COUNTRY COMPARATIVE GUIDES 2022

The Legal 500 Country Comparative Guides

Australia

FRANCHISE & LICENSING

Contributor

DC Strategy Lawyers

Brigid O'Neill

Practice Director | brigid.oneill@dcstrategy.com

Neda Whelan

Head of Franchising | neda.whelan@dcstrategy.com

This country-specific Q&A provides an overview of franchise & licensing laws and regulations applicable in Australia.

For a full list of jurisdictional Q&As visit **legal500.com/guides**

AUSTRALIA
FRANCHISE & LICENSING

1. Is there a legal definition of a franchise and, if so, what is it?

Franchising as an industry in Australia is regulated at the national level by the Competition and Consumer Act 2010 (Cth) (C&C Act), to provide uniformity in the operation of franchise businesses across all of Australia's eight States and Territories. The Australian Competition and Consumer Commission (ACCC), an independent statutory body, ensures compliance with the detailed franchising laws contained within the C&C Act and is known to take a proactive role in the franchise sector to facilitate competition and fair trade in Australia.

The C&C Act contains the Franchising Code of Conduct (Franchising Code) which is a detailed set of regulations controlling the management of the franchising sector in Australia. The Franchising Code sets out, quite specifically, a legal definition for a franchise in Australia which is far broader than most international equivalents. The ACCC unapologetically seeks to capture as many commercial activities as possible within the definition of franchising with a view to protecting franchisees and regulating trade in this industry.

Under the Franchising Code, a business arrangement will be captured by the Franchising Code and deemed a franchise by the ACCC if:

- it determines that one of the parties involved has a legal or beneficial interest in a franchised business; and/or
- a franchise agreement is determined to have been entered (as a written agreement, verbally or even by implied conduct):
- in which the first party is granted the right to carry on a business under a system or marketing plan substantially determined, controlled or suggested by the second party;
    - under which the operation of the business will be substantially associated with a brand or marketing under the control of the second party;
    - under which, before starting or continuing the business, first party must pay or agree to pay a fee or amount to the second party for the right to provide those goods of services.

2. Are there any requirements that must be met prior to the offer and/or sale of a franchise? If so, please describe and include any potential consequences for failing to comply.

The Franchising Code mandates the provision of extensive information by a franchisor to a prospective franchisee. On the whole, this is captured in a Disclosure Document, an Information Statement and a Key Facts Sheet (Disclosure Documentation) that must be provided to a prospective franchisee at stipulated points during the sale process and more detail is provided on these disclosure requirements at section 4 below.

It is pertinent to mention that a franchisor is also bound under the Franchising Code by document holding periods and requirements on the ability to take non-refundable deposits.

A franchisor who does not comply strictly with the requirements is exposed to financial penalties from the ACCC , potential termination of the Franchise Agreement by the affected franchisee and an action for compensation for any loss or damage the franchisee may have sustained as a result of the franchisor's breach.

3. Are there any registration requirements for franchisors and/or franchisees? If so, please describe them and include any potential consequences for failing to comply. Is there an obligation to update existing registrations? If so, please

 © 2022 Legalease Ltd

describe.

Recent amendments to the Franchising Code in 2022 introduced the obligation for franchisors to register their franchise system on the Australian Government Treasury managed Franchise Disclosure Register and provide information about both the franchisor and its franchise network in Australia. The information submitted to the Franchise Disclosure Register must be kept accurate and updated every year by 31 October, in combination with the ongoing requirement to update the Disclosure Document by the same time. There are no requirements for master franchisees or individual franchisees to register unless so required in their franchise agreements as the publication of the existence of those franchisees is normally captured in the franchisor's obligations.

Any failure by a franchisor to comply with the Franchise Disclosure Register obligations potentially exposes the franchisor to financial penalties from the ACCC which can be as high as AUD$10 million.

4. Are there any disclosure requirements (franchise specific or in general)? If so, please describe them (i.e. when and how must disclosure be made, is there a prescribed format, must it be in the local language, do they apply to sales to sub-franchisees) and include any potential consequences for failing to comply. Is there an obligation to update and/or repeat disclosure (for example in the event that the parties enter into an amendment to the franchise agreement or on renewal)?

