FRANCHISING UPDATE

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Franchising Update

By: Chris Nikou, John Kelly, Anna Trist

K&L Gates has recently welcomed partner Philip Vickery to the practice. Philip has assisted franchisors and master franchisees for more than 13 years. Philip and his team will practice from our Brisbane office.

The franchising team has been busy recently assisting franchisors in the domestic and international arenas; in particular we have assisted franchisors launch their systems in India, South Korea, Japan, Indonesia, Republic of Ireland and Northern Ireland, Paraguay, Guatemala, Colombia, Dominican Republic, Ecuador, El Salvador, Honduras, Peru and Nicaragua.

We also congratulate Chris Nikou, named the *Best Lawyers* ® 2016 Franchising Law "Lawyer of the Year" in Melbourne.

Domestically, it is an eventful time in franchising right now. This newsletter contains articles reflecting some of the legal issues franchisors have had to deal with in 2015.

The Audit Assurance Board recently reviewed and updated its guidance statement, dealing with the item requirements under item 21 of the disclosure document and their recommendations regarding what auditors need to do to comply with the new Franchising Code provisions.

By 1 November 2015, franchisors must have updated their disclosure documents to comply with the amendments to the Franchising Code that came into effect on 1 January 2015. We are happy to assist clients to meet this requirement.

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DISPUTE RESOLUTION CLAUSE REVIEW SERVICE

While dispute resolution clauses may be straightforward for domestic franchise agreements as a result of the Franchising Code, dispute resolution clauses can be one of the most neglected provisions in international master franchise agreements.

These clauses are frequently addressed at the end of contractual negotiations and sometimes receive little substantive consideration. This can mean that the opportunity is missed for parties to agree on the most

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appropriate dispute resolution procedures to be adopted for the myriad of disputes, large or small, which may arise under the contract. A carefully thought out dispute resolution clause can pay dividends down the line, with disputes being resolved swiftly and effectively at a lower cost whilst maintaining the valuable commercial relationships between the parties.

There are many options available to parties when faced with disputes under commercial contracts, some disputes may be amenable to alternate forms of dispute resolution such as negotiation, mediation or expert determination. Other disputes may demand a more formal dispute resolution process by court proceedings or arbitration (often in a neutral jurisdiction).

Most leading arbitration institutions have changed their rules in recent years and arbitration laws have changed in many jurisdictions, as well as court processes and jurisdictional requirements. These changes mean that the dispute resolution paths adopted in the past may no longer be appropriate for future disputes.

Consequently, the need for franchisors to review their standard dispute resolution provisions and their dispute resolution policies and protocols when dealing with international parties has heightened. Key considerations in any such review include the form, composition, venue, jurisdiction and procedures to be adopted in the dispute resolution process as well as the governing law of the process. It is important to consider the enforceability of a decision made in another Australian jurisdiction or in the country in which the other party to the contract has assets.

While international agreements and commercial contracts generally involve these considerations, there is significantly less flexibility when dealing with domestic franchise agreements and domestic master franchise agreements. The Franchising Code governs the dispute resolution process in some detail, regulating the initial attempts to resolve disputes, the appointment of a mediator and the terms that will govern the compulsory mediation in Australia. This process was amended when the Franchising Code changed on 1 January 2015. It is important that franchisors are aware of this process as it is compulsory, and failure to comply with it can result in significant fines (amongst other consequences).

We regularly work with clients in reviewing their dispute resolution provisions, both at the specific level (reviewing particular contracts) and at a more general level (looking at existing standard form clauses and templates and their policies and protocols). We would be happy to review your dispute resolution policies and procedures and provide you with our advice. If you are interested in our review service, please contact John Kelly at john.kelly@klgates.com or Chris Nikou at chris.nikou@klgates.com.

This article was written by John Kelly and Chris Nikou, both partners in the Melbourne office.

IS A FRANCHISEE'S OUTLET LICENCE A RETAIL PREMISES LEASE?

In an interesting recent decision from the Supreme Court of Victoria, Croft J held that an arbitration clause in a retail leases does not oust the Tribunal's jurisdiction. A detailed discussion of this issue can be found on Robert Hay's blog.

The Court also referred to a finding at first instance that the franchisee's outlet licence is in fact a sub-lease. This creates an interesting issue for practitioners acting for franchisees, franchisors or their landlords.

A common arrangement for a franchise in Victoria involves the franchisor:

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5. taking a head lease from the land owner
6. granting a franchise agreement and an 'outlet licence' to the franchisee.

In these arrangements, the franchisee is ordinarily not treated as a tenant of a retail premises lease.

However, it is well established that an agreement in substance creating a lease will be treated by the courts as a lease, even though the parties choose to call it a licence.

This was considered by the Tribunal in *Ireland v Subway Systems Australia Pty Ltd & Anor Retail Tenancies* [2012] VCAT 1061, in which Senior Member Riegler quoted the colourful words of Lord Templeton in Street v Mountford:

The manufacture of a five pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade.

