

## SOME OF THE LAWS AFFECTING FRANCHISING

### FRANCHISING CODE OF CONDUCT

On 1 January 2015 a new Franchising Code of Conduct (new Code) took effect which governs all franchise agreements entered into, renewed, extended or varied on or after that date. Some conduct under Franchise Agreements entered into before 1 January 2015, but after 1 October 1998 will continue to be governed by the former Franchising Code of Conduct (old Code). For a broader explanation of the interrelationship between the two Codes, read our article [The New Franchising Code of Conduct](#).

The new Code is a mandatory Code given the force of law by Section 51AE of the *Competition and Consumer Act 2010* (formerly the *Trade Practices Act 1974*). Any breach of the Code is a breach of the *Competition and Consumer Act*. Breaches of some provisions of the new Code will attract penalties of up to \$51,000, and these breaches may lead to infringement notices issued by the ACCC for \$8,500. The responsibility of enforcing the Code rests with the Australian Competition and Consumer Commission ("ACCC").

### WHAT IS A FRANCHISE

The new Code sets out the meaning of a franchise agreement as follows (see clause 5):

1. A *franchise agreement* is an agreement:
  - a. that takes the form, in whole or part, of any of the following:
    - i. written agreement;
    - ii. an oral agreement;
    - iii. an implied agreement; and
  - b. in which a person (the *franchisor*) grants to another person (the *franchisee*) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor; and
  - c. under which the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol:
    - ii. owned, used or licensed by the franchisor or an associate of the franchisor; or
    - iii. specified by the franchisor or an associate of the franchisor; and
  - b. under which, before starting or continuing the business, the franchisee must pay or agree to pay to the franchisor or an associate of the franchisor an amount including, for example:



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- iv. a fee based on a percentage of gross or net income whether or not called a royalty or franchise service fee; or
  - v. a training fee or training school fee;
- but excluding:
- i. payment for goods and services supplied on a genuine wholesale basis; or
  - ii. repayment by the franchisee of a loan from the franchisor or an associate of the franchisor; or
  - iii. payment for goods taken on consignment and supplied on a genuine wholesale basis; or
  - iv. payment of market value for purchase or lease of real property, fixtures, equipment or supplies needed to start business or to continue business under the franchise agreement.
2. For subclause (1), each of the following is taken to be a franchise agreement:
- b. the transfer or renewal of a franchise agreement;
  - c. the extension of the term or the scope of a franchise agreement;
  - d. a motor vehicle dealership agreement.
2. However, any of the following does not in itself constitute a franchise agreement:
- a. an employer and employee relationship;
  - b. a partnership relationship;
  - c. a landlord and tenant relationship;
  - d. a mortgagor and mortgagee relationship;
  - e. a lender and borrower relationship;
  - f. the relationship between the members of a cooperative that is registered, incorporated or formed under any of the following laws:
    - i. the *Corporations Act 2001*;
    - ii. the *Co-operatives Act 1992* (NSW);
    - iii. the *Co-operatives Act 1996* (Vic.);
    - iv. the *Cooperatives Act 1997* (Qld);
    - v. the *Co-operatives Act 2009* (WA);
    - vi. the *Co-operatives Act 1997* (SA);
    - vii. the *Cooperatives Act 1999* (Tas.);
    - viii. the *Cooperatives Act 2002* (ACT);
    - ix. the *Co-operatives Act 1997* (NT).

Any Agreement that fits within the definition is covered by the new Code. It does not matter what the Agreement is called. It can include licences, distributorships, distribution agreements and supply agreements.

As can be seen above, there are a number of exceptions when the Code does not apply. It is therefore important to look at the whole arrangement between the parties to determine whether or not it fits within the definition of a franchise agreement under the Code.

For the definition of a Franchise Agreement under the old Code, see clause 4 of the old Code.