The Franchising Code of Conduct (Franchising Code) mandates extensive pre-sale disclosure requirements which are to be provided to prospective franchisees in a Disclosure Document, Information Statement and a Key Facts Sheet (Disclosure Documentation). The Disclosure Documentation is not provided in a published template under the Franchising Code of Conduct, each franchisor must ensure that the documents they or their professional advisors draft, comply with the requirements. The franchisor is required to provide:

- a prospective franchisee, at least 14 days prior to executing the franchise agreement, with all statutory and contractual documents that are associated with the grant of a franchise, (Documentation Disclosure Period). The Disclosure Period allows the franchisee time to obtain professional advice (including legal and financial) prior to binding themselves to potentially onerous franchising terms;
- a prospective franchisee, at least 14 days prior to executing the franchise agreement, with the terms of any lease, sublease or licence to occupy to be held between the franchisor and the franchisee (Property Disclosure Period). The Property Disclosure Period is separate to the Document Disclosure Period and where the franchisor does not provide the property documents at the same time as the documentation documents, the two disclosure periods will run consecutively in overlap.

If the franchisor fails to comply, the franchisee has a post contractual right to cancel the franchise agreement within 14 days of execution without financial penalty and to recover amounts paid (Cooling Off Period).

A franchisor is also required to maintain the accuracy of their Disclosure Documentation and to formally update it each financial year. As the Australian financial year ends on 30 June, franchisors have until 31 October each year to update and upload their revised Disclosure Documents to the Franchise Disclosure Register. The only available exception to the deadline is for either foreign registered companies (where the alternate financial year has been advised to the Australian Securities and Investment Commission) (ASIC) or Australian companies with dispensation to operate under a typical financial year; in which case the deadline is amended to the date four months after the end of financial year.

During the franchise term, the franchisee may also request and is entitled to be provided with an updated copy of the Disclosure Document. Similarly, the Disclosure Document, as current at the time, is required to be provided as and when the franchise agreement is renewed.

There are likely to be additional disclosure obligations that come into play when the franchise being sold/granted is not a new (or greenfield) franchise but rather an existing business. In such circumstances, individual State and Territory laws may stipulate overlapping obligations and timetables for the franchisor (or the outbound franchisee) and will vary according to the State or Territory in which the franchised business is located.

In Australia, sub-franchises (issued by a master franchisee) are subject to the same terms and conditions as if the franchisor was issuing the franchise directly to a franchisee and any non-compliance will be treated by the ACCC in the same manner as all other franchises.

 © 2022 Legalease Ltd

5. If the franchisee intends to use a special purpose vehicle (SPV) to operate each franchised outlet, is it sufficient to make disclosure to the SPVs' parent company or must disclosure be made to each individual SPV franchisee?

The ACCC requires a franchisor to provide compliant Disclosure Documentation to the legal entity that is executing the franchise agreement and thus being bound by the obligations contained therein, be that an individual in their personal capacity, a corporation or even a special purpose vehicle. As such, where an SPV parent company is not expressly described as a party to the franchise agreement, provision of the Disclosure Documentation to that entity will not discharge the franchisor's obligations under the Franchising Code even if so requested by the prospective franchisee.

Any failure by the franchisor to ensure compliance with their disclosure obligations, exposes the franchisor to financial penalties from the ACCC which will be determined according to ACCC's assessment of the extent of the breach. Penalties imposed can be as high as AUD$10 million.

6. What actions can a franchisee take in the event of mis-selling by the franchisor? Would these still be available if there was a disclaimer in the franchise agreement, disclosure document or sales material?

Australia's robust competition and fair-trading regulations (when compared against other OECD jurisdictions) are enshrined within the federal level Competition and Consumer Act 2010 (C&C Act) which is overseen by the Australian Competition and Consumer Commission (ACCC). The C&C Act functions parallel to the rights that pre-exist at common law (and are often also found in other common law jurisdictions such as New Zealand, the United Kingdom, Canada and the United States).

The general principle in Australia is that parties to a business contract are entitled to "strike a commercial bargain" of their choosing and this could include detailed disclaimers or waivers in a franchise agreement to the benefit of a franchisor. These exclusions or waivers, despite how comprehensively drafted, will not operate to exclude the protections afforded under the C&C Act to prevent deliberately misleading, deceptive or unconscionable conduct on behalf of the franchisor prior to the execution of a franchise agreement.

