise.
- ✓ Marketing fund financial statements – a franchisor must provide its franchisees with annual copies of financial statements for any marketing fund operated by the franchisor.
- ✓ Materially relevant facts – a franchisor must disclose materially relevant events which arise during the term of the franchise to its franchisees.

Information statement

A franchisor must provide an information statement to prospective franchisees.

The information statement is a two page document, which includes certain prescribed statements that highlight the risks and rewards of franchising. The information statement must be in the form and contain the wording set out in Annexure 2 to the Code.²³ It cannot be edited or changed.

When does a franchisor provide an information statement?

A franchisor must provide an information statement to a prospective franchisee as soon as reasonably practicable after the prospective franchisee formally applies for, or expresses an interest in acquiring, a franchised business.

The obligation to provide an information statement does not apply in the case of a renewal or extension of term or scope of an existing franchise agreement.

Example

A franchisor receives an unsolicited phone call from a prospective franchisee asking general questions about its franchise system.

After receiving the information, the caller says that he will think about it further. The caller did not apply for or express an interest in acquiring the franchise, and thus the franchisor does not need to provide an information statement at this stage.

However, if the caller asks for a franchise application form, then the franchisor should send an information statement with the franchise application form.

Disclosure document

A franchisor must prepare and maintain a current disclosure document for its franchise system²⁴. This is a fundamental obligation and underpins the core objective of the Code, which is to ensure that a prospective franchisee is properly informed prior to entering into a franchise arrangement. The disclosure document sets out important information about the franchise business, the franchise system and the franchisor. The purpose of the disclosure document is to assist prospective franchisees to make a reasonably informed decision as to whether or not to purchase the franchise, and to provide existing franchisees with current information about the franchise.

Form of the disclosure document

The Code regulates the form of the disclosure document²⁵. Strict compliance is required. A disclosure document must:

- Comply with the format set out in Annexure 1 of the Code.
- Disclose all of the information required to be disclosed under each heading and for each item set out in Annexure 1 of the Code.
- If no applicable information exists for a particular item of the disclosure document, a franchisor may delete the applicable headings from the disclosure document. However, it must list the deleted headings in an attachment so that the prospective or existing franchisee is aware of what information has not been provided.
- Contain a table of contents, and if the disclosure document attaches other documents, these documents must be listed in the table of contents.
- Attach:
 - A copy of the Code.
 - A copy of the franchise agreement in the form in which it is to be executed.

22. Australian Competition and Consumer Commission, *Court declares licence agreements to be franchise agreements* (14 October 2006) www.accc.gov.au/media-release/court-declares-licence-agreements-to-be-franchise-agreements

23. *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth) cl 11

24. *Ibid* cl 8

25. *Ibid*

What information must be disclosed in a disclosure document?

The information required to be disclosed in a disclosure document falls within the following categories:

Front page – Important notice to the franchisee.

Item 2 – Details in relation to the franchisor company and its corporate associates.

Item 3 – Details in relation to the business experience of the franchisor and its executives.

Item 4 – Details of any current litigation and court proceedings relevant to the franchise.

Item 5 – Details of any agents who receive payments in connection with the introduction of the franchisee.

Item 6 – Details of existing franchised businesses including the number of existing franchisees, and the number of franchise terminations, sales and renewals for the last 3 financial years.

Item 7 – Details in relation to the master franchise (if applicable).

Item 8 – Details of intellectual property used in the franchise business.

Item 9 – Details in relation to the franchise site and/or territory, and the extent of any exclusivity granted to the franchisee.

Item 10 – Details of the franchisor's requirements for the supply of goods or services to the franchisee.

Item 11 – Details of the franchisor's requirements for the supply of goods or services by the franchisee to its customers.

Item 12 – Details of the supply of goods and services online (if any).

Item 13 – The franchisor's policy for selection of franchise territories and/or sites and details of whether the territory and/or site to be franchised has been previously operated. The information about whether the territory and/or site has been the subject of a previous franchise must be provided in a separate document with the disclosure document (often referred to as a 'Site and Territory Information Form').

Item 14 – Extensive details for all payments to be made by the franchisee in connection with the franchised business, including repayments (deposits), establishment costs, other payments made to the franchisor throughout the term of the franchise and payments to third parties made throughout the term of the franchise. This includes significant capital expenditure which the franchisee may need to incur throughout the term of the franchise.

Item 15 – Details in relation to each marketing or other cooperative fund controlled or administered by or for the franchisor, including the fund's expenses for the last financial year.

Item 16 – Details of material conditions in relation to any financing arrangements offered by the franchisor.

Item 17 – Details of the circumstances in which the franchisor has unilaterally varied a franchise agreement in the last 3 financial years, and the circumstances in which the franchisor may unilaterally vary the franchise agreement in the future.

Item 18 – Details of arrangements to apply at the end of the franchise agreement, including details in relation to options to renew.

Item 19 – Details of whether the franchisor will require the franchise agreement to be amended on transfer.

Item 20 – Earnings information for the franchised business (or a statement that no earnings information is provided by the franchisor).

Item 21 – A statement of the franchisor's solvency signed by at least one director of the franchisor stating that the franchisor is financially viable, and financial details for the franchisor including financial reports for the last 2 years or a statement from an independent auditor supporting the franchisor's statement of solvency.

Item 22 – Details of any information given under clause 17 of the Code (unilateral variation) which has changed between the date of the disclosure document and the date the disclosure document is given under the Code.

Item 23 – Receipt of delivery of the disclosure document.

The information disclosed in the disclosure document must be carefully checked to ensure that it is accurate and up to date and is not false or misleading in any way.

Franchisors must provide fulsome and detailed responses in the disclosure document, and should avoid simply cross referencing clauses in franchise agreements in response to questions in the disclosure document as this is inconsistent with the purpose of the disclosure document under the Code.

Franchisors may be subject to financial penalties and infringement notices for providing non-compliant disclosure documents.

Does a franchisor need to disclose earnings information?

Item 20 of the disclosure document covers disclosure of earnings information. Earnings information includes historical earnings data for a franchised business or other franchises in the franchise system, and projected earnings for a franchised business.

There is no requirement for the franchisor to provide any earnings information. However, if earnings information is provided, then the franchisor must include certain statements with that information.

For projected earnings for a franchised business, the franchisor must also provide information about the assumptions on which the projection is based.

Case study

Failure to provide current disclosure document²⁶

What happened:

SPAR was the franchisor who granted licences to franchisees to operate SPAR branded supermarkets.

In July 2010, SPAR gave MIS, a prospective franchisee, its current disclosure document. The disclosure document included a director's solvency statement and an independent auditor's report for the 2008/2009 financial year. Negotiations between SPAR and MIS continued for some time, with MIS ultimately executing a franchise agreement with SPAR in February 2011.

SPAR's 2009/2010 financial reports were prepared and finalised between the issue of SPAR's disclosure document to MIS in July 2010, and execution of the franchise agreement in February 2011.

SPAR's 2009/2010 financial reports showed that SPAR's financial position had seriously deteriorated since the publication of its 2008/2009 financial reports, with a loss of \$5.8 million.

The outcome:

The Court was asked to consider whether SPAR had complied with the Code in providing a 'current' disclosure document.

On appeal, the Full Court of the Federal Court held that SPAR had breached its disclosure obligations to MIS. The Court held that the disclosure requirement will only be satisfied if a prospective franchisee is provided with a disclosure document that is current as at the date a franchise agreement is entered into. The Court ordered that the franchise agreement between SPAR and MIS be set aside.

Case study

Inadequate disclosure²⁷

What happened:

James Home Services (**JHS**) granted a State master franchise for South Australia to a State master franchisee (SA State Master Franchisee). A disclosure document was provided by JHS to the SA State Master Franchisee.

A feature of the JHS franchise network was that State master franchisees had the right to grant regional master franchises within their State. JHS was not a party to the franchise agreements between State master franchisees and their regional master franchisees.

In the disclosure document given by JHS to the SA State Master Franchisee, JHS did not disclose information concerning 15 regional master franchisees that had ceased to operate in Victoria and New South Wales. The SA State Master Franchisee argued that had it known this information, it may not have entered into the State master franchise agreement with JHS for South Australia.

The outcome:

JHS argued that it was not required to give disclosure information about regional master franchisees that had ceased to operate because it was not a party to those franchise agreements. JHS said that the obligation to provide disclosure about regional master franchisees fell with the relevant State master franchisees who had granted those franchises.

The Court held that the Code requires franchisors to make disclosure about various enterprises operating as franchisees within the franchisor's franchise structure. JHS had breached the Code by failing to provide disclosure about regional master franchisees that had ceased to operate, even though JHS was not a party to those franchise agreements.

26. *SPAR Licensing Pty Ltd v MIS QLD Pty Ltd* [2014] FCAFC 50

27. *Dorrian & Anor v Rushlyn Pty Ltd & Anor* [2013] FMCA 101

Updating the disclosure document



A franchisor must update its disclosure document within four months of the end of each financial year.²⁸

This is a strict Code requirement.

In addition to the Code requirement to update annually, franchisors should also update their disclosure document at any time that the information included in the disclosure document becomes materially incomplete or inaccurate. If a franchisor changes the terms of its template franchise agreement, the franchisor should also update its disclosure document at that time to ensure that the disclosure document is consistent with the terms of the updated franchise agreement.

A franchisor is not required to update its disclosure document in any financial year, if it did not enter into a franchise agreement during the last financial year (including transferring, renewing or extending a franchise agreement) and does not intend to enter into another agreement in the following financial year.²⁹ This disclosure exemption will cease to apply if a franchisee requests a copy of the disclosure document. If a franchisee requests a disclosure document in these circumstances, the franchisor must update the disclosure document so that it reflects the position of the franchise as at the end of the financial year before the financial year in which the request is made.³⁰



Providing the disclosure document

The Code sets out when a franchisor must give its disclosure document to a prospective franchisee and to its existing franchisees (where requested). Important time frames are also imposed.

Prospective franchisee

- At least 14 days prior to the prospective franchisee signing the franchise agreement or making payment of a non-refundable amount (whichever is the earlier).

Existing franchisee

- At least 14 days prior to the renewal of the franchise agreement.
- At least 14 days prior to the extension of term or scope of the franchise agreement.

Existing franchisee

- Within 14 days of receipt of a request to provide a disclosure document.

Giving a Disclosure Document where there is a MOU or HOA

Pre-contract disclosure obligations may apply where the parties sign a 'Memorandum of Understanding' or 'Heads of Agreement' which set out the terms for the proposed franchise. Any such document needs to be carefully drafted.

Where the relevant document is drafted as an agreement to enter into a franchise agreement, then the Code disclosure obligations will apply, including the requirement that a disclosure document be given to the prospective franchisee at least 14 days prior to the signing of the document.³¹

28. *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth) cl 8(6)

29. *Ibid* cl 8(7)

30. *Ibid* cl 8(8)

31. *Ibid* cl 9(1)(d)

Giving a disclosure document to a person with an 'interest' in the franchise

The Code definition for 'franchisee' includes a person to whom a 'franchise' is granted. The definition of 'franchise' includes an 'interest in a franchise'.

The Code defines 'interest in a franchise' to include a legal or beneficial interest in the franchise, including as a result of a guarantee, shareholding, unit holding or partnership. Thus the obligation to provide a disclosure document may extend to persons with an 'interest in the franchise'.

This means that, in addition to the prospective franchisee entity, a franchisor needs to consider giving a disclosure document to:

- Each of the nominated guarantors.
- Each of the franchisee directors.
- Each of the franchisee shareholders / unitholders (where they are not the same as the franchisee directors).
- Any other person who may have an interest in the franchise's capital or income.

A franchisor will need to consider who has an 'interest' in a franchise on a case by case basis, and make disclosure accordingly.

As of 1 January 2015, franchisors may be subject to financial penalties and infringement notices for failing to provide a disclosure document in accordance with the Code requirements.

Attaching the franchise agreement

It is a Code requirement that a copy of the franchise agreement 'in the form in which it is to be executed' by the franchisee must be attached to the disclosure document.³²

A franchisor cannot attach its standard template franchise agreement or an incomplete draft document. The franchisor must complete all details and particulars that are relevant to the franchise grant in the franchise agreement that is annexed to the disclosure document (for example, the franchisee entity details, site and/or territory details, specific fee information etc.).

When does a franchisor need to provide a 'fresh' disclosure document?

The Code requires a copy of the franchise agreement in the form in which it is to be signed by the franchisee to be attached to the disclosure document.

In many cases, a franchisor and franchisee will enter into negotiations after disclosure, which may lead to changes to the franchise agreement. A franchisor does not need to re-disclose by attaching a copy of the changed form of franchise agreement, where the changes are required.³³

- To give effect to a franchisee's request.
- To fill in required particulars.
- To reflect changes to address or other circumstances.
- For clarification of a minor nature.
- To correct errors or references.

Example

A franchisor gives a prospective franchisee its disclosure document which attaches the franchise agreement in the form in which it is to be executed.

During negotiations, the franchisee requests a three month franchise fee relief period, which the franchisor agrees to. The franchisor inserts a special condition into the franchise agreement to reflect this arrangement.

The parties enter into the franchise agreement 14 days after the disclosure documents was initially provided. The changes were made to give effect to the franchisee's request and therefore the franchisor has complied with the Code's 14 day disclosure period requirement.

Disclosure of updated financial details

Franchisor financial statements and declarations need to be provided at Item 21 of the disclosure document.

If the disclosure document provided to the franchisee does not include current financial statements or declarations at Item 21, then the franchisor must provide the updated documents to the franchisee when such information becomes available, but in any event, before the franchisor enters into the franchise agreement.³⁴

Disclosure of lease arrangements

If the franchisor (or an associate of the franchisor) leases premises to the franchisee, the franchisor must give to the franchisee:

- A copy of the lease or agreement to lease (or a copy of the document that gives the franchisee the right to occupy the premises).
- Details of any incentive or financial benefit the franchisor would be entitled to receive as a result of that agreement.

The document that gives the franchisee the right to occupy the premises must be provided within one month after the document is signed or within one month of occupation.

Disclosure of other agreements

If a franchisor requires the franchisee to enter into any of the following kinds of agreements as a condition of the franchise agreement, the franchisor must provide copies of these agreements to the franchisee at least 14 days prior to the franchisee entering into the franchise agreement:

- A lease or hire purchase agreement for goods.
- An agreement under which the franchisee gains ownership of, or is authorised to use, any intellectual property.
- A security agreement, including a guarantee, mortgage, security deposit, indemnity, loan agreement or obligation to provide a bank guarantee to a third party.
- A confidentiality agreement.
- An agreement not to carry on business within an area or for a time after the franchise agreement is terminated.

32. Ibid cl 9(1)(c)

33. Ibid cl 9(3)

34. Ibid cl 17(1)

35. Ibid cl 15

Disclosure of marketing fund expenditure

a franchisor must prepare annual financial statements for any marketing fund that it controls or operates within four months of the end of each financial year.³⁶

A franchisor has an ongoing obligation to provide a copy of the annual marketing fund statement to all of its franchisees within 30 days of it being prepared.³⁶ This requirement is in addition to the franchisor's obligation to disclose certain information in relation to its marketing fund in the disclosure document. The marketing fund statement should be audited by a registered company auditor, unless 75% of the franchisor's franchisees who have contributed to the fund vote that no audit is required.³⁷ This approval must be obtained each year within three months after the end of the financial year.



Annual disclosure of a marketing fund's financial statements to franchisees is a strict Code requirement which is often overlooked by franchisors.

