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AUSTRALIA'S NEW REQUIREMENT FOR "FAIR" FRANCHISE AGREEMENT TERMS

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**Penny Ward
Baker & McKenzie
Melbourne, Australia**

AUSTRALIA'S NEW REQUIREMENT FOR "FAIR" FRANCHISE AGREEMENT TERMS

A new Australian law commencing later this year will require franchise agreement provisions to be objectively "fair". Although it is directed at "small" business and not specifically at franchising, franchise agreements are expected to be impacted by this new law more than most. The regulator, the Australian Competition and Consumer Commission (ACCC), has conceded this and has already announced that the franchising sector will be a priority for its compliance activities.

The law, contained in the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015 (Cth)*, extends an existing consumer unfair contract term law to "small" business contracts. For the reasons discussed below, its coverage is very broad and the description of "small" business is misleading. In many cases it will apply to agreements between large businesses.

The new law will apply to a contract entered into or renewed on or after **12 November 2016**. It will also apply to all variations or extensions of contracts already in place, that occur after that date.

An "unfair" term will be void. The balance of the agreement will continue if the agreement is capable of operating without the term.

1. Contracts to which the law will apply

The new business unfair terms law will apply to a term of a contract which has **each** of the following elements:

1.1 the term is in a "standard form contract"

The contract must be "standard form", a term which is not defined. Notably, it will be presumed to be "standard form" unless the party seeking to rely on the term proves otherwise.. A court may take into account such factors as it thinks fit in determining whether the contract is "standard form", but it must consider whether:

- one party had most of the bargaining power;
- one party prepared the contract before discussions between the parties;
- one party was, in effect, required to either accept or reject the contract as presented, except for terms relating to scope or price;
- there was an effective opportunity to negotiate the contract terms; and
- the terms of the contract took into account the specific characteristics of the party or the particular transaction.

The negotiation of a small number of terms is unlikely to prevent a contract being found to be "standard form". The fact that it may be in the interests of a franchise system as a whole that all franchisees enjoy the same terms will not be relevant. In light of the practice of minimising changes to franchise agreements, it is highly likely that franchise agreements will meet this "standard form" element.

1.2 one party has few employees

At least one party to the contract employs fewer than 20 employees. This will exclude casual employees, unless they are employed on a 'regular and systematic basis'.

Although this element was designed to separate "small" from "large" businesses, it is unlikely to have that effect. When contracting with a newly formed prospective franchisee, one would expect this element to be readily satisfied. Few new businesses hire staff before they have secured the rights to trade.

Any party to the contract can satisfy this element, and only employees of a contracting party are counted. It may be the franchisor entity that satisfies this element, where the entity entering into the franchise agreement is not the employer within the franchisor's corporate group.

1.3 the contract value will not exceed the threshold

The total consideration payable for the supplies under the contract does not exceed AUD 300,000 for contracts with a duration of 12 months or less or AUD 1 million for contracts with a duration of more than 12 months. This includes all consideration for the supplies to be made or rights to be granted, if the consideration or its method of calculation is disclosed before the contract is made.

The ACCC has taken the view that unless the agreement contains an obligation to make payments over the relevant threshold amount, merely assuming that the contract value will exceed the threshold will not suffice. Its position is that royalty payments calculated by reference to sales cannot be included for this purpose. As a result, only upfront or ongoing fixed or specified minimum payments can be counted in determining whether the threshold for being "small" will be exceeded.

2. What is an "unfair" term?

A term will be "unfair" if **each** of the following applies:

- it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
- it is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term. Importantly, a term will be presumed not to be reasonably necessary to protect a franchisor's legitimate interests, unless the franchisor can prove otherwise. (How many franchisors could produce a business case to justify each of the terms in their franchise agreement? They will need to be able to do so in future) ; and
- it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

In determining whether a term of a contract is unfair, a court may take into account such matters as it thinks relevant, but it must take into account the extent to which the term is "transparent" and the contract as a whole. This means that documents such as operations manuals or policies that form part of the contract need to be examined, as will obligations to comply with documents referenced in these. The ACCC takes the view that if a franchise agreement requires a franchisee to comply with external documents, such as operations manuals, then these will form part of the contract, whether or not the agreement specifies that they do. This means that each provision of each manual will also need to be examined for fairness.