In other words, if the franchisor can be proven to have acted during their pre-contractual representations in a way that was deliberately misleading, deceptive or unconscionable to the prospective franchisee, then any disclaimers that were agreed to by the franchisee will not be enforceable to protect the franchisor.

7. Would it be legal to issue a franchise agreement on a non-negotiable, "take it or leave it" basis?

It is entirely permitted within Australia to issue a franchise agreement on a non-negotiable basis or indeed to issue a franchise agreement weighted heavily in favour of the franchisor. That said, from a commercial perspective, such action would materially limit interest in the franchise offering due to the prevalence of mature market players within Australia. A non-negotiable or even heavily imbalanced franchise agreement would simply not attract the calibre of prospective franchisee that an international brand would be seeking.

It would, moreover, be legally inadvisable to issue franchise agreements on either a non-negotiable or heavily imbalanced basis. In the event that a franchisee subsequently sought to have the franchise agreement voided, a non-negotiable or heavily imbalanced franchise agreement would immediately open the franchise agreement to scrutiny under the 'unfair contracts' regime in Australia enshrined in the C&C Act.

8. How are trademarks, know-how, trade secrets and copyright protected in your country?

Australia is an active member of the Word Intellectual Property Organisation (WIPO) and a party to the Madrid System. This highlights the importance Australia places on the protection of intellectual property of all types.

Parties habitually enshrine detailed protections in the franchise agreement against misuse or unauthorised disclosure of confidential information, trade secrets or know-how. It is also commonplace for the intellectual property in agreements to be delineated between foreground and background intellectual property to enable foreground IP in mutually created works to be allocated to a particular party in the contract.

Businesses in Australia also benefit from vigorous protections of trade marks, copyright, designs and patents under federal level legislation i.e. Trade Marks Act 2005 (Cth), Copyright Act 1968 (Cth), Designs Act 2003 (Cth) and Patents Act 1990 (Cth). Protection is also

 © 2022 Legalease Ltd

available via common law remedies including common law trade mark rights and the tort of passing off

Whilst no formal system of registration exists for copyright works in Australia, copyright is automatically granted under the Copyright Act 1968 (Cth), for both 'original published works' and 'original unpublished works'.

There are some occasions where intellectual property does not fall into the categories of trademarks, patents or copyright i.e. trade secrets and or commercially sensitive information, however, these will be nevertheless protected by either common law rights and/or the terms of the agreement and contract.

Design registrations are also available in regard to unique presentations of otherwise 3D goods and registration may be obtained by registering a design under the Designs Act 2003 (Cth).

9. Are there any franchise specific laws governing the ongoing relationship between franchisor and franchisee? If so, please describe them, including any terms that are required to be included within the franchise agreement.

The Australian federal level Consumer & Competition Act 2010 (C&C Act) contains the Competition and Consumer (Industry Codes—Franchising) Regulation 2014, otherwise known as the 'Franchising Code of Conduct' (Franchising Code) which is a mandatory industry code for which compliance is carefully monitored by the dedicated regulator, the Australian Competition and Consumer Commission (ACCC).

We have mentioned above the extent to which the Franchising Code governs the establishment of franchise networks or the grants of franchises, but it also provides significant regulations around the ongoing relationship between franchisor and franchisee including disclosure requirements, document holding periods, cooling off periods, good faith obligations and much more. Whilst many of these requirements are covered in the franchising agreement, we would always encourage new market entrants to engage an experienced franchising lawyer to thoroughly explain these requirements and ensure compliant documentation.

10. Are there any aspects of competition law that apply to the franchise transaction (i.e. is it permissible to prohibit online sales, insist on exclusive supply or fix retail prices)? If applicable, provide an overview of the relevant competition laws.

The laws governing the promotion of competition, fair trading and consumer protection in Australia are robust in terms of consumer protections and the majority are contained in the federal level Consumer & Competition Act 2010 (C&C Act). Some States and Territories also have supplementary legislation which applies to certain industries.