In a December 2015 press release, the ACCC announced that it will use its audit powers to check franchisor compliance with these obligations. The ACCC reiterated this point at the National Franchise Council Convention Legal Symposium in October 2017.

Disclosure of materially relevant facts

A franchisor has an obligation to inform all franchisees in writing within a reasonable time (and in any event within 14 days) of the franchisor becoming aware of the occurrence of any 'materially relevant fact'.³⁸ Materially relevant facts are:

- Change in the majority ownership or control of the franchisor or the franchise system.
- Proceedings by a public agency, or judgment in criminal or civil proceedings or an award in an arbitration against the franchisor (or a franchisor director or associate) alleging breach of franchise agreement, the Code, the CCA and other specific provisions.
- Judgement against the franchisor under state and/or federal workplace legislation (except for unfair dismissal cases, in which case there is no duty to disclose).
- Civil proceedings against the franchisor or a franchisor director by 10% (or ten or more) of the franchisor's franchisees.
- Any judgment that is entered against the franchisor in Australia for a matter set out in Item 4 of the disclosure document.
- The franchisor (or an associate of the franchisor) becomes an externally administered body corporate.
- The existence and content of any court enforceable undertakings or orders given under section 87B of the CCA.

Disclosure of end of term arrangements

The Code imposes certain 'end of term' notification obligations on the franchisor.³⁹ Towards the end of the term of a franchise agreement, a franchisor must notify a franchisee, in writing, as to whether it intends to extend the franchise agreement or enter into a new agreement with the franchisee.

If the term of the franchise agreement is six months or longer, the franchisor must notify the franchisee of its decision at least six months before the end of the term of the franchise agreement.

If the term of the franchise agreement is less than six months, the franchisor must notify the franchisee of its decision at least one month before the end of the term of the franchise agreement.

If the franchisor intends to extend the franchise agreement, it must include a statement in the notice to the franchisee that informs the franchisee that it may request a copy of the disclosure document.



A franchisor has extensive disclosure obligations to prospective and existing franchisees. Failure to disclose as required by the Code can give rise to penalties and franchisee remedial action.

36. Ibid cl 15(1)(c)

37. Ibid cl 15(2)

38. Ibid cl 17

39. Ibid cl 18

Granting the franchise

The Code sets out procedural requirements for the grant of a franchise. Failing to comply with these requirements can result in the franchise agreement being declared unenforceable and/or give the franchisee other rights and remedies (such a refund of fees). In some cases financial penalties may be imposed against the franchisor.

Requirements for granting a franchise

The procedural requirements for franchise grants are summarised in the following table.

Information Statement	A franchisor must give to a prospective franchisee the information statement as soon as reasonably practicable after the prospective franchisee formally applies for, or expresses an interest in acquiring, a franchised business. ⁴⁰
Disclosure Document	A franchisor must give to the franchisee a copy of the franchisor's current disclosure document (attaching all relevant documents including a copy of the Code, site and territory information form and a copy of the franchise agreement in the form in which it is to be executed).
Allow a 14 Day Review Period	The franchisor must allow at least 14 days from the date the franchisee receives the disclosure document for the franchisee to review the documents before the franchisee enters into the franchise agreement or pays a non-refundable amount to the franchisor. ⁴¹
Disclosure Document Receipt	The last page of the disclosure document must include a form that the franchisee can sign in order to acknowledge receipt of the disclosure document. The franchisor should collect this signed form from the franchisee for record keeping purposes.
Franchisee Confirmation	A franchisor must not enter into a franchise agreement unless it has received a written statement from the franchisee that it has received, read and had a reasonable opportunity to understand the disclosure document and the Code. This statement must be collected prior to execution of the franchise agreement. ⁴²
Advice Statement	A franchisor must advise the franchisee to obtain its own independent legal, accounting and/or business advice prior to entering into a franchise agreement. The franchisor must obtain a signed statement from the franchisee which confirms that the franchisor informed the franchisee to obtain such advice, and that franchisee obtained the advice (or elected not to obtain the advice). This statement must be collected prior to execution of the franchise agreement. ⁴³
Execution of Franchise Agreement	Once the 14 day review period has lapsed, the franchisee may sign the franchise agreement.
Cooling-Off Period	Once the franchisee has signed the franchise agreement, the franchisor must give the franchisee a seven day cooling-off period during which the franchisee can elect to terminate the franchise agreement. If the franchisee exercises its cooling off rights, the franchisor must refund all payments made by the franchisee to the franchisor within 14 days. ⁴⁴



A franchisor must adopt a franchise grant procedure that complies with the Code.

40. Ibid cl 11

41. Ibid cl 9

42. Ibid cl 10

43. Ibid

44. Ibid cl 26

Application of franchise code procedures

The procedural requirements summarised above apply to all new franchise grants. Some of the Code's procedural requirements for franchise grants also apply where there is a renewal of the franchise term, an extension or change in scope of the franchise, or a transfer of the franchise.

The application of the Code requirements for different types of franchise transactions are summarised in the following table.

	Information Statement	Provide disclosure document / 14 day review period*	Confirmation of receipt of disclosure document	Advice Statement	Cooling-off period
New franchise: A franchisor grants a new franchise to a new franchisee.	✓	✓	✓	✓	✓
New franchise to existing franchisee: A franchisor grants a new (second) franchise to an existing franchisee (e.g. a multi-unit franchisee).	✓	✓	✓	✓	✓
Further / renewal term: A franchisor grants a franchise for a further term or a renewal term to an existing franchisee.	✗	✓	✓	✗	✗
Extension / change in scope of franchise agreement: A franchisor extends the scope or term of an existing franchise.	✗	✓	✓	✗	✗
Sale or transfer of franchised business: An existing franchisee sells its franchise business to a new franchisee. This includes where the new franchisee takes over the franchised business by a deed of assignment, or by entering into a new franchise agreement.	✓	✓	✓	✓	✗

* Franchisors may be subject to financial penalties for failing to comply.

Taking deposits

A franchisor can ask a franchisee to pay an amount as a 'deposit' or 'application fee' prior to entering into a franchise agreement. The Code includes provisions which regulate how this amount is collected and the terms on which such amount must be refunded. To comply with the Code:

- The amount must be fully refundable to the franchisee if it is paid by the franchisee prior to receiving a disclosure document.
- The amount may only be rendered non-refundable (in full or part) at the point which is 14 days after the franchisee has received a disclosure document.
- The terms for receiving and holding the amount should be communicated by the franchisor to the prospective franchisee before the money is received.
- The terms for receiving and holding the amount must be disclosed by the franchisor in its disclosure document.

Example

A franchisor asks a prospective franchisee to complete an application form and pay an application fee. The franchisor tells the franchisee that the application fee is intended to cover the franchisor's costs for securing a suitable site for the franchised outlet. The franchisor then undertakes a lengthy process for securing a site. The franchisor has not yet provided the prospective franchisee with a disclosure document or the franchise agreement.

The prospective franchisee subsequently decides not to proceed with the franchise. The franchisor must refund the application fee to the franchisee in full as the payment was made prior to the franchisee receiving a disclosure document.

Ending the franchise

The franchisee's right to carry on the franchised business is usually set for a defined period. Many franchises are set for a term of three years or five years, but there is no set or minimum term requirement.

Termination of a franchise agreement before the end of its term needs to be carefully managed and is regulated by the Code. A franchise agreement may only be terminated where termination is for the reasons set out in, and is conducted in the manner specified in the Code. The franchise agreement termination clauses must be consistent with the Code.



Franchisor's may be subject to financial penalties for failing to comply with the Code's obligations in relation to termination of a franchise agreement.

Unlawful termination can lead to claims by the franchisee for damages, and orders to set aside the purported termination.

Termination by franchisee during cooling-off

The Code gives the franchisee the right to terminate the franchise agreement during a seven day 'cooling-off' period.⁴⁵

The cooling-off period commences on the earlier of the franchisee entering into the franchise agreement or making any payment under the franchise agreement.

The franchisor must refund all payments made by the franchisee within 14 days of notice of termination. However, the franchisor is entitled to deduct from the amount required to be refunded, its reasonable expenses, provided that such expenses have been set out in the franchise agreement.⁴⁶ Note that the franchisee does not have a cooling-off right in the case of a renewal, transfer or extension of scope of a franchise agreement.⁴⁷

Termination by franchisor for franchisee breach

A franchisor may terminate the franchise agreement before the end of its term, by giving reasonable written notice to the franchisee, where the franchisee has breached the franchise agreement and has failed to remedy that breach within a reasonable time.⁴⁸

Before the franchisor can terminate the franchise agreement for breach, the franchisor must give to the franchisee a formal written notice, usually known as a 'Notice to Remedy Breach'. A franchisor must be able to demonstrate that:

- A Notice to Remedy Breach was properly served on the franchisee.
- The alleged breach and action required to remedy the breach were fully and accurately particularised in the Notice to Remedy Breach.
- The franchisee was given 'reasonable time' to remedy the breach.

45. Ibid cl 26

46. Ibid cl 26(3)

47. Ibid cl 26(2)

48. Ibid cl 27

What are the requirements for a notice to remedy breach?

To comply with the Code, the Notice to Remedy Breach must:

- Be in writing.
- Be sent to each of the contracting parties to the franchise agreement (i.e. the franchisee and where applicable the guarantors).
- Be sent to the address specified as being the contracting parties address for service of notices in the franchise agreement.

The Notice to Remedy Breach should set out in full:

- The clauses of the franchise agreement that the franchisee has breached.
- Particulars which evidence the breach.
- What action the franchisor requires the franchisee to undertake to remedy the breach.
- A reasonable time (which need not be more than 30 days) for the franchisee to remedy the breach.
- The franchisor's intention to terminate the franchise agreement if the breach is not remedied by the franchisee within the time allowed.

If the breach is not remedied within the time allowed, then the franchisor may take action to terminate the franchise agreement because of the breach. If the breach is remedied within the period allowed, the franchisor cannot terminate the franchise agreement because of that breach.



Termination of a franchise agreement is a serious step. 'Trivial' breaches of the franchise agreement may not justify termination of the franchise agreement.

Termination by franchisor in special circumstances

The Code provides that a franchisor may terminate the franchise agreement immediately (that is, without prior notice) in selected limited circumstances.⁴⁹ The limited circumstances where the franchisor can terminate the franchise agreement with immediate effect are where the franchisee:

- No longer holds a licence that the franchisee must hold to carry on the franchised business.
- Becomes bankrupt, insolvent under administration or an externally-administered body corporate.
- Is a company, and that company is deregistered by ASIC.
- Voluntarily abandons the franchised business or the franchise relationship.
- Is convicted of a serious offence.
- Operates the franchised business in a way that endangers public health and safety.
- Is fraudulent in connection with the operation of the franchised business.

A franchisor must be able to prove that special circumstances exist before terminating the franchise agreement without giving the franchisee prior notice. In order to rely on this clause of the Code, the franchise agreement must expressly give the franchisor the right to terminate the franchise agreement in these special circumstances.

49. Ibid cl 29

50. *Chahal Group Pty Ltd and Anor v 7-Eleven Stores Pty Ltd* [2017] NSWSC 532.

Case study

Termination for franchisee fraud⁵⁰

What happened:

A franchisee operated a 7-Eleven convenience store at McGraths Hill in New South Wales under a franchise agreement with 7-Eleven. The franchisee principal was the sole director of the franchisee company and was responsible for hiring two employees to work at the store.

The franchisee principal implemented an arrangement with the 2 employees for them to be paid relevant award rates into their bank accounts (as shown on their pay slips), but for the 2 employees to withdraw and return to the franchisee principal a specified cash amount from their pay each week. As a result, the 2 employees were underpaid.

Upon becoming aware of the cash-back arrangements, 7-Eleven terminated the franchise agreement and took possession of the franchised business on the basis that:

- The franchisee had acted fraudulently in implementing the cash-back arrangements.
- The continued occupation of the franchised business by the franchisee was likely to cause substantial damage to 7-Eleven's reputation.

The outcome:

In May 2017, the Supreme Court of New South Wales held that 7-Eleven was lawfully entitled to terminate the franchise agreement for fraud.

The case was significant as it shows that the deliberate, illegal and secretive underpayment of employees can amount to fraudulent conduct, entitling a franchisor to terminate a franchise agreement (where the franchise agreement permits termination on this basis). Importantly, the Court was satisfied that conduct in respect of only two employees was sufficient to make that finding, and that it was unnecessary for 7-Eleven to show that the conduct was more widespread within the franchisee's business.

Termination by franchisor in accordance with franchise agreement provision

The Code allows a franchisor to terminate a franchise agreement in accordance with a provision of the franchise agreement.⁵¹ For example, the franchise agreement may include a provision that entitles the franchisor to terminate the franchise agreement in the event that the franchisor ceases manufacturing the products sold through the franchise.

However, for such a termination to be valid, 'reasonable notice' of termination, and reasons for termination, must be given to the franchisee. What will constitute 'reasonable notice' will depend on the particular circumstances of the franchise and consequences for the franchisee. Generally, a substantial notice period will need to be given in order for the notice to be 'reasonable'.

Helpful information

For a detailed explanation of:

- Further Code requirements in connection with disputes and terminations, see pages [36](#) and [37](#).
- The impact of the Australian Consumer Law on a franchisor's ability to terminate a franchise agreement, see pages [44](#) and [45](#).
- Our advice regarding managing franchising disputes, see pages [56](#) to [59](#).

Disclosure of termination

A franchisor must disclose in its disclosure document details of any franchise agreement terminations.⁵²

Disputes in relation to termination of a franchise agreement

Termination of a franchise agreement carries significant consequences for both the franchisor and the franchisee. Therefore, any decision to terminate the franchise agreement must be carefully considered. The dispute resolution procedures set out in the Code (which include mediation) apply to disputes relating to termination of a franchise agreement. In addition to the Code, consideration has to be given to the rights of the franchisee to challenge termination in accordance with other statutory rights and the general law.

For example, a franchisee may be able to challenge the validity of termination based on the laws of equity, the duty of good faith, or unconscionable conduct (under the Australian Consumer Law). Franchise dispute resolution is covered later in this publication.



The Code regulates termination of a franchise agreement. A franchisor needs to proceed with caution if it wishes to terminate a franchise agreement. A substantial number of franchisee legal claims are based on unlawful termination of a franchise agreement by a franchisor.

Franchise transfers

A franchisor cannot prohibit a franchisee from selling its franchised business and transferring its franchise to a buyer. However a franchisor can control the process, and is permitted to reasonably withhold its consent to a transfer.

The Code provides that:

- A franchisor must not unreasonably withhold its consent to a franchisee's request to transfer its franchise.⁵³
- If a franchisee wishes to transfer its franchise, it must request the franchisor's consent. The franchisee must make this request in writing. A request for consent must be accompanied with all information that the franchisor may reasonably require to make an informed decision.⁵⁴
- A franchisor is taken to have given its consent if it has not, within 42 days after receiving the request from the franchisee, given to the franchisee written notice that consent is withheld and its reasons for withholding consent.⁵⁵
- If a franchisor has given its consent, it may reasonably revoke that consent within 14 days of giving its consent together with the reasons why consent is revoked.⁵⁶

Franchisor's consent to transfer

The Code sets out certain circumstances where it will be reasonable for a franchisor to withhold its consent to transfer of a franchise.⁵⁷ The circumstances set out in the Code include:

- The proposed transferee is unlikely to meet the financial obligations it will have under the franchise agreement.
- The proposed transferee does not meet reasonable requirements of the franchise agreement for the transfer of the franchise agreement.
- The proposed transferee does not meet the selection criteria of the franchisor.
- The proposed transferee does not agree, in writing, to comply with the obligations of the franchisee under the franchise agreement.
- The franchisee has not paid or made reasonable provision to pay any amount owing to franchisor.
- The franchisee has not remedied a breach of the franchise agreement.
- The proposed transferee has not provided the franchisor with a written statement that it has received and read the franchisor's disclosure document and the Code.