The test of "transparency" requires contract terms to be expressed in reasonably plain language, to be legible, to be presented clearly and to be readily available to any party affected by them. This will likely require particularly onerous provisions to be expressly brought to a franchisee's attention.

3. Terms exempted from the test

Certain provisions will not be subjected to this "fairness" test. Terms which define the main subject matter of the contract and the consideration provided for it will be exempt. This means that the scope of the franchise grant and the size of payments to be made cannot be challenged as unfair. However, the consideration will only be exempt from challenge if either the amount or its method of calculation is clearly disclosed up front.

In addition, terms which are required or expressly permitted by law cannot be challenged. Examples of these are provisions required by the Franchising Code, such as the cooling-off right and the mediation provisions.

4. "Grey" list of possible unfair terms

The legislation includes a list of terms that may be unfair. They are examples only, as unfairness needs to be judged in the context of each contract as a whole. While the listed terms are not prohibited, they create a presumption that they may be unfair. The list includes the following:

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

Many of the examples on the list are unilateral or uneven rights or restrictions, such as uneven rights of termination or the right of a party to vary the contract or the rights or supplies under it without reference to the other. Variations made by changing policies or manuals are expected to be reviewed. Other examples relate to restrictions on the rights of a party to enforce an agreement, or to the liabilities of a party under an agreement. Broad indemnities that can make a small business party liable for things outside their control and liquidated damages provisions that do not reflect actual losses are expected to be scrutinized.

Whether or not a term operates unfairly in practice will be irrelevant. If it has the potential to operate unfairly, that will suffice to render the provision void. It is therefore critically important that any unrestricted unilateral variation right is modified to include some constraints on its exercise.

5. What should franchisors do?

Although the unfair contract terms laws do not apply to standard form contracts entered into before **12 November 2016**, it is important to note that they will apply to any contract renewed after this time. For that reason, no franchisor should enter into an agreement containing a renewal clause unless it permits the franchisor to change the agreement terms at the time of renewal. If there is any risk of the parties "holding over" under an expired agreement, franchise agreements should be changed to contemplate this, to avoid the holding over resulting in a new agreement.

It will also apply to any changes made to existing agreements, manuals and other system documents on or after 12 November.

Franchisors should review the level of negotiation they will be prepared to accept on their franchise agreements to determine whether their agreements will be likely to be "standard form". Assuming they may be, franchisors then need to review the terms of their franchise agreements (and documents to which they refer) to determine the changes they may need to make to ensure enforceability after the law commences.

The consequences of failing to act on this may be severe. Including an "unfair" term in a contract will not result in a breach of any law or the imposition of a penalty, but the affected provision will be void. It will not be read down, and there will be no need for a court to declare it to be voidable. It will simply be unenforceable, providing a franchisee (or group of franchisees) with significant leverage in any dispute.

Foreign franchisors will need to be wary of changes their local master franchisees make to their local sub-franchise agreements but should ensure that they undertake this important review to preserve the enforceability of their system franchise agreements.

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Biography:

Penny Ward leads Baker & McKenzie's franchising practice in Australia and in the Asia Pacific region. Based in Melbourne, Penny was admitted to practice law in 1984 and has practiced franchising law for over 25 years. Penny is a past Chair of the International Franchising Committee of the International Bar Association and has served on the Franchising Consultative Committee of Australia's franchising regulator, the Australian Competition and Consumer Commission. She acted as legal adviser to the Franchise Council of Australia Limited for many years. Penny has written and spoken widely on domestic and international franchising both in Australia and abroad, to organizations such as the Franchise Council of Australia Limited, the ABA Forum on Franchising, the International Franchise Association and the International Bar Association. Penny has been listed as one of the most highly regarded franchising lawyers, by the International Who's Who of Franchise Lawyers.