Resale Price Maintenance	RPM can now be 'notified' to the ACCC. If the ACCC does not object within 60 days, you then have immunity to impose minimum resale prices or minimum advertised price policies. Franchisors can lodge a 'Resale Price Maintenance' notification with the ACCC to receive some protection from legal action against price fixing. It is recommended you obtain advice from a lawyer before seeking to lodge a notification with the ACCC and fix prices.
Cartel Conduct	It is common in franchise systems for franchisors to sell through company owned websites or to operate company owned stores. This will usually make the franchisor a 'competitor' with some or all of its franchisees for the purposes of cartel laws. This, in turn, makes it illegal for the franchisor to control retail prices in the franchise system without contravening cartel laws. These problems can be overcome by seeking 'authorisation' from the ACCC. Authorisation is available if an applicant can show that their conduct is not likely to substantially lessen competition. Since most franchise systems account for only a small share of the markets in which they operate, this is a test that many franchise systems will be able to satisfy. This opens up the possibility that many franchise systems may now obtain authorisation to allow franchisors and franchisees to explicitly discuss and agree promotions and pricing, enabling those systems to operate in a truly integrated way that has often previously not been possible due to competition law constraints.
Anti-competitive conduct	The C&C Act prohibits contracts, arrangements, understandings or concerted practices that have the purpose, effect or likely effect of substantially lessening competition in a market, even if that conduct does not meet the stricter definitions of other anti-competitive conduct such as cartels. Concerted practices are only prohibited if they substantially lessen competition in a market.

 © 2022 Legalease Ltd

11. Are in-term and post-term non-compete and non-solicitation clauses enforceable?

Australia Courts have demonstrated a reluctance to enforce non-compete clauses as they have held that a person has an inalienable right to "ply their trade" or, in other words, earn a living. In general terms, however, when drafted carefully and implemented correctly, non-compete clauses in franchise agreements can be appropriately and reasonably enforced. This is especially the case when an outgoing franchisee has received good consideration for the franchise they are exiting and circumstance show that the conduct of the outgoing franchisee is more than simply an attempt to earn a living i.e. opening a store of the same type, selling the same products and within the immediate vicinity of the previously franchised store.

12. Are there any consumer protection laws that are relevant to franchising? Are there any circumstances in which franchisees would be treated as consumers?

All consumers within Australia receive legislated guarantees within the Australian federal level Consumer & Competition Act 2010 (C&C Act) that products and/or services:

- meet relevant safety conditions;
- match the consumer expectations and representations made prior to purchase;
- fit the purpose and/or requirements for the stated intention; and
- are provided with appropriate knowledge and skill.

All products or services provided by franchisees to customers are subject to these consumer protection laws. A franchisor may also be subject to such laws vis a vis products and services provided to franchisees where the value of the products and services provided is less than $100,000. Any product or service valued above that amount sits outside of the consumer protections afforded by the C&C Act and is subject to contractual and equitable remedies.

13. Is there an obligation (express or implied) to deal in good faith in franchise relationships?

An express obligation exists within Division 3 of the Franchising Code, which states that:

"Each party to a franchise agreement must act towards another party with good faith, within the meaning of the unwritten law from time to time, in respect of any matter arising under or in relation to: (a) the agreement; and (b) this code."

14. Are there any employment or labour law considerations that are relevant to the franchise relationship? Is there a risk that the staff of the franchisee could be deemed to be the employees of the franchisor? What steps can be taken to mitigate this risk?

The federal level Fair Work Act 2009 (Cth) and the Fair Work Regulations 2009 (Fair Work System) apply in every State and Territory in Australia and govern any employee / employer relationship in Australia. They provide a safety net of minimum entitlements, enable flexible working arrangements and fairness at work and prevent discrimination against employees and are implemented by the Fair Work Ombudsman who independently conducts investigations and enforces compliance through the Courts.

In the franchising sector, the Fair Work System may extend individual franchisees' responsibility to employees further up the hierarchy to franchisors. In other words, if their franchisees or subsidiaries don't implement the Fair Work System (both to the letter and spirit of the law) the franchisor will also be held liable for any failings if they knew or should have known and could have prevented it and be treated as the ultimate employer, despite any other documents or conduct showing otherwise.