51. *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth) cl 28

52. *Ibid* annex 1 item 6.4

53. *Ibid* cl 25(2)

54. *Ibid* cl 24

55. *Ibid* cl 25(4)

56. *Ibid* cl 25(5)-(6)

57. *Ibid* cl 25(3)

The circumstances set out in the Code are not an exhaustive list of circumstances. Depending on the nature of the business, additional circumstances where it is reasonable for the franchisor to withhold its consent may exist. For example:

- The proposed transferee does not provide the franchisor with a satisfactory business plan.
- The proposed transferee cannot meet minimum financial and capital requirements.
- The proposed transferee is not of good character or reputation.
- The proposed transferee does not have the relevant business experience.
- The proposed transferee does not have the relevant educational requirements.

If the franchisor wishes to base its decision on circumstances that are not set out in the Code, it should set those circumstances out in the franchise agreement and refer to them in its disclosure document. It is also prudent for a franchisor to have a policy in place which clearly sets out its requirements and criteria for consent to a transfer to be granted.



A franchisee must seek the franchisor's consent to a franchise transfer, and the franchisor must not unreasonably withhold its consent.



Marketing and advertising funds

General obligations

The Code imposes certain obligations on a franchisor in relation to the establishment of a marketing fund and the use of the fees that are contributed to that marketing fund by franchisees.⁵⁸ The key obligations are:

- The franchisor must maintain a separate bank account for marketing and advertising fees contributed by franchisees.
- The franchisor must contribute to the marketing fund on the same basis as its franchisees for each company-owned store that it operates.
- Marketing and advertising fees may only be used to meet expenses that:
 - have been disclosed in the disclosure document;
 - are legitimate marketing or advertising expenses;
 - have been agreed to by a majority of franchisees; or
 - reflect the reasonable costs of administering and auditing the fund.

It is vital that a franchisor's disclosure document accurately discloses all expenses which the marketing fund may be used for (see Annexure 1, Item 15.1(f) of the Code for the specific disclosure requirements). The disclosures made in the disclosure document override any clauses in the franchise agreement which provide for additional and/or different expenses which the marketing fund may be used for. The importance of complying with the Code's marketing obligations was reinforced at the 2017 Franchise Council of Australia National Franchise Convention. The ACCC Deputy Chairman, Dr Michael Schaper, spoke candidly about the Commission's expectations for franchisor compliance with the Code and, importantly, compliance with the marketing fund obligations.

Annual financial statements for marketing funds

The Code also imposes obligations on franchisors in relation to preparing annual financial statements for marketing funds and providing copies of those financial statements to franchisees.⁵⁹

In summary:

- A franchisor must prepare an annual financial statement for its marketing fund within four months of the end of each financial year.
- A franchisor has an ongoing obligation to provide a copy of the annual financial statement for its marketing fund to all of its existing franchisees within one month of the statement being prepared (this obligation is in addition to the franchisor's other disclosure obligations).
- The annual financial statement for the marketing fund should be audited by a registered company auditor, unless 75% of the franchisor's franchisees vote that no audit is required within three months of the end of each financial year.

The ACCC has highlighted that failure to audit the marketing fund statement or to have the audited statement prepared within four months after the end of the financial year is a common area of franchisor non-compliance with the Code.



A franchisor's marketing fund must be established and managed in accordance with the Code.

58. Ibid cl 31

59. Ibid cl 15

Code provision	Code requirement	Compliance notes
Establish and maintain separate bank account (Clause 31(1))	A franchisor must maintain a separate bank account for marketing fees and advertising fees contributed by franchisees.	<p>A separate bank account is required.</p> <p>All marketing and advertising fees must be paid into the marketing fund bank account, or transferred to the marketing fund bank account on receipt.</p> <p>Franchisor outlet marketing fees must be paid into the marketing fund bank account.</p>
Franchisor units to contribute marketing fees (Clause 31(2))	If a franchisor operates one or more units of a franchised business, the franchisor must pay marketing fees and advertising fees on behalf of each unit on the same basis as other franchisees.	The Code refers to units operated by the 'franchisor'. There is an argument that units operated by another entity in the franchisor corporate group, are not units operated by the franchisor. However, it is generally established practice that corporate owned units which operate on the same basis as franchised units must pay marketing fees on the same basis as franchisees.
Using marketing fees to meet expenses (Clause 31(3))	<p>Marketing fees and advertising fees may only be used to:</p> <ul style="list-style-type: none"> ▪ Meet expenses that have been disclosed at item 15.1(f) of the disclosure document. ▪ Meet expenses that are legitimate marketing or advertising expenses. ▪ Meet expenses that have been agreed to by the majority of franchisees. ▪ Pay for the reasonable costs of administering and auditing the marketing fund. 	<p>Any term of the franchise agreement which provides for other expenses to be paid out of the marketing fund would not be enforceable.</p> <p>Item 15.1(f) of the disclosure document must clearly outline the expenses that the marketing fees may be used for.</p> <p>Failing to disclose a relevant marketing expense in the disclosure document will trigger the need for the franchisor to assert that an expense is 'legitimate' (which is open to objection) or otherwise to obtain the agreement of the majority of the franchisees (which adds time and cost, and agreement may not be reached).</p>
Prepare annual financial statements (Clause 15(1)(a) and (b))*	<p>The franchisor must prepare an annual financial statement detailing all of the fund's receipts and expenses for each financial year.</p> <p>The statement must be prepared within four months of the end of each financial year.</p>	<p>The statement must include sufficient detail of the fund's receipts and expenses to give meaningful information about sources of income and items of expenditure (particularly with respect to advertising and marketing expenditure).</p> <p>For a 30 June financial year end, the financial statement must be prepared by 31 October. Note that if the statement is to be audited, then the financial statement must be prepared in advance to allow time for the audit report.</p>
Audit of annual financial statement (Clause 15(1)(c) and (e))*	<p>The annual marketing fund statement must be audited by a registered company auditor within 4 months of the end of each financial year.</p> <p>A franchisor does not have to have the statement audited if 75% of the franchise network vote that no audit is required, and that agreement is made within 3 months of the end of the financial year.</p>	<p>For a 30 June financial year end, the audited report must be prepared by 31 October.</p> <p>If a franchisor does not want to have the financial statement audited, it must obtain franchisee agreement.</p> <p>Agreement must be obtained by a vote of all franchisees who contribute to the marketing fund, and 75% (or more) of franchisees must vote that no audit is required.</p> <p>The franchisee vote and agreement must be obtained within 3 months of the end of each financial year. For a 30 June financial year end, agreement must be obtained by 30 September.</p>

Code provision	Code requirement	Compliance notes
Provide copy of statement and report to franchise network (Clause 15(1)(d))*	A copy of the marketing fund financial statement and the audited report must be provided to each existing franchisee within 30 days of preparation.	Franchisors should take care providing the financial statement and the audited report to franchisees at the same time. The financial statement is likely to have been prepared at a date in advance of the audit, and therefore the 30 day time limit may be a different date. The ACCC closely monitors franchisor compliance with the marketing fund provisions in the Code. See for example the recent ACCC action against Dominos in which an infringement notice (and penalty) was imposed against Dominos for providing its marketing fund financial statement and audited report to franchisees outside of the required time frames.
Disclose information in disclosure document (Item 15 of Annexure 1)	A franchisor must disclose certain information in relation to the marketing fund and collection and use of marketing fees at Item 15 of the disclosure document. An accurate and current response must be given to each disclosure item.	Failure to disclose the required information in the disclosure document in the form specified will amount to a breach of clause 8 of the Code. A breach of clause 8 of the Code is a penalty provision, and civil penalties may be applied. Misleading or inaccurate information in the disclosure document may amount to misleading or deceptive conduct in contravention of the Australian Consumer Law. Information disclosed in a disclosure document must be consistent with actual practice and relevant contractual terms in the franchise agreement.
Obligation to act in good faith (Clause 6)*	Each party (the franchisor and the franchisee) to a franchise agreement must act in good faith towards the other party. The obligation to act in good faith extends to pre-agreement negotiations and disputes and cannot be contractually limited.	The general obligation on the franchisor to act in good faith, extends to the collection of marketing fees from franchisees and the operation and administration of the marketing fund.
Keeping certain information (Clause 19)	A franchisor must keep all documents which support statements and claims made by a franchisor in its disclosure document(s) for at least 6 years.	The Code imposes obligations on franchisors to retain all records relevant to preparation of the marketing fund financial statements and each of the marketing disclosures made at Item 15 of a disclosure document.

* This is a penalty provision. A franchisor's failure to comply with this provision may attract civil penalties of up to \$63,000 per breach. Infringement notices in the amount of \$10,500 per breach may also be issued by the ACCC.

Terms of the franchise agreement

The Code does not specify a 'proforma' franchise agreement, nor does it impose a set of terms or require certain terms to be included in the franchise agreement. However, the Code does prohibit or restrict certain terms from being included in a franchise agreement.

Release on Liability

The franchise agreement must not contain or require a franchisee to sign a general release of liability or waiver of any verbal or written representation made by the franchisor.⁶⁰ Any such clause in a franchise agreement will have no effect.

Jurisdiction for Settling Disputes

The franchise agreement must not require a party to bring an action or proceedings in relation to a dispute in any State or Territory outside of which the franchised business is based, or in any jurisdiction outside of Australia.⁶¹

There is a similar prohibition in relation to mediation of disputes. The franchise agreement must not require a party to participate in a mediation in any State or Territory outside of which the franchised business is based, or in any jurisdiction outside of Australia.⁶² Any such clauses in a franchise agreement will have no effect.

Costs of Settling Disputes

A franchise agreement must not contain a clause that requires a franchisee to pay the franchisor's costs to settle a dispute under the franchise agreement.⁶³ Any such clause in a franchise agreement will have no effect.

Restraint of Trade Clauses

The Code regulates the enforcement of 'restraint of trade' clauses in franchise agreements that apply after the term of the agreement has expired or otherwise comes to an end.⁶⁴

If, once a franchise agreement has expired, the franchisee seeks to extend the franchise agreement and the franchisor does not agree to the extension, then the Code provides some protection to the franchisee by deeming any restraint of trade clauses in the franchise agreement as having no effect.

The 'protection' for the franchisee will only apply if:

- the franchisee had indicated, in writing, that it wants to extend the franchise agreement on substantially the same terms as those contained in the franchisor's then current franchise agreement;
- the franchisee is not in breach of the franchise agreement at the time it expires; and
- the franchisee has not infringed upon the franchisor's intellectual property, or breached its confidentiality agreement under the franchise agreement during the term of the franchise agreement and either:
 - the franchisee claims compensation from the franchisor for goodwill because the franchise agreement is not extended, but the compensation given by the franchisor is a nominal amount and does not provide genuine compensation for goodwill; or
 - the franchise agreement does not allow the franchisee to claim compensation for goodwill in the event that the agreement is not extended.

It is important to note that the 'protection' does not apply where the franchisor has terminated a franchise agreement for breach of the agreement by the franchisee.

Other obligations and requirements

Requiring the franchisee to incur significant capital expenditure

The Code regulates the ability of the franchisor to require a franchisee to undertake significant capital expenditure in relation to the franchisee's franchised business.⁶⁵ A franchisor must not require a franchisee to undertake significant capital expenditure during the term of the franchise agreement. However, there are some exceptions to this general rule. A franchisor can require a franchisee to undertake expenditure which:

- Was disclosed to the franchisee in the disclosure document that it received before entering into, renewing, or extending its franchise agreement.
- Will be incurred by all or a majority of franchisees and a majority of those franchisees approve the expense.
- Is necessary to comply with legislative obligations.
- Has been agreed to by the franchisee.
- Is considered necessary by the franchisor as a capital investment in the franchised business, justified by a written statement which sets out the:
 - rationale for making the investment;
 - the amount of capital expenditure required;
 - anticipated outcomes and benefits of the investment; and
 - expected risks associated with the investment.

What expenditure may be 'significant capital expenditure'?

The Code does not provide a definition of 'significant capital expenditure'. Significant capital expenditure could include expenditure related to:

- A store upgrade.
- Introduction of a new point of sale system.
- Introduction of new equipment.

60. Ibid cl 20

61. Ibid cl 21(1)

62. Ibid cl 20(2)

63. Ibid cl 2

64. Ibid cl 23

65. Ibid cl 30

Disclosing former franchisees details

A franchisor is required to disclosure details of former franchisees in its disclosure document.⁶⁶ However, where a former franchisee requests that its details not be disclosed, the franchisor must not disclose those details. It is important to note that a franchisor must not engage in conduct with the intention of influencing a former franchisee to make, or not make, a request that its details not be disclosed to prospective franchisees in the franchisor's disclosure document.⁶⁷

Association of franchisees

The Code provides that a franchisor must not engage in conduct that would restrict its franchisees (and former franchisees) freedom to form an association, or interact with each other for a lawful purpose.⁶⁸

Record-keeping

A franchisor must keep certain records to both monitor, and provide evidence of, compliance with the Code (and any other applicable legislation).⁶⁹ The Code requires franchisors to maintain the following documents for at least six years:

- Copies of all documents it is required to generate or publish under the Code, such as its disclosure document(s), franchise agreement(s) and marketing fund statement(s).
- Where a franchisee or prospective franchisee is required to give something to the franchisor in writing, the franchisor is required to keep this type of document or a copy of it. This includes any documents provided electronically.
- If a franchisor makes any statement or claim in its disclosure document which relies on another document to support that statement or claim, it must keep a copy of the supporting document.

What kinds of documents provided by the franchisee should be retained by the franchisor?

Typical documents that a franchisee may provide to a franchisor include:

- Confirmation of receipt of the disclosure document.
- Professional advice statement.
- Marketing fund audit votes.
- Requests to transfer a franchise to a third party (and any additional information provided regarding the transfer).
- Requests for a disclosure document.
- Notices of dispute.
- A request not to disclose the franchisee's details (where that franchisee becomes a former franchisee of the franchise network).

The ACCC has the power to obtain documents or information from a franchisor that the franchisor is required to keep, generate or publish under the Code.



66. Ibid annex 1 item 6

67. Ibid cl 32

68. Ibid cl 33

69. Ibid cl 19

Good faith obligation

On 1 January 2015, a duty of 'good faith' in franchise arrangements was introduced to the Code.

The Code includes a general obligation on both parties to a franchise arrangement (the franchisor and the franchisee) to act in good faith in their dealings with the other party.⁷⁰ The wide drafting of this good faith obligation means that the duty of good faith will be relevant to almost all aspects of the relationship between a franchisor and a franchisee or a prospective franchisee, including:

- Pre-contractual negotiations.
- Performance of a franchise agreement.
- Dispute resolution.
- The end (including termination) of a franchise agreement.



Failure to act in 'good faith' is a breach of the Code, which could give rise to a financial penalty (in addition to any other remedies that an aggrieved party may have at law).

What it Meant by 'good faith'?

The Code provides that 'good faith' takes on the same meaning that exists at common law (which will continue to develop and evolve in Australia over time).

Under common law, the duty of good faith generally includes an obligation on the parties to cooperate in achieving the contractual objectives of an agreement, in compliance with honest standards of conduct and in compliance with standards of conduct that are reasonable having regard to the interests of the parties. Conduct may lack good faith if a party acts dishonestly, for an ulterior motive or in a way that undermines or denies the other party the benefits of a contract.⁷¹

The Code lists the following non-exhaustive factors that a court may have regard to when determining if a party has breached its obligation to act in good faith:

- Whether the party acted honestly and not arbitrarily.
- Whether the party cooperated to achieve the purposes of the franchise agreement.