## **MANDATORY PROCEDURES**

The Code sets out procedures that must be followed and cannot be waived, such as:

- The Franchisor must give the Franchisee a Disclosure Document at least fourteen days before a franchise agreement is entered into, renewed or extended or if it is proposed to extend the scope of a franchise agreement. The term "extend the scope" is defined in the new Code to cover a range of matters such as terms and conditions of the franchise agreement, the rights of a party under the franchise agreement and liabilities that would be

imposed on a party under the franchise agreement. A common example that would be covered is extension of a territory. According to clause 8(2) of the new Code (clause 6A of the old Code), the purpose of the disclosure document is to give the Franchisee information from the Franchisor to help the Franchisee to make a reasonably informed decision about the franchise. It also gives the Franchisee current information from the Franchisor that is material to the running of the franchised business.

- The Franchisor must obtain a statement from the proposed Franchisee that they have received advice about the Agreement from any of a legal advisor, business advisor or accountant. It is not mandatory for a Franchisee to obtain advice from each or in fact any one of these people. The Franchisee can choose not to obtain any advice (which is not recommended). But, a Franchisor must tell the Franchisee that they should get the advice and get the Franchisee to acknowledge that either they got the advice or decided not to get the advice.
- There is a mandatory seven day cooling off period in which a Franchisee can terminate a franchise agreement. The notice of termination can be given within seven days of the earlier of either entering into the franchise agreement or making a payment under the Agreement. Although the Code is not specific, it is recommended any notice of termination should be given in writing. Note that the cooling off provision does not apply to the renewal, extension, extension of the scope or transfer of an existing franchise. If the Franchisee does "cool off", the Franchisor must within 14 days refund any money paid less the Franchisor's reasonable expenses, but only if they have set out the amount of those expenses or their method of calculation in the Agreement.
- Franchisors must give Franchisees copies of leases for any premises leased to carry on the franchise, as well as details of any incentive or financial benefit the franchisor may receive. The copy must be given within one month of the document being signed.
- Franchisors must not stop Franchisees meeting together or forming an association.
- Franchise agreements must not require a franchisee to sign a general release of the franchisor from liability.
- A franchise agreement entered into on or after 1 March 2008 must not contain, or require a franchisee to sign, a waiver of any verbal or written representation made by the franchisor.
- Franchisors must tell franchisees or prospective franchisees about matters, in writing, within not more than 14 days after the franchisor becomes aware of it. There is a list of such matters in clause 17(3) of the new Code and they include such things as a change in majority ownership of the franchisor, proceedings being started against the franchisor or a director, a judgement against the franchisor or changes in the intellectual property.
- Specific provisions cover marketing funds and the auditing of those funds. If a franchisor maintains a marketing fund then they must keep a separate bank account for that fund.
- A franchisee can ask for an up to date disclosure document once a year and the franchisor must provide the document within 14 days. This time limit can be extended to 2 months if the franchisor meets the criteria under clause 8(7) of the new Code for not carrying out their annual disclosure document update.
- Franchisors must consider a request for consent to assignment/sale of the franchise within a certain time and cannot unreasonably refuse to give consent. There are a number of situations listed in the Code where it is reasonable to withhold consent like when a Franchisee cannot meet the financial obligations under the agreement or does not meet the selection criteria set by the Franchisor. Franchisors may also revoke consent, with reasonable reasons, within 14 days of granting consent. Franchisors may be deemed to

have consented to a transfer if they do not provide consent by a certain time.

- Franchisors must give notice requiring breaches to be remedied and give the Franchisee the opportunity to remedy the breaches before the Franchisor can terminate the Agreement. There are limited circumstances where this does not apply, for example, if the Franchisee becomes bankrupt or endangers public health and safety.
- The new Code imposes an obligation of good faith between the parties. Good faith is not defined, so it will be determined on a case-by-case basis in accordance with the common law. Good faith will however include acting honestly in dealings with one another and not arbitrarily, and cooperating to achieve the purpose of the franchise agreement. Good faith does not prevent a party from pursuing their legitimate commercial interests.
- Part 4 deals with resolving disputes. The parties to a dispute must follow either the franchisor's complaint handling procedure or the complaint handling procedures in the Code. The franchisor's procedures may be more specific than those in the Code and include additional steps the parties are to undertake. If there is no procedure laid down by the franchisor then the parties follow the procedure in the Code. Although it is not mandatory that the parties instigate the mediation provisions, it has been held by the courts that once a party has issued a notice of dispute, it is mandatory that the other party attends at a mediation and try and resolve the dispute.