Where the Fair Work System has been correctly implemented by all parties, it is unlikely that a franchisor would be deemed the employer of and responsible for a staff member of the franchisee unless the franchise is operated under a joint venture between the franchisee and franchisor. In such circumstances, the franchisor may be considered as being the directing hand or otherwise managing the franchise. One means of mitigating such a risk is by ensuring that a franchisor hold no more than 49% of any entity operating the franchise.

15. Is there a risk that a franchisee could be deemed to be the commercial agent of the franchisor? What steps can be taken to mitigate this risk?

 © 2022 Legalease Ltd

Where a franchisee is also acting as an agent for a franchisor in the capacity of an agent for the franchisor, then yes that

A franchisee may be deemed to be the commercial agent of the franchisor where it acts on behalf of the franchisor within the common meaning of agency e.g. assisting in the recruitment of franchisees. In such circumstances, it would always be advised that the activity be undertaken through a separate corporate entity than the existing franchisee.

16. Are there any laws and regulations that affect the nature and payment of royalties to a foreign franchisor and/or how much interest can be charged?

Royalties earnt from Australian franchisees can be forwarded to a foreign franchisor so long as the foreign franchisor has registered with the Australian Securities & Investment Commission (ASIC) as a foreign entity conducting business within Australia.

The foreign franchisor, although domiciled abroad, is still required to meet ASIC and Australian Tax Office (ATO) reporting requirements for all such income earnt conducting business in Australia. Accounting advice as to the tax implications and cost associated with making such payments to a foreign based company should always be sought by a foreign franchisor.

17. Is it possible to impose contractual penalties on franchisees for breaches of restrictive covenants etc.? If so, what requirements must be met in order for such penalties to be enforceable?

In Australia, Courts will not enforce contractual financial "penalties" that are considered to be punitive by intent. A party may only recover actual damages and as such, any contractual drafting for anticipated breaches must evidence a genuine pre-estimate of loss and also require all parties to take reasonable efforts to mitigate any losses.

18. What tax considerations are relevant to franchisors and franchisees? Are franchise royalties subject to withholding tax?

Any entity or person conducting business in Australia is subject to reporting requirements on its earnings obtained within Australia and potential onshore taxation obligations. As such, franchisors and franchisees are advised to engage with an Australian accountant when considering their corporate structure to ensure that tax implications have been appropriately factored. Some issues to consider include:

- possible depreciation claims for equipment obtained;
- allowable overhead expenses and the cost of sales;
- capital gains on the acquisition or sale of a franchise business; and
- the general service tax (GST) which is payable on all business transactions within Australia where the recipient of the goods/services takes the benefit of the goods/services in Australia. This applies to both franchisees providing products/services to consumers and to a franchisor collecting franchise fees, royalties etc. The only exception to this rule is if the business generates less than AUD $75,000 a year.

Franchise payments and/or royalties are subject to withholding tax in Australia when business is transacted in Australia in any of the following circumstances:

- a foreign resident franchisee payer to a foreign resident franchisor;
- an Australian franchisee payer to a foreign resident franchisor; and
- an Australian franchisee payer to an Australian resident franchisor where the franchisor conducts their business outside of Australia.

19. How is e-commerce regulated and does this have any specific implications on the relationship between franchisor and franchisee? For example, can franchisees be prohibited or restricted in any way from using e-commerce in their franchise businesses?

E-commerce is, like all transactions to consumers, governed by the Consumer & Competition Act 2010 (C&C Act) in Australia. A franchisor, through the franchise agreement, may prevent the ability of franchisees to sell online, seek to retain control over online sales or structure the management of e-commerce sales such as where a franchisee fulfills an order or provides the service requested by the consumer on the franchisor's website. All such activities are subject to the C&C Act and should also be noted prominently within the franchisor's disclosure document.

 © 2022 Legalease Ltd

20. What are the applicable data protection laws and do they have any specific implications for the franchisor/franchisee relationship? does this have in the franchising context?

The federal level Privacy Act 1988 (Cth) (Privacy Act) and the Spam Act 2003 (Cth) (Spam Act) impose significant obligations on both franchisors and franchisees in regard to marketing activities to consumers.