However, the Code states that the obligation to act in good faith does not prevent a party to a franchise agreement, or a person who proposes to become such a party, from acting in their legitimate commercial interests. More specifically, the Code is clear that if a franchise agreement does not allow a franchisee to renew or extend the agreement, this does not mean that a franchisor has not acted in good faith in negotiating or giving effect to the agreement.

While the Code provides examples of what is not a breach of the good faith obligation, it is less certain on what the positive duty to act in good faith is comprised of. The definition of good faith in the Code by reference to common law means that the courts will be guided by case law when analysing a party's conduct.

Legitimate business conduct is not a breach of 'good faith'

The concept of 'good faith' does not prevent a party from acting in their own legitimate commercial interests.

In the ACCC's Franchisor Compliance Manual, the ACCC notes that:

*'good faith will require parties to act honestly and cooperatively during the negotiation of a Franchise Agreement, [however] it is unlikely to compel a franchisor to make requested additions or changes to an agreement. Similarly, the decision by a franchisor not to offer a franchisee an option to renew or extend their Franchise Agreement does not mean that the franchisor has not acted in good faith in negotiating the agreement.'*⁷²

Examples of conduct that may show a lack of 'good faith'

In the ACCC's Franchisor Compliance Manual, the ACCC provides the following examples of conduct that may raise concerns under the obligation of good faith.

A franchisor may not be acting in good faith if:

- A franchisor treats a franchisee differently to other franchisees because the franchisee has raised concerns about the franchise system.
- A franchisor raises numerous minor and immaterial breaches of a franchise agreement with a franchisee in an aggressive and intimidatory manner designed to extract concessions or cessation of complaints.⁷³

A franchisee may not be acting in good faith if:

- A franchisee uses confidential information provided by the franchisor to compete with the franchisor.
- A franchisee uses social media to post negative comments about the franchisor or a dispute with the franchisor.⁷⁴



All parties to a franchise agreement (including the franchisor and the franchisee) have a statutory obligation to act towards each other in good faith.

70. Ibid cl 6

71. This approach has been cited with approval in a number of cases including *Burger King Corp v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558 and *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1. In *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1952) 26 NSWLR 234, Priestley JA observed that the reasonableness requirement has much in common with the notion of good faith. This approach received support in a number of subsequent decisions and good faith is often equated with the concept of reasonableness

72. Australian Competition and Consumer Commission Franchisor Compliance Manual (8 December 2014) www.accc.gov.au/publications/franchisor-compliance-manual

73. Ibid

74. Ibid

What should franchisors do?

The breadth of the Code's good faith obligation means that it will apply to almost all aspects of a relationship between a franchisor and a franchisee or a prospective franchisee. In particular, franchisors should be conscious of this obligation when:

- Negotiating the terms of a franchise agreement with a prospective franchisee.
- Deciding whether or not to enter into a franchise agreement with a prospective franchisee.
- Considering whether to consent to the transfer of a franchise.
- Considering whether a franchisee has satisfied its conditions of renewal of a franchise agreement.
- Determining arrangements in relation to the supply of goods or services to franchisees.
- Dealing with disputes with franchisees or prospective franchisees.
- Considering whether to terminate a franchise agreement.

There are some basic guidelines that franchisors should adhere to in order to minimise the risk of being found to be in breach of the duty of good faith. For example, franchisors and commercial parties generally should ensure that decisions made and actions taken have legitimate business objectives that can be demonstrated. In order to assist parties in this respect, franchisors should maintain detailed records that set out their business objectives which can be referred to later if required. In drafting notices of breach or notices of termination, a franchisor should ensure that it identifies the nature and basis of the allegations it makes against a franchisee and what action must be taken by the franchisee to remedy the breach. It is also strongly recommended that a franchisor instigate and participate in mediation prior to ultimately terminating a franchise agreement.

A franchisor should resist issuing notices of breach and threatening termination of a franchise agreement where it has no genuine intention to terminate the agreement, but is seeking to manipulate an outcome or coerce the franchisee into conduct which is not directly related to the breach notice. Equally, withholding consent to a renewal or transfer of a franchise for an ulterior purpose should be resisted.

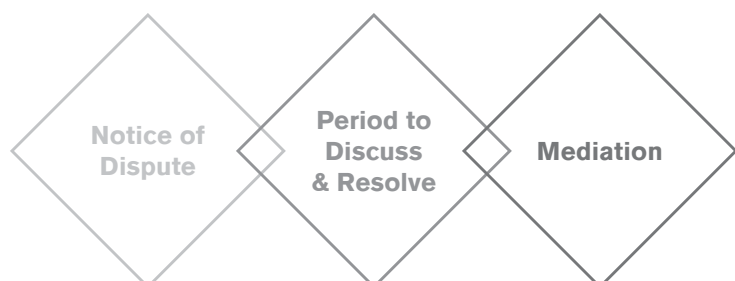


The ACCC can seek penalties of up to \$63,000 for breaches of penalty provisions of the Code.

The ACCC also has additional powers to collect information from franchisors and conduct compliance audits, so franchisors should be diligent in maintaining records that evidence the business's rationale for decisions made and actions taken with respect to franchisees and prospective franchisees.

Complaint handling and dispute resolution

The Code provides mechanisms for parties to a franchise agreement to try to resolve disputes in a timely and cost effective manner. The Code's dispute resolution procedure is set out in Part 4 of the Code. The procedure broadly involves a sequence of attempts to try and resolve the dispute through discussions between the parties, followed by mediation.



The Code provides that all franchise agreements must include clauses which provide for a complaint handling and dispute resolution procedure that is consistent with the procedure set out in the Code.⁷⁵ Part 4 of the Code does not affect the right of a party to bring legal proceedings.

Dispute resolution process

Where there is a franchising dispute, any party to the franchise agreement may initiate the complaint handling procedure under the Code or the franchise agreement. The Code dispute resolution process involves the following steps:

1

Notice of Dispute

The complainant must give the other party written notice of the nature of the dispute, the outcome they are seeking and the action they think will settle the dispute.

2

Informal discussions

The franchise parties should then try to agree about how to resolve the dispute.

3

Mediation

If the franchise parties cannot agree how to resolve the dispute within 3 weeks of their informal discussions, either party may refer the matter to mediation.

Mediation involves an informal meeting and negotiation between the franchise parties facilitated by a mediator. Mediation is a cost-effective way of resolving franchising disputes without resorting to complex and costly legal action.

⁷⁵. *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth) cl 34

⁷⁶. *Ibid* cl 40

⁷⁷. *Ibid* cl 41(3)

⁷⁸. *Ibid* cl 36

The Code requires that a mediation relating to a franchise agreement must be conducted in Australia. The parties to the dispute are equally liable for the costs of a mediation unless otherwise agreed.

The mediator must be agreed to by all of the franchise parties. If the parties cannot agree to the person appointed as mediator, then they can ask the Australian Office of the Franchising Mediation Adviser to appoint a mediator. The Australian Office of the Franchising Mediation Adviser will appoint a mediator from its panel of mediators for franchise disputes.

What is the role of the mediator?

The role of the mediator is to help the parties to a dispute to identify the issue(s) in dispute, facilitate the discussion between the parties and assist the parties to negotiate a resolution to the dispute that is acceptable to all parties.

Mediators don't give legal advice or make decisions like a judge. They simply assist parties to come together and negotiate an outcome that is acceptable to both parties.

A party's obligation to attend mediation

If a franchise party initiates mediation, then it is mandatory for all other parties to the dispute to attend the mediation under the Code. It is a penalty offence for a party not to attend mediation.⁷⁷

It is also a requirement under the Code that the franchise parties try to resolve the dispute, and approach the dispute in a reconciliatory matter.⁷⁸

This includes:

- Attending and participating in meetings.
- Not taking action (and not refusing to take action) during the dispute that could damage the reputation of the franchise system.
- If mediation is used, making it clear at the beginning of the mediation what the party is trying to achieve and observing obligations of confidentiality.



All parties to a franchising dispute must follow a process that is consistent with the Code's complaint handling and dispute resolution procedures.

Helpful information

For a detailed explanation of:

- Further Code requirements in connection with disputes and termination, see [page 28](#).
- The impact of the Australian Consumer Law on a franchisor's ability to terminate a franchise agreement, see [pages 44 to 46](#).
- Our advice regarding managing franchising disputes, see [pages 56 to 61](#).

Consequences of failing to comply with the Code

Failure to comply with the penalty provisions of the Code may result in the ACCC taking court action and seeking a financial penalty or issuing an infringement notice against an infringing party. Failure to comply with the other (non-penalty) provisions of the Code may result in the ACCC seeking appropriate remedies including court enforceable undertakings against an infringing party.

Franchisee parties (prospective and existing franchisees, as well as franchisee owners) may also take legal action seeking remedies against a franchisor, including damages for loss or damage they have suffered as a consequence of breach of the Code.

Who is liable for breaches of the code?

The franchisor company is primarily responsible for compliance with the law, including the Code.

However, individuals can also be liable for non-compliance with the law. Individuals' liability can extend to the directors, the secretary, other officers or the board members of the franchisor company. Liability can also extend to employees of the franchisor company. A person may be liable if they:

- Attempt to breach the Code.
- Assist, or induce, another party to breach the Code.
- Are a party to the breach of the Code.
- Are knowingly concerned with a breach of the Code.

Financial penalties for breaches of the Code

The ACCC can seek financial penalties for breaches of certain penalty provisions of the Code. Not all breaches of the Code will attract a financial penalty. There are currently 24 penalty provisions in the Code.

The current financial penalty for a breach of a Code penalty provision is \$63,000 per breach.⁷⁹ Ultimately a court will determine the final penalty amount (if any) that is imposed against the person who has breached the Code. Additionally, the ACCC can issue infringement notices where the ACCC has reasonable grounds to believe that a person has contravened certain provisions of the Code. The penalty amount for an infringement notice can vary, but in most cases, the current penalty amount is fixed at \$10,600 per breach for a corporation and \$2,520 per breach for an individual.

The ACCC has stated that infringement notices will be used to allow the ACCC to move swiftly to deal with situations where it has reasonable grounds to believe there have been breaches of the Code, while the court penalties will be used to provide more teeth in deterring rogue operators.

Note that penalty units are reviewed on a regular basis, resulting in increased financial penalties.

⁷⁹. As at 1 July 2017. Section 4AA of the *Crimes Act 1914* (Cth) sets the value for a penalty unit at \$210 per unit. The Code penalty provisions each have a civil penalty of 300 penalty units

Which breaches of the Code will attract financial penalties?*

The following breaches of the Code may attract financial penalties:

Failure to act in good faith.

Failure to provide a disclosure document to a prospective franchisee (or renewing franchisee, or existing franchisee).

Failure to provide a Code compliant disclosure document.

Failure to update the disclosure document each financial year.

Failure to allow a prospective franchisee 14 days to review a disclosure document.

Failure to provide a copy of lease documentation, and other relevant agreements before entering into the franchise agreement.

Failure to comply with the marketing fund provisions, including providing annual financial statements for the marketing fund to all franchisors.

Failure to disclose materially relevant facts to the franchise network.

Failure to provide notice of end of term arrangements (within the specified time frames).

Failure to provide reasonable written notice of proposed termination of a franchise agreement for breach.

Restricting franchisees from forming associations.

Failure to attend mediation, or follow the process for mediation.

*Note that the above is a non-exhaustive list.

What are infringement notices?

The ACCC can issue an infringement notice where the ACCC has reasonable grounds to believe that a person has contravened certain provisions of the Code. The infringement notice will include information about the nature of the alleged contravention, the penalty to be paid and the period for payment (28 days) to avoid court action. If the franchisor pays the infringement notice within the required period, the ACCC may not take court action in relation to the alleged contravention. A franchisor may choose not to pay an infringement notice penalty, in which case the ACCC may decide to take court action.

Each breach of the Code can attract a separate infringement notice. For example, a failure by a franchisor to provide disclosure documents to three prospective franchisees could result in the ACCC issuing three infringement notices. The ACCC's infringement notice process is transparent, with details of the payment that the franchisor has to make being made public via an online register and a media release.

Claims by franchisees

Aggrieved franchisees can also seek remedies where the franchisor has breached the Code. Examples of remedies include:

- Compensation or damages for loss or damage suffered by a franchisee.
- Corrective orders requiring the franchisor to do an act or thing (for example, refunding franchise fees paid by the franchisee as required under the Code).
- Injunctions which restrain the franchisor from engaging in the certain conduct (for example, restraining the franchisor from terminating a franchise agreement).

Franchisors should also remember that non-compliance with the Code could also breach certain selections of the CCA. For example, failing to provide a disclosure document could give rise to a separate claim for misleading or deceptive conduct and/or unconscionable conduct in breach of the CCA. Most franchisee claims and ACCC prosecutions for breaches of the Code will include claims based on the CCA.

Case study

Examples of legal action taken for non-compliance with the Code

Domino's Pizza:

In May 2017, the franchisor was issued with two separate infringement notices requiring payment of penalties totaling \$18,000 for failure to provide the marketing fund financial statement and audit report to its franchisees.⁸⁰

Pastacup:

The ACCC commenced proceedings against Pastacup alleging that the disclosure document it provided to prospective franchisees did not comply with the Code as it failed to disclose that the company's former director was also a director of two previous Pastacup franchisor companies which became insolvent. In November 2017, the Federal Court ordered Pastacup to pay penalties totaling \$100,000 for breaches of the Code. The Federal Court also ordered the former founder and director of Pastacup to pay \$50,000 for being knowingly concerned in the breaches.⁸¹



Failing to comply with the Code can carry serious consequences including financial penalties. The ACCC actively investigates and audits franchisor compliance with the Code.

80. Australian Competition and Consumer Commission *Domino's pays penalty for alleged Franchising Code breach* (8 May 2017) <https://www.accc.gov.au/media-release/domino%E2%80%99s-pays-penalty-for-alleged-franchising-code-breach>

81. Australian Competition and Consumer Commission *ACCC takes action against Pastacup for alleged breaches of Franchising Code* (22 September 2016) <https://www.accc.gov.au/media-release/accc-takes-action-against-pastacup-for-alleged-breaches-of-franchising-code>



Chapter four The Competition and Consumer Act

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The *Competition and Consumer Act 2010* (Cth) (the **CCA**) (previously known as the *Trade Practices Act 1974* (Cth)) regulates the way in which a franchisor conducts its business, and importantly how it interacts with its franchisees.

The CCA is relevant to how a franchisor operates its business (for example setting prices, controlling product and service delivery), how it promotes its business to the public and to franchisees, how it manages and controls system and operational compliance within its franchise system, and how it deals with its franchisees. All franchisors must comply with the CCA.

A franchisor cannot ask a franchisee to waive the franchisor's non-compliance with the CCA or include a clause in the franchise agreement which excludes or modifies the operation of the CCA.

The CCA has two core objectives:

1. To promote and protect competition and fair trading - the CCA contains very broad provisions that aim to protect and promote competition by prohibiting or restricting certain anti-competitive behavior in Australian markets. These provisions are commonly referred to as the restrictive trade practices provisions.
2. To protect consumers (including 'business consumers') - the CCA contains very broad provisions that aim to protect Australian consumers (including business consumers – which extends to franchisees) by regulating the manner in which goods and services are advertised, sold and supplied. The relevant consumer protection provisions are contained in the Australian Consumer Law schedule to the CCA.