The mandatory provisions set out in the Code cannot be waived by either party. This means that a Franchisee cannot sign a Franchise agreement until the fourteen days disclosure period has lapsed. The Franchisee should not start the business until the seven day cooling off has lapsed. If the Franchisee was to "cool off" during the 7 days and training had started, the Franchisor could justifiably retain the training fee.

## **OTHER LAWS**

Although the Franchising Code of Conduct is the first law most people think of with franchising, there are many other laws that impact on the Franchisor/Franchisee relationship and the Agreement.

## **COMPETITION AND CONSUMER ACT**

The *Competition and Consumer Act 2010* not only gives force to the Code, but also contains many other provisions which impact franchising. In fact, most litigation in franchising is brought under the old *Trade Practices Act*. Many of the applicable sections are now covered by *The Australian Consumer Law*. That Law has also been introduced by the various States which will mean uniformity between the various States and the Commonwealth. The specific provisions in the Act most litigated under the old *Trade Practices Act* are:-

- the unconscionable conduct provisions in Part 2.2; and
- section 18 dealing with misleading and deceptive conduct.

Although there have been a number of cases before the Courts claiming unconscionable conduct, there is no conclusive definition. There probably never will be. To see if conduct has been unconscionable it is necessary to look at a person's conduct as a whole to see whether or not in all the circumstances the conduct is unconscionable. The Act lists a number of matters the Court can have regard to, but that list is not exhaustive. It includes:-

- the strengths of the bargaining powers between the parties;
- whether a party was able to understand the documents;
- if there was any undue influence or pressure exerted on a party or unfair tactics used;
- whether goods could be obtained at an equivalent price elsewhere;
- if the Code was complied with; and

- if the parties acted in good faith.

It is not unconscionable for a person to enforce their rights under an agreement but it is possible that the method used to enforce those rights may be unconscionable. A very basic example may be when a Franchisee is in breach of an agreement and a franchisor sends a notice of breach giving an unreasonably short time to fix the breach. The franchisor has the right to enforce the agreement but must act reasonably when taking advantage of those rights. They must give a reasonable time to remedy any breach. What is reasonable will depend on the circumstances. For example: the shop is dirty – clean it within 24 hours. That is reasonable. But to replace a whole computer system or a vehicle then 30 days would be more reasonable. The notice need not be for more than 30 days.

Section 18 or at least its equivalent section 52 under the *Trade Practices Act* is probably the most litigated section. It states "*A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead and deceive*".

It has been very widely interpreted. Some points to take into account when looking at section 18 are:

- it operates despite any disclaimers;
- it applies whether or not the misrepresentation was innocent;
- intent is totally irrelevant - all that is relevant is if the conduct was misleading and deceptive or likely to mislead and deceive;
- it is not necessary to actually mislead anyone - what is necessary that the statement was misleading and deceptive. That is because the section uses the words "likely to mislead and deceive";
- silence can be misleading - if a person is left under the wrong impression;
- care must be taken to distinguish between statements of existing facts and predictions as to the future;
- if a person is claiming to have actually been misled, courts will look closely at the person who claims to have been misled. Their experience in business, what they should have known, the advice they took and the investigations they made themselves.

Many other sections in the Act also impact franchising or the way a Franchisee or a Franchisor carries on business. They include:-

- Price Fixing - which is a contact arrangement or understanding with the purpose effect or likely effect of fixing prices. The parties engaged in price fixing must be in competition with each other. Bear in mind it is not necessarily that any price actually be fixed or that any agreement to fix prices works. There merely has to be some understanding regarding prices. Note also that Price Fixing is a cartel provision.
- Re-Sale Price Maintenance - this applies when a supplier tries to fix the price at which a product is resold. It can also apply to the amount of discounts offered or the terms of trade given to the buyer. Note suppliers can fix the maximum price but never the minimum price.
- Third Line Forcing - this is forcing a purchaser to acquire goods or services from another party. To breach this section three parties are needed. The purchaser, the seller and the third party from whom the seller requires the purchaser to buy products before the seller will supply. There must be three parties and at least 2 products.
- Exclusionary agreements – where a party is excluded from supplying or buying products. This agreement needs to be made between competitors. The most common example would be market sharing where competitors agree to stay out of each other's areas.
- Arrangements which substantially lessen competition in a market.