The Privacy Act

The Privacy Act governs how personal and sensitive information are to be collected, stored, managed, modified, used and ultimately destroyed. Some key matters relating such material is whether it was obtained with express consent, that the subject has been provided with sufficient information as to how their information may be used and stored and that the subject has been offered the opportunity to opt out. Every business in Australia is required to have a privacy policy available to customers and these are often provided on business websites.

Franchisors and franchisees are required to meet the same Privacy Act standards of care in their handling of personal and other private information. This includes the information held by franchisors about franchisees which can not be disclosed or shared without the franchisee's consent. Franchisors are strongly advised to have robust privacy policies that are cascaded to franchisees as franchisors can be held liable in the event that their franchisees do not comply with data protection and privacy laws.

The Spam Act

The Spam Act prohibits the sending of unsolicited commercial electronic messages to a digital address accessed in Australia (whether originating domestically or abroad). Electronic messages include emails, instant messaging, SMS and other mobile phone messaging. Franchisors and franchisees must abide by specific regulations in the sending of electronic messages such as having obtained consent, clearly identifying the sender and including an unsubscribe facility.

Failure to comply with the Spam Act may result in a penalty of up to AUD $220,000 for a single day's contravention and if there is a repeat contravention, a penalty of up to AUD $1.1 million may be incurred.

21. Is the franchisor permitted to restrict the transfer of (a) the franchisee's rights and obligations under the franchise agreement or (b) the ownership interests in the franchisee?

A franchisor is entitled to be notified and approve the transfer/assignment of any existing franchise to third party and will likely require a deed of assignment thereto. It is also common practice in some franchise networks that transfers/assignments are not permissible, the franchisor instead requiring the execution of a new franchise agreement upon completion of the sale/transfer of the business.

Similarly, a franchisor is usually entitled to be notified of changes in the ownership of the franchisee entity and require a deed of variation to amend the Director/nominated manager and guarantor (as is applicable to the circumstances).

In both instances, a franchisor may impose restrictions so long as they are considered reasonable and do not cause a breach of the Consumer & Competition Act 2010 (Cth).

22. Does a franchisee have a right to request a renewal on expiration of the initial term? In what circumstances can a franchisor refuse to renew a franchise agreement? If the franchise agreement is not renewed or it if it terminates or expires, is the franchisee entitled to compensation? If so, under what circumstances and how is the compensation payment calculated?

The right of a franchisee to request a renewal is not enshrined in law and as such, is entirely dependent on the terms of the relevant franchise agreement. That said, it would be rare to find a franchise agreement with a reputable franchisor which does not offer either contractual renewal rights or the ability of a franchisee to enter a new franchise agreement with the franchisor. In either circumstance, the franchisor is entitled to consider both the discharge of the franchisee's contractual obligations and the financial success of the franchise outlet in their decision making, noting though that such decisions must be reasonable and not unduly critical without cause. Where no objective bona fides reasons exist, a franchisor is at risk of having the franchise agreement non-compete restrictions deemed of no effect under the Franchising Code.

 © 2022 Legalease Ltd

If following expiry or termination a franchise is not being sold to third party, any monies paid for franchise assets, equipment and/or stock will need to be negotiated between the franchisor and franchisee unless already dealt with expressly in the franchise agreement. If a franchise agreement is terminated following a material breach, the franchisee has no immediate right to compensation. In any event, the franchisor's disclosure document issued at the commencement of the franchise must outline any circumstances in which the franchisor offers any form of compensation.

23. Are there any mandatory termination rights which may override any contractual termination rights? Is there a minimum notice period that the parties must adhere to?

Whilst the usual clauses pertaining to termination for convenience and cause exist also in Australia, the Franchising Code does alter the mechanics as franchisors are required to provide a period of not less than 30 days for the franchisee to remedy notified breaches.

Franchisors also bear the weight of a higher threshold for material breach which would otherwise have allowed for immediate termination in commercial transactions. Franchisors are required to provide not less than seven days' notice of what would otherwise be considered grounds for "immediate" termination.

24. Are there any intangible assets in the franchisee's business which the franchisee can claim ownership of on expiry or termination, e.g. customer data, local goodwill, etc.