Consumer protection

Australian Consumer Law

The Australian Consumer Law (**ACL**) (set out in Schedule 2 of the CCA) is a national law which regulates fair trading and consumer protection in the Australian market.

The ACL covers general standards of business conduct, prohibits unfair trading practices, regulates specific types of business-to-consumer (including business-to-business consumer) transactions, provides basic consumer guarantees for goods and services, and regulates the safety of consumer products and product-related services.

The ACL has direct application to the way that a franchisor conducts its business, promotes its franchise system and deals with its franchisees. The ACL is also relevant to the manner in which a franchisor interacts with its suppliers, customers and the public generally.

What are some examples of franchisor business practices that carry an ACL compliance risk?

The ACL is relevant to a wide range of franchisor business practice and conduct, such as:

- Promoting the franchise system and network.
- Negotiations and discussions with franchisees during the franchisee recruitment phase.
- Disclosure of information to franchisees, both prior to signing the franchise agreement and during the term of the franchise agreement.
- Making changes to the franchise system or the manner in which franchisees operate their businesses.
- All communications made to the franchise network, including through social media and e-commerce.
- The exercise of contractual rights under the franchise agreement.
- Enforcing compliance, including issuing notices of breach to franchisees.
- Decisions to renew or not renew the franchise agreement.
- Decisions to terminate or end the franchise agreement.

Misleading or deceptive conduct

General obligation to not engage in misleading or deceptive conduct

The ACL contains a general obligation on all persons doing business to not engage in misleading or deceptive conduct.

The requirement to not engage in misleading or deceptive conduct is set out in section 18 of the ACL. This section provides that '*a person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.*'

Misleading or deceptive conduct includes any conduct (including written and verbal representations and silence) which misleads or deceives, or is likely to mislead or deceive. Intention is not a requirement for a breach of this provision. In other words, it does not matter whether or not the misleading or deceptive conduct was intentional or was intended to mislead or deceive the other party.



Misleading or deceptive conduct is concerned with the overall impression created by particular conduct. For conduct to not be misleading or deceptive, the overall impression of the conduct must be truthful.

Risk of franchisee claims for misleading or deceptive conduct

Many franchisee claims against franchisors include claims based on allegations of misleading or deceptive conduct by the franchisor (including the franchisor's directors, managers, employees and representatives). Disclaimers, waivers and liability exclusion clauses are not effective to exclude statutory liability for misleading or deceptive conduct, but can be helpful to limit exposure in some scenarios.

A franchisor must take care with its communications to prospective franchisees, individual franchisees and the franchise network. All communications must be accurate, complete and current.

'Risk' areas for franchisors include:

Promoting and marketing the franchise

Franchisors need to ensure that all marketing and promotional material provided to prospective franchisees in relation to the franchise network is accurate. This applies to advertising materials, franchise brochures, information provided at trade fairs, and website information.

Franchisors must be very careful when making any claims concerning the potential turnover, profitability or likelihood of success of a franchised business. Providing financial information, including franchise revenue, operating costs and profit, is often high risk.

Example

A franchisor's marketing brochure includes financial data for a 'typical store' (such as revenue, expense, and profit details). The financial data is for a profitable company owned store and is not for a franchised store.

This is not disclosed in the brochure. Additionally, the financial data does not include franchise fees and other costs associated with a franchised operated store.

The financial data does not accurately model the usual expenses and profit for a franchised store and is therefore misleading and inaccurate.

Information provided to prospective franchisees

All information provided to a prospective franchisee should be carefully checked to ensure that the information is accurate and not misleading. This applies to information contained in franchise proposals and the disclosure document, and specific information in relation to the franchise to be acquired by the prospective franchisee.

Pre-contractual discussions with franchisees also need to be carefully managed. Franchisors need to take care to ensure that all communications are accurate, current and complete. This applies to all written and verbal communications.

Example

A prospective franchisee informs a franchisor's sales representative that the number of stores operating in NSW is an important consideration for its decision to purchase a franchise. The franchise sales representative tells the prospective franchisee that 'we have 10 franchised stores in New South Wales, with more joining us every month'.

The prospective franchisee signs the franchise agreement in reliance on this representation. However, the statement is not accurate. Eight of the existing franchised stores have previously given notice that they would not renew their franchise agreements, and accordingly the size of the NSW network will be reduced to 2 stores within 3 months.

The sales representative's statement to the prospective franchisee is misleading. The prospective franchisee may be able to make a claim for damages if it can show that its business has suffered as a consequence of the decline in store numbers.

'Hot spots' – franchisee claims

There are some recognised 'hot spots' for franchisors that often give rise to claims that the franchisor's representations induced a franchisee to buy a franchise and enter into a franchise agreement. Care needs to be taken to ensure that any representations made in the following areas are accurate, current and complete:

- Potential future turnover of the franchised business.
- Profitability of the franchised business.
- Likelihood of success of the franchised business.
- Future developments in the shopping centre where the franchised business will operate.
- 'Traffic flow' or 'foot traffic' of past franchised businesses.
- The extent of exclusivity granted to the franchisee.
- The franchisor's future business intentions.
- The obligations of the franchisor, specifically in relation to future training and the provision of back-office systems.

Statements made to the franchisee during the term of the franchise

Franchisors need to take care with all representations made to the franchise network. This applies to representations made to individual franchisees as well as representations made to the entire franchise network.

Example

A current franchisee asks its franchisor's territory manager whether its franchise agreement will be renewed at the end of the term of the agreement. The franchise agreement has 12 months remaining, and the franchisee wishes to know whether the franchise will be renewed before it signs a new lease and completes an expensive store re-fresh.

The territory manager says 'don't worry, head office will definitely give you another agreement when your current franchise agreement expires'. Following this representation, the franchisee signs a new five-year premises lease and completes the expensive store re-fresh.

However, head office refuses to renew the franchisee's franchise agreement, and makes the decision to take back that store and run it as a company owned store. The franchisor is exposed to a risk of a claim for misleading or deceptive conduct as a result of the statements made by the territory manager, because the franchisee relied on those statements when it signed the new five-year premises lease and completed the expensive store re-fresh.

The franchisee could seek damages and/or an order from the Court that the franchisor renew the franchisee's franchise agreement for an additional term.

Case study

Representations made in disclosure documents and franchise proposals⁸²

What happened:

SensaSlim supplied an oral spray called SensaSlim Solution and claimed that it could cause weight loss. The SensaSlim Solution was distributed through franchisees to be on-sold to consumers through retail outlets.

Around 110 areas were sold to franchisees (who were referred to as area managers) for the cost of \$59,950 each. SensaSlim earned approximately \$6.4 million from the sale of these franchises.

The 'controlling mind' of the SensaSlim business was Peter Foster. Mr Foster had a poor business reputation, including in relation to the sale of weight loss drugs in the past. Because of that reputation, SensaSlim concealed his involvement in the business, and represented that the only directors who played an active role in managing the business were Peter O'Brien and Michael Boyle. Importantly, Mr Foster was not disclosed as being an officer of the franchisor in the SensaSlim disclosure document.

SensaSlim's franchise proposal made various claims in relation to the SensaSlim Solution and the franchise opportunity. The franchise proposal included a claim that the SensaSlim Solution was the subject of 'a large worldwide clinical trial'. Representations were also made that SensaSlim franchisees were already participating in, and profiting from, the SensaSlim franchise, and that a SensaSlim franchise had a certain earning potential of \$4,000 per week.

In 2011, the ACCC initiated proceedings against SensaSlim and its officers. The proceedings alleged that SensaSlim engaged in misleading and deceptive conduct and made false representations in its franchise disclosure documents and in its proposals to prospective franchisees.

The outcome:

The Federal Court found that there were three separate contraventions of the ACL.

- The deliberate concealment of Mr Foster's involvement with SensaSlim from the disclosure documents was misleading because its intention was to 'create a façade of respectability for the business' and to mislead persons to become franchisees. The Court found that Mr Foster went to great lengths to hide his involvement in the business from franchisees and others. The Federal Court imposed the maximum penalty of \$1.1 million for this highly 'fraudulent and covert' contravention.
- SensaSlim's claim in its franchise proposal that its oral spray was the subject of 'a large worldwide clinical trial', was false. No such trial was ever conducted. The Court found that this misrepresentation constituted two courses of conduct: (1) deliberately and fraudulently inducing prospective franchisees to pay for the business; and (2) misleading prospective franchisees and consumers as to the scientifically proven effectiveness of the product. The Court ordered SensaSlim to pay a pecuniary penalty of \$1.1 million for each contravention.
- SensaSlim's claim about what a franchisee could earn was made without reasonable grounds and was therefore misleading and deceptive. SensaSlim was ordered to pay a pecuniary penalty of \$250,000 for this breach.

The total pecuniary penalty for SensaSlim's misrepresentations made in its disclosure documents and franchise proposals was \$3.35 million. Mr Foster, Mr O'Brien and Mr Boyle were found to be knowingly concerned in and party to some of SensaSlim's contraventions. In addition to the orders made against SensaSlim, the Court imposed a pecuniary penalty on each of the officers, and ordered that they be disqualified from managing corporations for lengthy periods of time. Mr Foster was personally ordered to pay a penalty of \$660,000.

82. *Australian Competition and Consumer Commission v SensaSlim Australia Pty Ltd (in liq)* (No 5) [2014] FCA 340 (8 April 2014)

Obligation to not make false or misleading representations

In addition to the general protection against misleading or deceptive conduct, section 29 of the ACL prohibits businesses from making certain false or misleading representations. False or misleading representations that fall within this section of the ACL can attract penalties of up to \$1.1 million for companies, \$220,000 for individuals and criminal prosecution. In a franchising context, the types of representations that may contravene section 29 of the ACL include:

- False or misleading representations that the franchisor's services are of a particular standard.
- False or misleading representations in relation to the price payable for the franchise grant.
- False or misleading representations that a particular person will also buy a franchise.
- False or misleading representations that purport to be testimonials about the franchise.
- False or misleading representations that the franchise system has certain approvals or affiliations that it does not have.

Representations concerning a future matter

Representations concerning a 'future matter' are a special category of potentially misleading or deceptive conduct.

Representations made in relation to future matters will be deemed to have been misleading, unless the person making the representation had reasonable grounds for doing so, which is supported by evidence, at the time of making the representation.

Common examples of representations falling into this special category include:

- Financial projections.
- Future training figures.
- Future competitor activity.
- Market predictions.
- Making promises in relation to the occurrence of future events, such as an intention to make an investment upgrade or to conduct a particular marketing campaign for a product.
- Profit potential.

Most franchisee claims relate to these kinds of representations. Financial information can be provided to prospective franchisees, however, it must be accurate, provide a complete 'picture', and clearly explain the context within which it is given. It must also be provided in a manner that complies with the Code.

As a matter of general practice, a franchisor should limit financial information to historical trading figures for the actual franchised outlet (or for identified 'like' outlets) with appropriate explanations and qualifications. All costs and expenses should be identified and the trading figures should cover a full trading year or period.

Obligation to not engage in unconscionable conduct

Section 20 of the ACL includes a general prohibition on persons engaging in unconscionable conduct in connection with the supply or possible supply of goods or services.

This section applies to a franchisor's dealings with its franchisees, including in relation to the termination of a franchise agreement. To date, most legal proceedings and ACCC investigations for 'unconscionable conduct' have arisen out of franchisor conduct towards its franchisees.

The concept of unlawful unconscionable conduct requires more than hard commercial dealing or the mere enforcement of standard contractual rights, even if the consequences of such dealings or the enforcement of those rights may be quite serious for the affected party. In all of the circumstances the conduct must be 'unconscionable'. The ACL sets out certain factors that a court may consider when determining whether conduct is 'unconscionable'. These include:

- Whether the person was able to understand the relevant documentation.
- The relative bargaining strengths of the parties.
- Whether undue influence or pressure or unfair tactics were used.
- Whether the conditions imposed went beyond those required to protect legitimate interests.
- The conduct of the business with other like businesses or consumers.
- The extent of any non-disclosure of relevant facts.
- Whether the corporation acted in good faith in engaging in the conduct.

Franchise 'churning'

'Churning' is the practice of selling a franchise site repeatedly in circumstances where the franchisor is aware that the site is likely to, or will, fail. While still untested before the courts in Australia, franchisors should be aware that franchise churning is likely to give rise to claims of franchisor unconscionable conduct.

Prohibition on unfair contract terms

In November 2015, new legislation was introduced giving small businesses protection against 'unfair contract terms' in standard form contracts. The unfair contract terms laws commenced on 12 November 2016 and are set out in Part 2-3 of the ACL. Where a franchise agreement is a 'standard form' 'small business contract', then the ACL may provide protection to a franchisee against the enforcement of a term that is an 'unfair contract term'.

The term 'standard form' is not defined in the ACL, but there is a series of factors that a Court must consider in determining whether or not a contract is 'standard form'. A contract provided by one party to another on a 'take it or leave it' basis will be considered 'standard form'. Accordingly, most template franchise agreements will be 'standard form', unless the parties have engaged in a genuine negotiation of the contract before it is signed.⁸³

The ACCC also takes a firm view that franchise agreements should be treated as 'standard form' 'small business contracts'. A contract will be a 'small business contract' if:

- it is for the supply of goods or services or an interest in land;
- at the time the contract was entered into, at least one of the parties was a business that employed fewer than 20 persons;
- either:
 - the upfront price payable under the contract doesn't exceed \$300,000; or
 - the duration of the contract is more than 12 months, and the upfront price does not exceed \$1,000,000.

A term in a 'standard form' small business contract will be 'unfair' if it:

- would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
- is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term (there is a rebuttable presumption that this is the case); and
- would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

For a Court to declare a term to be unfair, all three of the above elements must be established.

The ACL includes a list of 'generic' terms which may be unfair. However, these terms are examples, and the unfairness test would need to be applied on a case by case basis. These terms are not unique to franchise agreements and could be found in many forms of commercial contracts.

Terms identified by the ACL as being 'unfair'

The ACL includes a list of terms that could be unfair. These terms are:

A term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract.

A term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract.

A term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract.

A term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract.

A term that permits, or has the effect of permitting, one party (but not another party) to renew or not renew the contract.

A term that permits, or has the effect of permitting, one party to vary the upfront price payable under the contract without the right of another party to terminate the contract.

A term that permits, or has the effect of permitting, one party unilaterally to vary the characteristics of the goods or services to be supplied, or the interest in land to be sold or granted, under the contract.

A term that permits, or has the effect of permitting, one party unilaterally to determine whether the contract has been breached or to interpret its meaning.

A term that limits, or has the effect of limiting, one party's vicarious liability for its agents.

A term that permits, or has the effect of permitting, one party to assign the contract to the detriment of another party without that other party's consent.

A term that limits, or has the effect of limiting, one party's right to sue another party.

A term that limits, or has the effect of limiting, the evidence one party can adduce in proceedings relating to the contract.

A term that imposes, or has the effect of imposing, the evidential burden on one party in proceedings relating to the contract.

A term of a kind, or a term that has an effect of a kind, prescribed by the regulations.

83. In the case of *Diab Pty Ltd v YUM! Restaurants Australia Pty Ltd* [2016] FCA 43 the Federal Court noted that the international franchise agreement to which Yum! and the franchisees were parties, was a 'standard form' contract

Franchise agreements should be carefully reviewed for any 'unfair' terms. This requires a review of the franchise agreement, and all other franchise related contracts and terms including operations manuals, premises licence agreements, franchisor supply terms of trade, equipment leases, confidentiality agreements and so on.