Franchising is generally seen to promote competitive conduct in the marketplace. But there are times when franchise agreements may breach the Act. An example would be when a franchisor requires a Franchisee to obtain products from a third party that are needed to operate the business. That is third line forcing and strictly a breach of the Act. A franchisor may be able to

notify the ACCC that it proposed to engage in third line forcing and the ACCC will not take any action if it can be shown that the conduct is not anti competitive and there is some public benefit.

Fines for breaching the *Competition and Consumer Act* are considerable. For conduct such as price fixing and re-sale price maintenance the fines for a corporation can be as high as \$10 million. Fines can also be imposed on individuals within the company if it was those individuals who actually engaged in the conduct. Those fines can be up to \$500,000. There are also prison sentences that can be imposed.

## **TRADE PRACTICES COMPLIANCE PROGRAMS**

Every franchise system should have a Trade Practices compliance program. It is a program that assesses the company's business, looks at the ways the *Competition and Consumer Act* may be breached, assesses the possibility of breaches and the risks involved to the business arising out of a breach and brings in systems and procedures that need to be followed throughout the company. It is not enough to have a program written down, there needs to be a culture of Trade Practices compliance within the company. If a company has that type of a culture and is constantly aware of its obligations under the *Competition and Consumer Act*, if there does happen to be a slip-up, the Courts can be more lenient when looking at fines but that depends on the breach and the severity.

## **TRADE MARKS**

A franchise agreement generally grants a right to a franchisee to use the trade mark. The Code acknowledges in the meaning of the franchise agreement that the business must be substantially associated with a trade mark.

It is up to a franchisor to obtain registration of the trade mark in the countries in which the business is operated. It is also generally the responsibility of the Franchisor to defend the trade mark. In other words, if it is discovered that a person is wrongfully using a trade mark, the franchisor should take action against that person to protect the trade mark to make sure it is available for use by Franchisees.

Registration of trade marks is covered by the *Trade Marks Act 1995*. The Act does give certain rights to persons who are defined as "authorised users", but most franchise agreements do not give Franchisees the option to exercise any rights as authorised user.

Franchise agreements generally set out very clearly the terms on which a franchisee may use a trade mark and the consequences if the franchisee breaches those clauses.

## **OTHER INTELLECTUAL PROPERTY**

There is a lot of intellectual property associated with franchises. There are usually Operations manuals, Training manuals, Procedures manuals, there may be software specifically written for a particular franchise. There might be secret recipes or special machinery not available anywhere else. It also can extend to designs, know how, trade secrets, recipes and things that would be essential to the successful operation of the franchise system as a whole and the franchise business.

Most of these items would be simply protected by copyright legislation but there are some such as designs that can be registered. Be careful if you are getting an outside person to write your software or Operations manual because they may claim copyright as the author. If outside help is engaged, it should always be made clear that the ownership of the copyright rests with the franchisor.

So far as special recipes and equipment is concerned, these can be patented. The one drawback people see with patenting is that the recipe or plans for the equipment get published by the

Patents Office. That means that anyone can search in the Patents Office and find out the full details. Some franchise systems choose not to register simply to maintain complete secrecy. The drawback with that is that another person may independently come up with the same design or ingredients and if patent protection is not obtained, that other person has full rights to exploit their independent invention. That is provided, of course, they do not claim any association with the original product, because that would be misleading and deceptive.

## **BUSINESS NAMES**

Most Franchisees operate their businesses under business names. There is national legislation covering business names and under that legislation a person must not carry on a business under a business name unless that business name is registered.

The purpose of business name registration is to protect consumers by identifying persons trading under names that are not the same as their personal, company or other entity name.