After considering the text of the agreement, the surrounding circumstances and other relevant authorities, the Tribunal concluded that the outlet licence in fact granted exclusive possession to the franchisee and was a sub-lease.

If, as the Tribunal's decision suggests, a franchisee's outlet licence can be regarded, in substance as a sub-lease, the consequences could be significant.

For example:

7. *the Retail Leases Act 2003 (Vic)* (RLA) will almost always apply to the franchisee's outlet licence. That means, for example, that the franchisee is entitled to a disclosure statement, an estimate of outgoings and a five year minimum term and that s 52 of the RLA governs the franchisor's repair and maintenance obligations
8. there is an interesting question over whether the head lease to the franchisor is a retail premises lease for the purposes of the RLA
9. it is controversial whether a licensee (as opposed to a tenant) has standing to seek relief from forfeiture if the licence is terminated. However, if the franchisee is in fact a sub-tenant, then there is no doubt that it has standing to seek relief from forfeiture.

What, then, happens if the terms of the franchise agreement are inconsistent provisions of the RLA?

In the *Subway* case, Croft J refers to this problem and to the fact that the franchise agreement in that case was with another entity within the franchisor's group of companies. However, while expressing a view that the RLA may render specific provisions of a franchise agreement void if those provisions were inconsistent with specific provisions of the RLA, his Honour did not need to finally resolve this question.

The important point from this case for franchisors to note at this stage is that a franchisee's outlet licence may well be characterised as a sub-lease, which could give to the franchisee significant leverage when the franchise agreement comes to an end. The extent of that leverage will, as always, depend on the circumstances.

The Tribunal's determination that the outlet licence was in fact a sub-lease was not appealed and Croft J expressly left the question open.

This article was written by Sam Hopper, Barrister. You can follow Sam's blog at http://samhopperbarrister.com/.

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ACCC PUBLISHES GUIDELINES ON ITS USE OF INFRINGEMENT NOTICES

The Australian Competition and Consumer Commission (ACCC) have published much needed guidance on its use of infringement notices issued under the *Competition and Consumer Act 2010 (Cth)* (CCA).

This guidance is timely because:

- the ACCC has actively issued infringement notices to the business community, having collected over AUD522 600 in penalties under infringement notices in 2014-15
- the amount of penalties sought by the ACCC under infringement notices has recently increased significantly over recent years.

A copy of the Guidelines, titled "Guidelines on the use of infringement notices" (Guidelines), can be found here.

What are Infringement Notices?

The ACCC has stated that infringement notices are designed to provide "a timely, cost efficient enforcement outcome in relation to relatively minor contraventions of the Act".

The ACCC is empowered to issue infringement notices where it has "reasonable grounds to believe" that a person has contravened certain consumer protection provisions of the CCA, including:

- unconscionable conduct provisions
- unfair practices provisions (save for certain sections, such as misleading and deceptive conduct provisions)
- certain unsolicited consumer agreement and layby agreement provisions
- certain product safety and product information provisions.

The ACCC may also issue an infringement notice to a person in relation to:

- the failure to respond to a substantiation notice
- the provision of false or misleading information to the ACCC in response to a substantiation notice.

Infringement notices can also be issued by the ACCC in relation to a variety of different kinds of contraventions of the Franchising Code. These include failure to:

- act in good faith
- provide a disclosure document
- attend mediation
- provide reasonable written notice of proposed termination for breach.

What are the Infringement Notice Penalties?

The penalty amount in each infringement notice will vary depending on the alleged contravention of the CCA, but in most cases is fixed for each individual contravention at:

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- AUD10,800 for a corporation (or AUD108,000 for a listed corporation)
- AUD2,160 for an individual.

Different penalties apply in connection with substantiation notices.

Infringement notice penalty amounts in relation to breaches of the Franchising Code by a body corporate are currently set at AUD9,000 (AUD1,800 for an individual) per breach.

Infringement notice penalties are calculated by reference to the value of penalty units set by the *Crimes Act 1914*. From 31 July 2015, the value of a penalty unit increased from AUD170 to AUD180. Therefore, the infringement notices relating to conduct prior to 31 July 2015 attracted lower penalties than what will now be recovered.

How Active Have the ACCC Been in Issuing Infringement Notices?

In 2014−15, the ACCC received payment for 16 infringement notices from 12 traders, with penalties totalling over AUD522,600. Examples of infringement notices issued by the ACCC include:

- **SingTel Optus Pty Ltd:** 27 infringement notices totalling AUD178,000 in relation to representations it made in the promotion of its 'Max Cap' mobile phone plans. The ACCC's Media Release can be found here
- **Foxtel Management Pty Ltd:** seven infringement notices totalling AUD46,200 for running a nationwide advertising campaign that the ACCC believed was misleading. The ACCC's Media Release can be found here
- **InvoCare Ltd:** an infringement notice totalling AUD102,000 for allegedly making a false or misleading representation concerning its standard contract. The ACCC's Media Release can be found here.

When Will the ACCC Likely Issue an Infringement Notice?