Examples of terms in franchise agreements that are at risk of being 'unfair'

The ACCC has outlined certain terms that are particularly problematic in franchise agreements.⁸⁴ These include:

- Unconstrained powers of the franchisor to unilaterally vary agreements (or operations manuals).
- Broad restraint of trade clauses.
- Excessive liquidated damages clauses.
- Unreasonable termination clauses.

In addition, the ACCC has also recognised the following clauses as being of concern:

- Early termination fee clauses.
- Auto-renewals and/or rollover provisions.
- Limited or no liability clauses.
- Indemnity clauses.
- Forfeiture clauses.

If a court declares a provision 'unfair', then the term will be void and therefore unenforceable. However, the contract will continue to bind the parties if the contract can operate without the unfair term. A franchisor who seeks to enforce a declared unfair term, will contravene the ACL. Such a contravention may result in an injunction, an order to provide redress to the small business affected, or any other order that the Court considers appropriate. Note that some terms are exempt from the application of the ACL⁸⁵, as well as some contracts such as company constitutions.

Checklist - reviewing a franchise agreement for 'unfair terms'

- ✓ Is the term a term identified in the ACL as potentially being unfair? If yes, careful consideration must be given to the risk of this term being unfair.
- ✓ Is the term a term identified by the ACCC as potentially being unfair? If yes, careful consideration must be given to the risk of this term being unfair.
- ✓ Is the term transparent in that it is written in plain English and clearly expressed?
- ✓ Is there a legitimate reason for the term to be in the contract. If so, this should be documented.
- ✓ Are the restrictions, limitations or obligations contained in the term really necessary?
- ✓ Is the term largely redundant in that the franchisor rarely enforces or relies on it?

Application of unfair term contract terms legislation to operations manuals

While the operations manual is often a separate document to a franchise agreement, it can be expressed to form part of the franchise agreement, and is enforced through the franchise agreement. The ACCC considers that terms that allow the franchisor to unilaterally vary aspects of the operations manual, especially in an unrestrained manner, may be likely to be unfair.

84. Australian Competition and Consumer Commission ACCC *advises franchising industry to consider its agreements ahead of new unfair contracts law* (10 October 2016) <https://www.accc.gov.au/media-release/accc-advises-franchising-industry-to-consider-its-agreements-ahead-of-new-unfair-contracts-law>

85. *Competition and Consumer Act 2010* (Cth) sch 2 ('The Australian Consumer Law') s 26. Terms that are exempt are terms that define the subject matter of the contract, terms that set the upfront price payable under the contract, and terms that are required or permitted by statute

Case study

Franchisor misrepresentations induced franchisees to enter into franchise agreements⁸⁶

What happened:

South East Melbourne Cleaning Pty Ltd (in liquidation) (**Coverall**) was the franchisor for a national cleaning franchise.

During the franchisee recruitment phase, Coverall made various statements and representations to two franchisees in relation to future work and income. The representations included that:

- Coverall would refer work that would allow the franchisee to generate a minimum revenue each month.
- Regardless of whether Coverall in fact referred sufficient work to the franchisee to earn the minimum revenue each month, Coverall was obliged to and would pay an amount up to the minimum revenue amount each month.

The franchise agreement did not contain clauses giving effect to these representations.

Coverall's disclosure and franchise grant process was also reviewed. During the recruitment process Coverall:

- Provided earnings information that was a projection or forecast, which was not based on reasonable grounds and did not include the specific information set out in Item 20 of Annexure 1 of the Code.
- Entered into franchise agreements without first obtaining signed advice statements from the franchisees.

The outcome:

In summary, the Federal Court held that Coverall had:

- Engaged in misleading or deceptive conduct by making false representations about the prospective earnings of its franchised businesses.
- Breached various procedural obligations set out in the Code.
- Engaged in unconscionable conduct by refusing to remit payment to the franchisees for services which had been provided by the franchisees to their customers.

The franchise agreements were declared void. The Federal Court also ordered Coverall to pay \$500,000 in pecuniary penalties for the various breaches. Importantly, the Court found that Coverall was an experienced franchisor who dealt with two first time franchisees who had not sought any independent legal, business or accounting advice. Coverall used its bargaining power and incorrect earnings information to encourage and ultimately induce the franchisees to enter into the franchise agreements. It was for this reason that the substantial penalties against the franchisor were warranted. However, the Court also noted that Coverall's small size and relatively weak financial position, and the franchisees' small losses, served as mitigating factors to the overall penalties awarded. These factors ultimately reduced the penalties claimed by ACCC from \$600,000 to \$500,000.

The Court also declared, by consent, that Coverall's former director, Brett Jones, was knowingly concerned in Coverall's unconscionable conduct contraventions. The Court ordered by consent that Mr Jones pay a penalty of \$30,000 and pay compensation of \$23,000 to the two affected franchisees as a refund for the franchise fee they paid and the monies owing for work completed. Mr Jones was also ordered to pay a contribution to the ACCC's costs.

86. *Australian Competition and Consumer Commission v South East Melbourne Cleaning Pty Ltd (in liq)* (formerly known as Coverall Cleaning Concepts South East Melbourne Pty Ltd) [2015] FCA 25

Case study

Franchisor bullying tactics⁸⁷

What happened:

Allphones was the franchisor for a large national telecommunications retail network.

From 2004, Allphones represented to potential franchisees that their franchise system was like 'a true partnership' where they shared profits, assuring franchisees that Allphones would use its bargaining power to their benefit. However, Allphones negotiated commissions and bonuses with suppliers which it did not disclose to franchisees. Allphones also altered documents from carriers in order to disguise charges.

In 2006, Allphones identified a group of franchisees referring to it in its management reports in a derogatory way. To try and ensure that these franchisees did what they were told, Allphones implemented a business plan targeting franchisees who did not meet performance criteria that was unilaterally adopted by Allphones, or who were identified as not being 'loyal' to Allphones, to pressure them to sell, transfer or otherwise terminate their franchises. These tactics included:

- Withholding stock.
- Stopping a franchisee's income while simultaneously requiring the franchisee to continue to bank daily takings into Allphones' account and meet other obligations like rent and wages.
- Threatening franchisees with 'breach' notices suggesting that the company would take steps to terminate their franchises.

On a number of occasions where franchisees tried to rely on the Code, and discuss their concerns, or implement dispute resolution procedures, Allphones blocked them.

The outcome:

In 2010, the Federal Court declared that Allphones had engaged in misleading and deceptive conduct, contravened the Code and engaged in unconscionable conduct in its dealings with franchisees. The Federal Court found that Allphones' unconscionable conduct in dealing with its franchisees was both systemic and prolonged.

Allphones was ordered to pay to 55 franchisees \$3 million in damages for money that had been withheld. The \$3 million was to be divided amongst the franchisees according to the timeframe that they were a franchisee and duration and performance of their business. The amount paid reflected underpayment of rebates and commissions and refunds of charges that had been implemented by Allphones.

Competition Law

Restrictive Trade Practices

Many franchise agreements include clauses that restrict or control certain activities, for example restrictions on what products the franchisee can sell and the suppliers for those products. Franchisors also have policies and procedures that likewise restrict or control certain activities. The aim for the restrictions and controls is to ensure consistency and uniformity throughout the franchise network.

The CCA includes a number of sections that regulate 'restrictive trade practices'. These sections impact the 'control' that a franchisor can exercise over the supply of goods and services throughout its network. These sections have particular application to the control that a franchisor can exercise over pricing and product supply throughout the network.



Clauses in a franchise agreement (and the franchisor's policies and procedures) that restrict or control pricing, customers, territorial activities and product supply must be carefully considered. These restrictions may breach the restrictive trade practices provisions contained in the CCA.

Resale price maintenance

The CCA prohibits a corporation from engaging in the practice of resale price maintenance. Resale price maintenance is a restraint between a supplier and a purchaser. Resale price maintenance occurs where a supplier provides products or services to a purchaser on the condition that the purchaser must not resell the products or services below the supplier's specified price.

Resale price maintenance is relevant in franchise networks where the franchisor (or an associate of the franchisor) supplies products directly to its franchisees. Where this is relevant, the franchisor needs to be careful about any control that it seeks to impose over the prices charged by its franchisees for the sale of those products to third parties.

Example

A franchisor supplies sunglasses to its franchisees, and requires its franchisees to resell those sunglasses at the franchisor's recommended retail price. This is resale price maintenance.

87. *Australian Competition and Consumer Commission v Allphones Retail Pty Ltd (No 2)* [2009] FCA 17

In order to constitute resale price maintenance, the price restriction must relate to the supplied goods (or services). If the goods are transformed, treated or otherwise varied by the franchisee before being sold, then resale price maintenance does not apply.

Example

The franchisor of a hamburger restaurant franchise chain does not engage in resale price maintenance when it sets the price that its franchisees must sell hamburgers to customers. This is because the franchisor does not supply the hamburgers to the franchisee.

The franchisee makes the hamburgers in its own kitchen from products that it obtains from its suppliers. However, note that this conduct may constitute price fixing if the franchisor also sells hamburgers in competition with its franchisees.

There is no prohibition on mandating and enforcing maximum prices under the resale price maintenance provisions. A franchisor can advertise the goods or services it supplies are available at \$x and enforce the \$x as the maximum price above which franchisees must not sell the goods or services to third parties. Franchisors are permitted to provide recommended resale prices to franchisees. However, if sanctions are imposed by the franchisor (or benefits not given to franchisees) for selling below the recommended retail price, then this will constitute resale price maintenance.

Franchisors need to be careful when setting recommended retail prices that the prices are truly recommended and are understood by franchisees as such. The provisions of the CCA are broad enough to catch not only a franchisor forcing its franchisees to supply goods or services at particular prices, but also treating franchisees differently depending on whether or not they abide by the recommended retail prices.

What pricing controls may give rise to resale price maintenance?

Some examples of behavior that may constitute resale price maintenance include:

- Clauses in a franchise agreement which require the franchisee to comply with the franchisor's pricing policies.
- Threats to terminate a franchise agreement (or impose other sanctions) if pricing policies are not adhered to.
- Communications to the franchise network that 'encourage' uniform minimum pricing.
- Providing guidelines for when recommended retail prices can be changed e.g. 10% discount can be offered to VIP customers.
- Providing rebates or more favorable trading terms to franchisees that comply with the franchisor's recommended retail prices.
- Providing franchisees that comply with the franchisor's recommended retail prices with additional marketing support.
- Refusing to supply goods or services to franchisees who do not comply with the franchisor's recommended retail prices.

Price fixing

The CCA prohibits businesses from entering into a contract, arrangement or understanding with a competitor, which has the purpose, effect, or likely effect of fixing or controlling the price for goods or services. This is commonly known as 'price fixing'. Price fixing is a form of cartel conduct. In a franchising context, price fixing could arise in dealings between (amongst others):

- The franchisor (in respect of company owned outlets or internet sales) and franchisees.
- The franchisor (in respect of company owned outlets or internet sales) and an independent competitor.
- Franchisees operating within the same franchise network.
- Franchisees and an independent competitor.

The parties to the relevant contract, arrangement or understanding must be commercial competitors in order for price fixing to arise.

Example

A group of franchisees meet to discuss prices charged by their outlets. They agree to set uniform prices throughout the network. This will be a price fixing arrangement if the franchisee outlets are competitors.

Example

A franchisor agrees with its franchisees to set standard prices for the entire network of company owned and franchised outlets. This will be a price fixing arrangement if the franchisor's outlets compete with the franchisee outlets, or the franchisor operates an online store which competes with the franchisee outlets.

Exclusive dealing and third line forcing

Broadly speaking, exclusive dealing occurs when a supplier (or buyer) imposes certain restrictions on the buyer's (or supplier's) freedom to choose with who, in what, or where they deal. This is known as full-line forcing or exclusive dealing. The CCA prohibits exclusive dealing only where it has the purpose, effect or likely effect of substantially lessening competition in a market. Exclusive dealing in a franchising context may arise where the franchisor restricts:

- The type of products that the franchisee may stock.
- The kinds of suppliers from who the franchisee may obtain products.
- The area(s) in which the franchisee may market and sell their products.
- The type of customers that the franchisee may supply.

These exclusive dealing examples will be prohibited by the CCA where the conduct has the purpose, effect of likely effect of substantially lessen competition in a market. Whether conduct will substantially lessen competition in a market will depend on an assessment of the market in which the franchise network operates and the franchise network's market share. For the majority of franchise networks, it is unusual that exclusive dealing would have the effect of substantially lessening competition in a market. However, exclusive dealing that is prohibited by the CCA can be relevant in franchise networks that have a significant share of the market in which they operate.

Third line forcing is a special category of exclusive dealing. Third line forcing occurs where a supplier only supplies goods or services to a customer, or only gives a particular price or discount to a customer, on the condition that the customer buys goods or services from a particular third party.

In a franchising context, there will be third line forcing where the grant of the franchise is made on the condition that the franchisee purchase certain goods or services from a specified third party. Third line forcing is very common in franchising. In a franchising context, third line forcing may arise:

- If the franchisor requires franchisees to obtain certain goods or services from third party suppliers.
- If the franchisor polices the use of recommended suppliers (for example, by imposing sanctions on franchisees if they do not use the franchisor's recommended suppliers).
- In product promotions where the promotion is only available to franchisees that purchase the promotional product from a particular third party supplier.
- If the franchisor offers more beneficial payment terms to franchisee customers who acquire selected products from certain retail partners.

Important amendments were made to the CCA in 2017 which removed the strict prohibition on third line forcing. Currently, third line forcing will only be prohibited where it has the purpose, effect or likely effect of substantially lessening competition in a market. Exclusive dealing can be 'sanctioned' by filing a Notification or an Authorisation with the ACCC.

Case study

Franchisor resale price maintenance and price fixing⁸⁸

What happened:

The Jurlique case provides an example of where a franchisor's pricing policies comprised illegal resale price maintenance and price fixing. The Jurlique case involved resale price maintenance and price fixing conduct which occurred between 1996 and 2003. The conduct was engaged in by Jurlique's founder and former managing director, Dr Klein, and four Jurlique companies that manufactured and sold a range of premium skincare products to franchised outlets and other retail outlets. J&J Franchising (one of the Jurlique companies) supplied Jurlique treatments through its Melbourne Central day spa. Jurlique franchisees also supplied Jurlique treatments from outlets located in Fountain Gate, Doncaster, Southland and Malvern.

The Federal Court found that J&J Franchising operated the Melbourne Central day spa in competition with the Melbourne franchisees and therefore the franchisor and its franchisees were 'competitors'. The relevant price fixing conduct included:

- Arrangements with the franchised outlets to supply Jurlique treatments at the same price as the Melbourne Central day spa.
- Supplying treatment menus and promotional material to the franchised outlets with the same prices that were charged by the Melbourne Central day spa.

The relevant resale price maintenance conduct included:

- Attempting to induce franchisees not to sell Jurlique products at less than the prices specified by Jurlique.
- Entering and offering to enter into arrangements for the supply of Jurlique products on the condition that the products were not to be sold for prices less than the prices specified by Jurlique.
- Withholding supply of Jurlique products from franchisees that had sold products below the retail prices specified by Jurlique.
- Using product statements of prices that were likely to be understood as the prices below which products were not to be sold.

The outcome:

The four Jurlique companies were fined a total of \$3.2 million and Dr Klein was personally fined \$200,000.

88. *Australian Competition and Consumer Commission v Jurlique International Pty Ltd* [2007] FCA 79

Consequences of breach of the CCA

There are serious consequences for breaching the CCA. Breaches of the CCA can result in the imposition of financial penalties, orders for damages and/or compensation payments, ACCC investigations, bad publicity, legal proceedings and costs.