The national business name registration system:

- replaces the former state based registers and reduces administration for businesses trading in multiple jurisdictions;
- is administered and maintained by ASIC;
- is online;
- carries out automatic checks for identical or similar company or business names which are already registered.

Franchisors usually grant franchisees the right to register a business name and that right is contained in the franchise agreement. The agreement will also have restrictions on the use of the name. Only the franchisor is usually permitted to register a company which contains the name associated with the system.

When a business name is registered the business name owner is provided with an 'ASIC Key' which is a unique set of numerals and essentially acts as a password. Franchisors require franchisees to provide the Key to the franchisor and this confers the power to deregister the business name at the end of the franchise.

Because of the different legislations covering registrations, franchise systems should have:

- Business names registered;
- Trade marks registered;
- Domain names registered on the Internet.

If the system has all three, it makes protection a lot easier. If a franchisor forgets to register one of these, another person could register, for example, a trade mark and then the Franchisor would need to bring action to stop the use of the trade mark by someone else. That action may not be successful. It is much easier and cheaper to register first.

## **GENERAL LAWS**

A franchise agreement is a contract between the parties. It is governed by general contract laws. If a franchisor expects a franchisee to adhere to the systems and procedures of the system, a franchisor needs to be specific about that in the franchise agreement.

Franchise agreements need to contain terms to protect the system and maintain the franchisor's goodwill in the system and the image. These terms would include rights of management if the franchisee was breaching the agreement or in some cases, if the franchisee became ill or disabled.

It would also include restraints to apply at the end of the franchise so that a franchisee could not use the intellectual property and the system to compete with the franchisor or other franchisees.

Some restraints are enforceable if they are reasonable and franchise agreements need to be very carefully drafted to make sure that the restraint is not more than is reasonably necessary to protect the franchisor.

Restraints for trade and competition against the franchisor are only enforceable under the new Code if they meet the limited criteria under clause 23. This criterion only applies to franchise agreements entered into, renewed, extended or varied after 1 January 2015, and provides that restraints will not be effective if:

- a. the franchisee had given written notice to the franchisor seeking to extend the agreement on substantially the same terms as those:
  - i. contained in the franchisor's current franchise agreement; and
  - ii. apply to other franchisees or would apply to a prospective franchisee; and
- b. the franchisee was not in breach of the agreement or any related agreement; and
- c. the franchisee had not infringed the intellectual property of, or a confidentiality agreement with, the franchisor during the term of the agreement; and
- d. the franchisor does not extend the agreement; and
- e. either:
  - i. the franchisee claimed compensation for goodwill because the agreement was not extended, but the compensation given was merely a nominal amount and did not provide genuine compensation for goodwill; or
  - ii. the agreement did not allow the franchisee to claim compensation for goodwill in the event that it was not extended.

Customer Lists are generally not considered confidential information. But, a franchisor can nominate a Customer List as confidential information. As with any intellectual property, the more you do to protect it, the more protected it is. So, if you do nothing you get no protection. If a Customer List is to be protected, there must be confidentiality agreements. It must form part of the confidential information and it must be covered by the restraint clause.

## LEGAL COSTS

Generally, franchise agreements provide a franchisee must pay the franchisor's legal costs associated with the preparation, execution and stamping of the agreement. There is no set fee for franchisor's legal costs and they vary from system to system. Franchise agreements that fall under the new Code cannot require a franchisee to pay the franchisor's costs of dispute resolution.

Franchisors must take care when drafting agreements to make sure that the provisions of the various stamp duty legislations are addressed so that stamp duty is not imposed unexpectedly.

If an existing franchised business is being sold, that is the same as the sale of any other business. It is a transaction which is subject to full stamp duty in most of the States.

Franchisees should obtain legal advice. Most franchise systems say the franchise agreement will not be amended, so franchisees sometimes do not see the point in obtaining advice. There are many laws that impact on franchising and the consequences of some terms in franchises are not appreciated unless they are properly explained by qualified professionals. Franchisees need that explanation so they can make a fully informed commercial decision about whether they want to proceed.