Issuing an infringement notice signifies that the ACCC considers a contravention of the CCA has occurred that requires a more formal sanction than an administrative resolution (eg resolution of issue by agreement), but also believes the matter may be resolved without legal proceedings.

However, an infringement notice is only likely to be issued in circumstances where the ACCC would be willing to commence legal proceedings if the recipient of the notice elected not to pay the infringement notice penalty.

The Guidelines indicate that the ACCC is more likely to consider the use of an infringement notice in place of legal proceedings in the following circumstances:

- the ACCC forms the view that the contravening conduct is relatively minor or less serious
- there have been isolated or nonsystematic instances of noncompliance
- there have been lower levels of consumer harm or detriment
- the facts are not in dispute or the ACCC considers the circumstances giving rise to the allegations are not controversial

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- infringement notices form part of the broader industry or sector compliance and enforcement program following the ACCC raising concerns about industry wide conduct.

What Are the Implications for Businesses?

Substantial Monetary Penalties

Despite criticism, the ACCC may continue its practice of issuing multiple infringement notices where it considers it is appropriate to do so. This may occur where the ACCC believes there have been multiple contraventions, where the contraventions have occurred in multiple states or territories, where contraventions have involved different types of media, or where it is considered desirable to deter similar conduct by the specific business involved or the broader industry. The payment of multiple infringement notice penalties may result in payment of a substantial amount of money (especially given the increase in penalty unit rates over recent years).

Court Proceedings and Additional Remedies

There is no legal obligation on a recipient to pay an infringement notice. However, non-payment of infringement notice penalties will expose the recipient to the prospect of proceedings arising from the ACCC's concerns. Infringement notice penalties are lower than the maximum penalty a Court could impose should the recipient be found to have contravened the CCA. For example, should the ACCC be successful, a company may be liable to pay a penalty of up to AUD1.1 million for each contravention of the statutory prohibition on unconscionable conduct, in addition to legal costs, or a penalty of up to AUD54,000 for a breach of a penalty provision of the Franchising Code.

Where appropriate, the ACCC may also seek additional remedies, including Court enforceable undertakings.

ACCC Infringement Notice Register and Media Releases

The ACCC operates a public "Infringement Notice Register" of paid infringement notices on its website. Entries on the register ordinarily list the person or business that paid the notice, the date paid and the section of the relevant legislation. Additionally, the ACCC often issues a media release that confirms payment has been made and includes details of the alleged matters and the amount paid. Given the affect this may have on a business' reputation, it is vital that all options are carefully considered prior to payment of the penalty.

What Should a Business Do If It Receives an Infringement Notice?

When issued with an infringement notice, the recipient will be provided with information including the nature of the alleged contravention, the amount to be paid and the period for payment if the recipient wishes to avoid Court action. On receipt of an infringement notice, it is advisable for the business to obtain legal advice as to the appropriate response.

Below are a number of steps a recipient may take once they receive an infringement notice.

Request an extension to comply with the infringement notice. The compliance period for payment of an infringement notice penalty is 28 days. This may be extended for a maximum of a further 28 days. Any extension request made to the ACCC should be made as soon as possible.

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Request that the infringement notice be withdrawn. If a business believes that they have not engaged in the conduct alleged by the ACCC or there is additional information the ACCC should consider, a recipient may request that the infringement notice be withdrawn. Any withdrawal request must be provided to the ACCC as soon as possible and it is advisable that the business obtains legal advice to maximise the potential for a successful outcome. Any information provided to the ACCC in response to an infringement notice should be carefully considered and must not be false or misleading.

Pay the infringement notice penalty. Payment of the infringement notice is not taken to be an admission of wrong doing by the recipient and involves no Court finding of any contravention of the CCA. Further, the ACCC cannot commence Court proceedings in relation to the alleged contravention. However, this does not impact on the rights of action other parties may have against the recipient and the recipient should consider the possible implications of paying the penalty (discussed above).

Not pay the infringement notice penalty. There is no legal obligation on a recipient to pay an infringement notice. However, non-payment of an infringement notice during the compliance period will expose the recipient to the prospect of ACCC initiated Court proceedings in relation to the alleged contravention detailed in the infringement notice once the compliance period expires. The recipient should seek legal advice before taking such action (or inaction).

This article was written by Philip Vickery, partner in the Brisbane office.

FRANCHISING RESOURCES:

Clients are invited to contact us, if any of the following resources could be of use:

10. Copy of the Franchising Code (effective 1 January 2015)
11. Checklist: summary of the changes to the Franchising Code
12. Checklist: updated summary of franchisor obligations under the Franchising Code (including the existing and new obligations)
13. Checklist: list of clauses, a breach of which may attract a financial penalty under the Franchising Code
14. Checklist: business processes and procedures that should be considered as a result of the changes to the Franchising Code
15. Audit guidelines

These resources were prepared by Anna Trist, special counsel in the Melbourne office. To request a copy of one or more of these resources, please email Anna at anna.trist@klgates.com.

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