Breaches of the CCA are often unintentional. However, it is not a defence to claim that the breach 'was a mistake' or that you 'did not know that the conduct would breach the CCA'. Ignorance of the law, mistake or unintentional breach, do not provide a defence for breaches of the CCA.

Financial penalties

Breaches of the CCA can result in substantial financial penalties (fines). In some cases, the fines can amount to millions of dollars, depending on the circumstances of the breach. Breach of the competition provisions (including price fixing and resale price maintenance) by a corporation may attract a penalty the greater of:

- \$10 million;
- three times the value of the benefit that the corporate group obtained that is reasonably attributable to the contravening act or omission; or
- (where the value of such benefit cannot be determined) 10% of the annual turnover of the corporate group during the 12 month period ending at the end of the month in which the contravening act or omission occurred.

Breach of the ACL provisions (including unconscionable conduct and false or misleading conduct) by a corporation may attract penalties of up to \$1.1 million.

Individuals who are involved in committing a breach of the CCA can also be held personally liable and fined for the breach. Breaches of the competition provisions of the CCA carry fines of up to \$500,000 per breach, while breaches of the ACL carry fines of up to \$220,000 for certain breaches. Some serious breaches of the CCA also carry criminal liability including jail terms. A company cannot indemnify its directors, officers or employees for any liability to pay fines (or legal costs) for breaches of the CCA.

court action

A company or individual (including a competitor, supplier or customer) who suffers loss, damage or harm as a consequence of a breach of the CCA, has the right to apply to the court for damages and other remedies. Claims can include damages for loss of income and loss of profit. The courts have wide powers to make orders to stop breaches of the CCA and to provide relief to companies or individuals who have suffered harm as a consequence of the breach.

Other adverse consequences

In addition to penalties and court orders, breaches of the CCA also have a negative impact on business generally.

Other adverse consequences of breaching the CCA include:

- Illegality of business models and practices.
- Unenforceability of key contracts.
- Negative publicity.
- Diversion of management time away from the business.
- Costs associated with any investigation or legal claim.
- Lengthy and time consuming litigation.

Case study

Examples of fines imposed on franchisor companies

Examples of the range of penalties that the courts have imposed on franchisors for breaches of the CCA are set out below.

- SensaSlim – In 2016, the Federal Court ordered penalties totaling \$3.55 million against SensaSlim for making false representations to franchisees in relation to the SensaSlim Solution and business.⁸⁹
- Allphones – In 2010, the Federal Court ordered a penalty of \$3 million against Allphone for unconscionable conduct, and misleading or deceptive conduct.⁹⁰
- Jurlique – In 2007, the Federal Court ordered penalties totaling \$3.4 million against Jurlique for price fixing and resale price maintenance in relation to dealings with Jurlique's franchise network.⁹¹

89. *Australian Competition and Consumer Commission v SensaSlim Australia Pty Ltd (in liq)* (No 5) [2014] FCA 340

90. *Australian Competition and Consumer Commission v Allphones Retail Pty Ltd* (No 2) [2009] FCA 17

91. *Australian Competition and Consumer Commission v Jurlique International Pty Ltd* [2007] FCA 79



Chapter five The role of the ACCC

The ACCC is the independent statutory body responsible for promoting and enforcing compliance with the CCA. The role of the ACCC extends to ensuring that franchising industry participants comply with the Code.

ACCC action

The ACCC can, and does, take investigative action based on complaints received from franchisees. For the 2017/2018 financial year, the ACCC reported that it received 542 'complaints' concerning franchise matters.⁹² In a press release dated 28 November 2017 in relation to the issue of infringement notices issued on Fastway Couriers Path, the ACCC stated that:

'The ACCC is sending a clear message that it will act to ensure prospective franchisees receive the information required by the Franchising Code so that they are able to make informed decisions about the purchase of a franchise'.

When will the ACCC action a complaint?

The ACCC considers all franchisee complaints, however it does not pursue every one. The ACCC's focus is on complaints which harm the competitive process or result in widespread consumer or small business detriment. The ACCC's Compliance and Enforcement Policy⁹³ sets out the factors that the ACCC will consider when deciding whether or not to pursue a complaint.

These include:

- Significant public interest or concern.
- Substantial consumer or small business detriment.
- Unconscionable conduct, particularly involving large national companies or traders, which impacts on consumers and small businesses.
- A blatant disregard of the law.
- An issue of national or international significance.
- Conduct detrimentally affecting disadvantaged or vulnerable consumers.
- Conduct in concentrated markets which impacts on small firms or suppliers.
- A new or emerging market issue.
- Conduct that is industry-wide or is likely to become widespread if the ACCC does not intervene.
- Whether the action is likely to be worthwhile, educative or will have a deterrent effect.
- A history of previous contraventions by the person or business.



The ACCC has wide powers to investigate possible breaches of the Code and the CCA. The ACCC vigorously and very publicly enforces compliance with these laws.

Case studies

Examples of court action taken by the ACCC

Some of the recent actions taken by the ACCC include:

Fastway Couriers (Perth) (November 2017):

The ACCC issued Fastway Couriers with an infringement notice penalty of \$9,000 for alleged non-compliance with the Code by a regional franchisor. It was alleged that the franchisor's disclosure document did not include details of former franchisees that had terminated or transferred their franchises.⁹⁴

Pastacup (November 2017)

The Pastacup franchisor was ordered to pay penalties of \$100,000 for breaches of the Code. Pastacup's co-founder and former director was also ordered to pay \$50,000 for being knowingly concerned in the breaches. The Federal Court found that Pastacup's disclosure document failed to disclose previous directorship of the insolvent Pastacup franchisors.⁹⁵

Coverall (March 2015)

The Federal Court declared that Coverall engaged in unconscionable conduct, made false or misleading representations and contravened the Code when it signed up two individuals to its cleaning franchise network. The Federal Court imposed a \$500,000 penalty on Coverall, and ordered Coverall's former director to personally pay a penalty of \$30,000 and also compensation of \$23,000 to the two affected franchisees.⁹⁶

Ultra Tune (January 2019)

The Federal Court found that Ultra Tune has breached its obligation to act in good faith and made false and misleading representations to a prospective franchisee about the price of a franchise, the ongoing rent of the premises, and the age of the franchise. It also found that Ultra Tune breached the Code in the way it dealt with its marketing fund statement and then attempted to cover up all of its conduct by relying on documents which were not provided to the franchisee. Ultra Tune was ordered to pay a penalty of \$2.6 million for what the Court described as 'a most serious and fundamental breach' of the Code.⁹⁷

Harvey Norman Franchisees

It is not just franchisors who have to be mindful of their obligations. The ACCC took action against ten Harvey Norman franchisees in relation to false or misleading representations to consumers about their consumer guarantee rights. The proceedings brought by the ACCC against the Harvey Norman franchisees led to penalties totaling \$286,000.⁹⁸

92. Australian Competition and Consumer Commission Annual Report 2017-18 https://www.accc.gov.au/system/files/ACCC-%26-AER-Annual-Report-2017-18_0.pdf

93. A copy of the ACCC's Compliance and Enforcement Policy can be found at <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities>

94. Australian Competition and Consumer Commission *Fastway Couriers (Perth) pays penalty for alleged Franchising Code Breach* (28 November 2017) <https://www.accc.gov.au/media-release/fastway-couriers-perth-pays-penalty-for-alleged-franchising-code-breach>

95. *Australian Competition and Consumer Commission v Morild Pty Ltd* [2017] FCA 1308

96. *Australian Competition and Consumer Commission v South East Melbourne Cleaning Pty Ltd (in liq) (formerly known as Coverall Cleaning Concepts South East Melbourne Pty Ltd)* [2015] FCA 25

97. *ACCC v Ultra Tune Australia Pty Ltd* [2019] FCA 12

98. Australian Competition and Consumer Commission *Harvey Norman franchisee ordered to pay penalties of \$52,000 for false or misleading representations about consumer rights* (14 January 2016) <https://www.accc.gov.au/media-release/harvey-norman-franchisee-ordered-to-pay-penalties-of-52000-for-false-or-misleading-representations-about-consumer-rights>



ACCC audit and investigation powers

The ACCC uses a range of compliance and enforcement tools in order to encourage compliance with the Code. In deciding which tool (or combination of tools) to use, the ACCC takes into account a broad range of factors, which are outlined in the ACCC's Compliance and Enforcement Policy.⁹⁹ The ACCC has various powers to investigate and action breaches of the law. These powers include:

Information gathering powers

The ACCC can use a range of tools to gather information and documents that may assist with the investigation of an alleged breach of the Code or the CCA, or to monitor compliance with the Code.

Audit power

The ACCC has an 'audit power' which it can use to compel a franchisor to provide any information or document it is required to keep, generate or publish under the Code. This includes disclosure documents, marketing fund statements and franchise agreements. It can also issue a notice for any documents that support claims made in a disclosure document. The ACCC has used its audit power to quickly determine whether franchisors are complying with the Code.

Power to obtain information, documents and evidence

Section 155 of the CCA gives the ACCC the power to obtain information, documents and evidence when investigating possible contraventions of the CCA. This power can be used by the ACCC where there is reason to believe that the information, documents or evidence being sought are relevant to an investigation. Criminal penalties apply for failing to comply with a section 155 notice issued by the ACCC.

Substantiation notices

The ACCC can require a franchisor to substantiate a claim or representation it has made to a franchisee or prospective franchisee regarding the supply or possible supply of goods or services. This includes entering into a franchise agreement.

During the 2017/2018 financial year, the ACCC reported that it issued 14 separate audit notices to franchisors to check their level of compliance with the Code¹⁰⁰. The ACCC selected those franchisors because they had a history of Code related complaints, or randomly selected them from industries that appeared to generate a disproportionate volume of complaints.

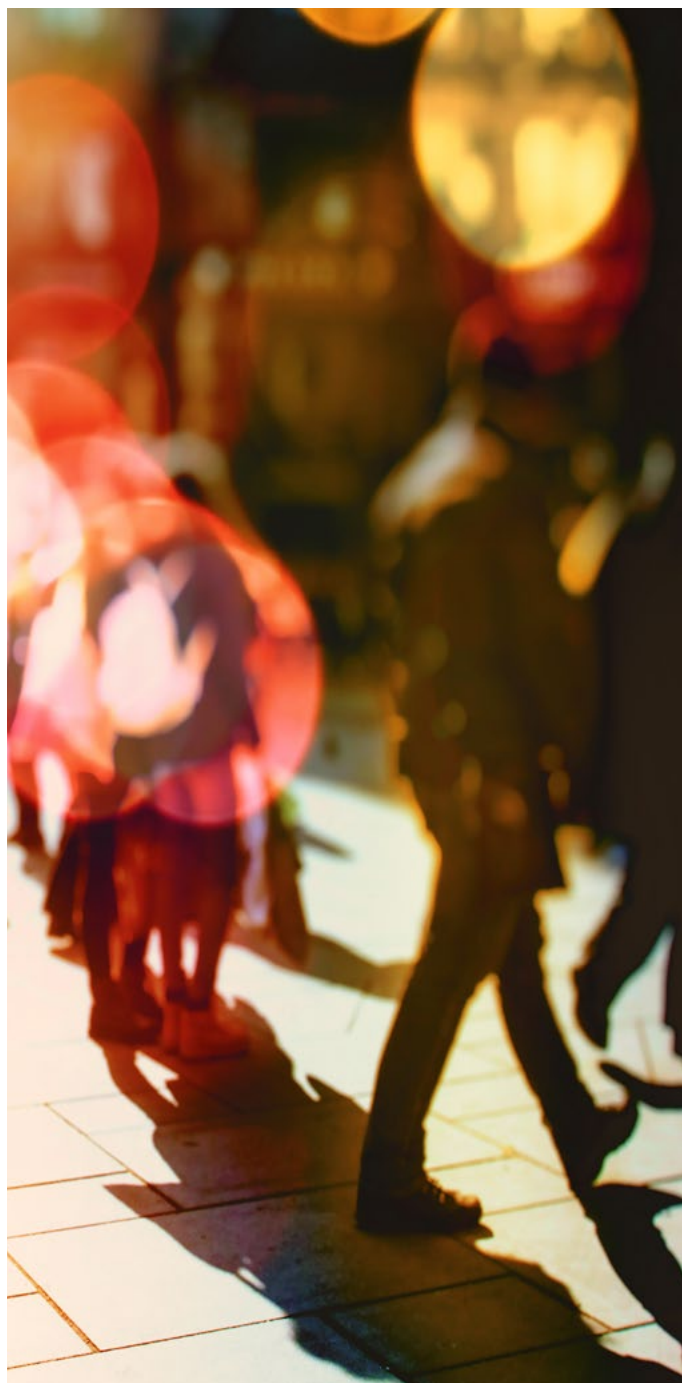
99. A copy of the ACCC's *Compliance and Enforcement Policy* can be found at <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities>

100. *Australian Competition and Consumer Commission Annual Report 2017-18* https://www.accc.gov.au/system/files/ACCC-%26-AER-Annual-Report-2017-18_0.pdf

Small Business and Franchising Consultative Committee

The Small Business and Franchise Consultative Committee is a forum where competition and consumer law concerns related to the small business and franchising sectors can be discussed by industry and government.

Membership of the committee includes industry representatives, legal professionals, small business and franchising advocates and academics. Committee meetings are held at least twice a year. The first meeting of the committee took place on 13 May 2016. Topics discussed in detail with committee members in this meeting included the ACL review, the role of the newly formed Australian Small Business and Family Enterprise Ombudsman and upcoming regulatory developments (for example, excessive card surcharging, business-to-business unfair contract terms and country of origin food labelling).





Chapter six Managing franchising disputes

It is inevitable that almost all franchisors will eventually face some form of legal dispute with disgruntled franchisees, which may include allegations (from either the franchisee or the franchisor) of misleading, deceptive or unconscionable conduct, failure to act in good faith or breach of contract. The long-term impact of such disputes, both in monetary terms and in resources and mental energy consumed, can come at great cost to franchisors.

If a dispute arises between the parties to a franchise agreement, either party may take action to resolve the dispute by commencing the internal complaint-handling procedure set out in the franchise agreement (which must comply with the Code) or the dispute resolution procedure set out in the Code¹⁰¹.

Regardless of whether the complainant (which could either be the franchisor or the franchisee) initiates the procedure outlined in the franchise agreement or the Code, all parties are required by the Code to try and resolve the dispute. The obligation to act in good faith will also apply to the franchisor and the franchisee during the dispute resolution process.

For agreements entered into, renewed, transferred or varied in any way on or after 1 January 2015, the franchisor cannot require the franchisee to cover the franchisor's costs of settling a dispute. In the case of mediation, usually, the parties will split the costs of the mediator, room hire and other associated expenses equally.

Commercial considerations

The key to managing any dispute, whether it is large or small, is to be clear at the outset as to what is to be achieved. Consider:

- What are the key problems?
- What do you want to achieve?
- What is driving the franchisee?
- What action is required to achieve the business' objectives?

Dispute resolution steps

Step 01

Inform the other party of the dispute

The Code requires the complainant to first write to the respondent (the person with whom the complainant has a dispute)¹⁰². The complainant must inform the respondent in writing of the nature of the dispute, the outcome that they want, and what action they think will resolve the dispute.

The franchise agreement may also include specific steps that need to be taken in connection with a formal notice or to activate the contractual dispute resolution process set out in the agreement. These steps should be strictly followed and evidence that these steps have been taken must be retained.

Step 02

Try to resolve the dispute

The parties should then discuss the dispute and try to reach a mutually acceptable agreement on how the dispute is to be resolved¹⁰³. This would usually be achieved through meetings and face to face meetings, though for less serious matters it could be by phone. The parties are under an overarching obligation to approach the resolution of the dispute in a reconciliatory manner¹⁰⁴. This includes the parties trying to negotiate a resolution by:

- Attending and participating in meetings at all reasonable times.
- Not taking any action that would have the effect of damaging the reputation of the franchise, including (for example) by supplying inferior goods, services or support, or refusing to supply goods, services or support.

Step 03

Mediate

If the parties cannot agree how to resolve the dispute within three weeks of the written notice of dispute, then either the complainant or respondent may ask for mediation¹⁰⁵. Mediation involves an informal negotiation between the parties that is facilitated by an independent third party mediator.

101. *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth)pt 4

102. *Ibid* cl 40

103. *Ibid* cl 40(2)

104. *Ibid* cl 36

105. *Ibid* cl 40(3)

Mediation

Resolving the dispute through mediation

Mediation is seen as a cost effective way of resolving franchising disputes without resorting to complex and costly legal action. Participants in mediation should be aware that mediators do not give legal advice or make decisions like a judge: they assist parties to come together and negotiate an outcome that is acceptable to both parties.

Participating in mediation

Once mediation has been requested by a party, it becomes mandatory for both parties to attend mediation and to genuinely try to resolve the dispute through mediation. Failure to participate in mediation can leave a party exposed to the ACCC seeking a pecuniary penalty or issuing an infringement notice.

The parties are required to attend the mediation by sending someone with authority to enter an agreement to settle the dispute on behalf of that party. Showing a genuine effort to try to resolve the dispute requires:

- Attending and participating in the mediation.
- At the beginning of the mediation process, making the party's intention clear as to what the party is trying to achieve through the mediation process.
- Observing any obligations relating to confidentiality that apply during or after the mediation process.
- Not taking any action that would have the effect of damaging the reputation of the franchise, including (for example) supplying inferior goods, services or support, or refusing to supply goods, services or support.

Appointment of the Mediator

The parties to a dispute can agree as to who the mediator should be. Failing agreement, either party can ask the Office of the Franchising Mediation Adviser to appoint a mediator to help resolve the dispute.¹⁰⁶

Venue for mediation

Under the Code, mediation must be conducted in Australia.¹⁰⁷ For agreements entered into, renewed, transferred or varied in any way on or after 1 January 2015, the franchisor cannot require the franchisee to participate in mediation outside the State or Territory in which their franchised business is based.¹⁰⁸

Cost of mediation

If using the complaint handling procedure under the Code, the costs of mediation must be shared between the parties to the dispute unless otherwise agreed. The costs of mediation include the cost of the mediator, room hire and any additional inputs (for example, expert reports) that both parties agree are necessary to conduct the mediation. The parties must pay their own costs to attend the mediation.¹⁰⁹

Mediation process

Once a mediator is appointed, the mediator contacts both parties to:

- Arrange a time and place for mediation.
- Confirm who will attend the mediation.
- Arrange for an exchange of documents, as appropriate.
- Have the parties agree on and sign a mediation agreement.

It is essential that appropriate persons participate in the mediation. At a minimum, this means that a decision maker with the authority to resolve the dispute must attend the mediation. Additionally, and depending on the circumstances, the person(s) most knowledgeable with respect to the central underlying facts regarding the dispute should also consider attending. It is equally important to ensure that the appropriate person(s) from the opposing side also participates in the mediation.

There is no requirement to have legal representation at mediation. However, if a party does decide to have a lawyer present, it should inform the mediator of this prior to mediation, as the other party may also wish to be legally represented.

All mediations are different. However, they generally follow a similar format. A typical format for a mediation is outlined below.

- At the beginning of a mediation, the parties (with their legal advisers, if present) and the mediator meet for a joint session, during which each party may make a brief presentation. At the conclusion of the presentations, the mediator may ask questions and/or comment on certain aspects of the dispute.
- The parties (and their respective legal advisers) then go to separate rooms. The mediator will then meet with one side and then the other (and go back and forth) to discuss the issues in dispute and agree on next steps to assist the parties in discussing and (hopefully) resolving those issues. This part of the mediation process is sometimes described as 'shuttle diplomacy'.
- The parties may then be brought together for additional joint sessions to discuss factual issues and/or proposed settlement terms.
- Sometimes the mediator may ask to meet separately with one or all of the legal advisers.

106. Ibid cl 40(4)

107. Ibid cl 41(2)

108. Ibid cl 21

109. Ibid cl 43

Termination of mediation

If a dispute is unresolved after 30 days from commencement of the mediation process, either party may ask the mediator to terminate the mediation. If such a request is made, the mediator is required to terminate the mediation.

If the mediation has not been successful and has been terminated, the mediator must issue a certificate of termination stating the names of the parties, the nature of the dispute, that the mediation is finished and that the dispute has not been resolved. The mediator must give a copy of this certificate to the mediation adviser and to both parties.¹¹⁰

Alternatives to mediation

Any action taken under the Code or the franchise agreement to try to resolve a dispute does not affect a party's right to commence legal action.¹¹¹ In addition, the dispute resolution mechanisms provided for in the code do not prevent a party from directly approaching the ACCC with their concerns.

Court action can be costly and time consuming. It can damage relationships, and there is no guarantee that it will provide the desired outcome. In all but the most urgent of circumstances, it will therefore be more practical and cost effective to first try to resolve the dispute using the mechanisms provided for in the Code.

Breach notices

The Code regulates termination for breach of a franchise agreement and, in particular, the process that a franchisor must follow. When preparing a breach notice, it is very important to read and have regard to both the code and the franchise agreement. Where possible, both the Code and the franchise agreement must be complied with. If there is a divergence between the two, then the Code will prevail to the extent of the inconsistency, and the franchisor should then seek legal advice on their rights and obligations. The first step in formally dealing with a franchisee breach is the issue of a 'breach notice'. Breach notices usually follow 'warning' letters, compliance audits or other actions by the franchisor to bring problems or issues to the attention of the franchisee. Clause 27 of the Code explicitly specifies what must be included in a breach notice. To comply with the statutory requirements under the Code, a franchisor's breach notice must:

- Be in writing.
- Give the franchisee notice that the franchisor proposes to terminate the franchise agreement because of the breach.
- Tell the franchisee what the franchisor requires to be done to remedy the breach.
- Allow the franchisee a reasonable time to remedy the breach (which need not be more than 30 days).

Failure to comply with the Code in this respect is a breach of a penalty provision. Significantly, technical defects in the drafting and delivery of a breach notice may invalidate the entire process that follows. For this reason, issuing a valid and compliant breach notice is a key step, and is the foundation of every step that follows in the dispute resolution process.

Except in limited circumstances, a franchisor can only terminate if the breach identified in the breach notice is not remedied within the time specified in the notice (which must be a reasonable period of time but need not be more than 30 days). While the law on the issue is still untested, franchisors should not assume that they can always specify a notice period that is less than or equal to 30 days. Ultimately, the period of time must be reasonable having regard to the franchisee, the issue in dispute, its severity and the time that would be required to rectify it (among other factors).

There are limitations on the breaches for which a franchisor can terminate, in the sense that it will be unconscionable to terminate a franchise for a trivial breach of the franchise agreement.

Termination notices

The Code provides for three ways to terminate a franchise agreement:

1

Clause 27

A failure to remedy a breach of the franchise agreement after a notice of breach has been issued.

2

Clause 28

In the absence of breach, where the franchisor has the right to terminate the franchise agreement without the consent of the franchisee, then the franchisor can terminate the agreement on reasonable notice, and must give reasons for the termination to the franchisee.

3

Clause 29

Immediate termination of the franchise agreement in special circumstances.

The franchisor must give reasonable written notice of any proposed termination, and reasons for it, to the franchisee before terminating the franchise agreement. Failure to comply with the above provisions is a breach of a penalty provision of the Code.

As with a breach notice, once again, technical defects in a termination notice may invalidate the entire process.

Helpful information

For a detailed explanation of:

- The Code requirements in connection with disputes and termination, see pages [28](#) and [36 to 37](#).
- The impact of the ACL on a franchisor's ability to terminate a franchise agreement, see pages [44 to 45](#).

110. Ibid cl 42

111. Ibid cl 37



About Maddocks



Maddocks is an independent Australian law firm that provides legal services to corporations, businesses and governments throughout Australia. We advise clients across consumer markets, construction, technology, telecommunications, healthcare, education and professional services from our Canberra, Melbourne and Sydney offices. We aim to work together to make a difference...every day.

We're committed to our clients. In fact, our brand and market reputation reflect this focus. Our service is based on a deep understanding of our clients' legal requirements in the context of their business objectives. We're highly regarded for exceptional, practical legal services that genuinely add value.

We work collaboratively with our clients to build strong, sustainable relationships – our longest is now more than 100 years old. Our lawyers aim to deliver consistently high standards of service, and we understand the importance of accessibility, responsiveness and transparency. Working with us, you'll enjoy open communication, meaning well scoped, appropriately resourced and effectively managed matters.

Maddocks has a specialist, dedicated and passionate Consumer Markets & Franchising team.

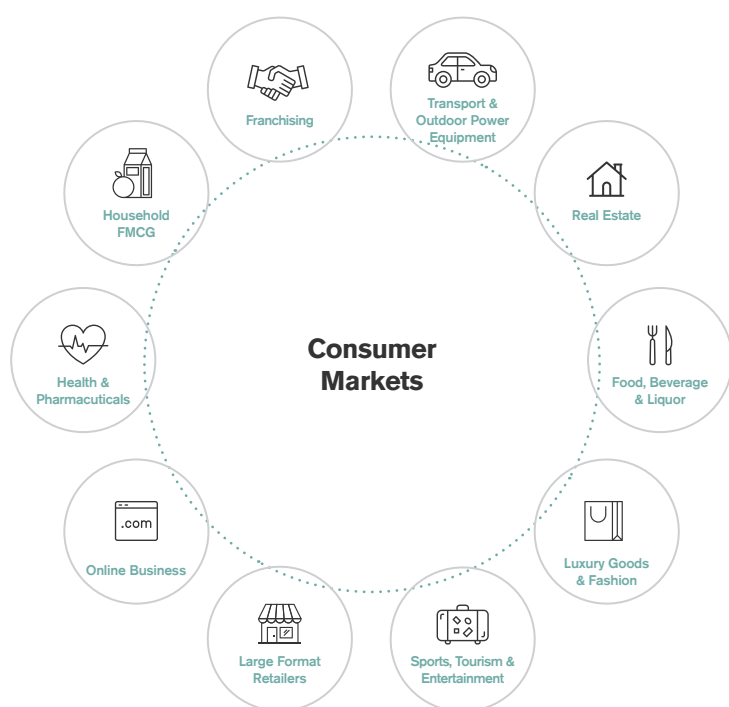
Our industry leading team continues to grow significantly, as our premier practice brings together experts in their field. Comprising commercial and litigation lawyers, our team can assist you with all commercial and dispute related issues.

We believe in working with our clients, both large and small, to build long-term and effective relationships. We invest our time in getting to know you, your business and your drivers.

What we do

We provide strategic, effective and commercial advice to clients who operate local, national and international distribution networks at a wholesale and retail level, for consumer goods and services.

Our lawyers have in-depth industry knowledge at local, national and global levels in industries that include:



We act for clients like you

Our clients range from start-up operations to listed multi-national businesses and private equity funds. See below for some examples of the clients we have worked with.

How can we help?

We act for a wide range of founder and entrepreneur clients, angel investors, private companies, listed entities and private equity funds. Below are some examples of how we can assist you:

For franchisor clients wanting to franchise, our lawyers are focused on acting for franchisor clients and our experience is preeminent. For those clients that have decided to franchise for the first time, we can guide you through the entirety of the process – from how to structure your model, and what you need to kick off franchising successfully, to the preparation of considered franchise documents that will prepare your business for the years to come. Every franchise system is unique and our experienced lawyers will ensure your franchise documents are tailored to your needs, avoiding the headaches that can arise from a ‘cookie cutter’ approach.

For established franchisor clients, we advise on the application of the Franchising Code daily and have specialist expertise in its content and application. We regularly assist clients to enforce franchise agreements, navigate the mediation process and implement changes to the network in a considered way – most importantly, we understand the nuances of engaging successfully with franchisees. Our deep knowledge of the regulatory environment means we are able to provide legal and strategic advice quickly and cost efficiently.

Our lawyers also understand the importance of acting strategically and with conviction when involved in a dispute in a franchise network. Our team can assist you at any point in the following timeline, with the aim of short circuiting the friction, resolving issues and getting relationships back on track.



For clients wanting to expand, we know the importance of choosing the right expansion model, and we bring commercial acumen to the fore in negotiations with potential partners and investors. With our significant breadth of expertise and experience we can road test possible models with you – from licensing, partnerships, franchising, joint ventures, mergers and acquisitions and equity investment to non-share based equity schemes. We can assist you to efficiently identify those models that are legally appropriate and tax effective for you. Our team is able to give you alternative expansion ideas you may not have otherwise considered and provide guidance on the costs of implementing and operating the different models.

For founders seeking investment or to exit, we have built our practice around assisting you with this exciting and important process. We have worked with many founders to navigate a partial or full sale and know what is important in getting a deal over the line. We work with you to minimise legal costs and understand where legal services deliver real value in the investment or sale process.

For clients with an in house legal team, we know how to interface with in house legal teams and understand acutely the need for timely, accurate and commercial advice. We understand the sensitivities of balancing stakeholders at the client's end and can work with you to deliver a seamless product, or look after the entirety of a project.

For private equity fund clients, we have a multi-disciplinary team that can assist you in negotiating and documenting your M&A transactions. We are a full service firm that can assist with due diligence and tax advice, as well as advise on and document the property and employment related aspects of a transaction – we can do this in the timeframes that you require.

For accountants and financial advisors, we can work with you to deliver a unified product to your clients, or look after the legal issues directly. We value relationships with other professionals and the importance to the client of building a team of trusted advisors.

Here is what we do

We recognise that our clients need responsible, collaborative and innovative advisors. We work with our clients, and other specialist practitioners at Maddocks, to deliver highly integrated and flexible legal advice in areas including the following:

- Establishing and operating franchise models including advising on model structure, drafting franchise, dealer and licence agreements and documents required by the Franchising Code of Conduct. We also provide ongoing compliance advice and document management services and represent parties at mediations and prepare breach and termination notices.
- All aspects of the dispute avoidance, resolution and litigation process, including urgent applications and injunctions, court proceedings and trial and ACCC prosecutions.
- Model restructures including franchise, licence or dealer model conversion to or from franchises or agencies, and corporate roll ups and buy backs.
- All aspects of competition and consumer law, including advising on issues of anti-competitive conduct, assisting with ACCC investigations and designing and implementing compliance programs. We can also assist with compulsory investigation notices and, if necessary, contested matters.
- All aspects of M&A, private equity transactions and private investment including negotiating and documenting asset and share sales, joint ventures and partnerships, effecting due diligence and tax structuring and duty advice.
- Privacy, including advice regarding data collection, compliance and cross border data transactions.
- E-business and online transactions, including structuring of innovative business models, terms and conditions for online trading and legislative compliance.
- The protection and enforcement of IP rights.
- Succession and estate planning.
- Comprehensive workplace relations advice.
- Lease negotiation and retail leasing advice.

Maddocks Consumer Markets & Franchising team

The Maddocks Consumer Markets & Franchising team brings together a group of leading franchise industry sector lawyers, each with a focus on delivering practical, commercially-focused solutions and advice for our clients. Each of our team members has specific experience and knowledge of the franchise industry sector, advising local, national and international franchise networks.



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