It is customary in Australia for the franchise agreement to explicitly specify which (if any) assets will be retained by a franchisor on expiry or termination. The franchisee will generally be expected to obtain and pay for their own equipment and stock to operate the business and as such will have rights to sell or retain such items at the expiry or termination of the franchise.

In regard to intangible assets, it is common practice for the franchisor to retain ownership of intellectual property and associated goodwill, leaving the franchisee with only the goodwill that may be attributed to that particular franchise store i.e. customer loyalty. Even customer databases are generally anticipated by the franchise agreement to automatically assign to the franchisor upon their creation and/or update. The disclosure document and franchise agreement should both state what is expected in regard to goodwill in the franchise business and if any is to be retained by the franchisee.

25. What due diligence should both the franchisor and the franchisee undertake before entering into a franchise relationship?

A franchisor should ensure that the franchisee will have sufficient skills to establish and run a franchise business. Many franchisors will have a prospective franchisee complete a personality/aptitude test. It is also advisable for franchisors to request proof of available capital to ensure appropriate cash flow.

The franchisee should ensure that the business model they are buying into will be able provide the level of returns they are hoping to achieve and that the franchise agreement term provides sufficient time to make a return on their investment. Franchisees should further investigate the reputation of individual franchisors and satisfy themselves of the ongoing support provided to the franchise network.

26. How widespread is franchising and what are the most active sectors? Are there any specific economic, cultural or regulatory issues that make franchising particularly attractive?

The franchising business model was brought to Australia by DC Strategy in the 1970s and has since that time, consistently flourished with notable growth occurring since the 1980s. The franchising market is now considered mature. Second only to New Zealand, Australia boasts more franchising outlets per capita than any other country.

Currently, Australia has over 1,100 franchisors, 65,000 franchise units, and 8,000 company-owned units in a huge cross-section of sectors although the most popular are in the non-food retail industry, which accounts for over 25% of successful franchise systems. In 2022, food retail concepts that promote health and well-being continue to do exceptionally well.

The franchising of foreign brands into Australia has succeeded extremely well as its market conditions are relatable to other western countries i.e. USA and UK and so existing models can be exported. Australia is considered to be the prime test market for all western exports and is thus frequently used as a pilot country for franchising.

 © 2022 Legalease Ltd

27. Is there a national franchising association? Is membership required? If not, is membership commercially advisable? What are the additional obligations of the national franchising association?

The Franchise Council of Australia (FCA) is the peak business organisation representing a compliant, sustainable and profitable franchise sector. The FCA provides a platform for franchisors, franchisees, business advisors and small to medium businesses to influence government policy, communicate with political leaders and key decision makers, network with peers and engage in policy debates.

Whilst membership with the FCA is not mandatory, it is strongly encouraged as they provide excellent resources for both franchisors and franchisees to navigate the franchising landscape. Members of the FCA are expected to adhere to the FCA Members Standards which are not unduly onerous.

The FCA organises an annual Australia wide Conference in addition to smaller State based regulatory updates and business summits at which members can improve knowledge and network with both peers and sector advisors. The FCA also run a franchising certification program for executives new to the franchising sector.

28. Are foreign franchisors treated differently to domestic franchisors? Does national law/regulation impose any debt/equity restrictions? Are there any restrictions on the capital structure of a company incorporated in your country with a foreign parent (thin capitalisation rules)?

Foreign companies operating in Australia as a general rule, need to be registered with the Australian Securities and Investments Commission (ASIC), the independent statutory body with governs and regulates Australia's integrated corporate, markets, financial services and consumer credit markets.

During the registration process, a foreign company will be allocated an Australian Registered Body Number (ARBN) which is used as their corporate identifier in all correspondence and transactions with ASIC or government departments.

A registered foreign company must also have a local agent which is responsible for any obligations the company must meet and may, in its own right, be liable for any breaches or penalties. The agent is therefore not simply a letterbox service, the agent must be capable and experience in the provision of foreign entity agency services in Australia.

Foreign owned companies looking to invest in Australian businesses will need to obtain expert advice as to:

- whether they require clearance from the Australian Government Foreign Investment Review Board (FIRB); and
- the impact (if any) of thin capitalisation rules which disallow deductions for a portion of specified debt finance expenses (Debt Deduction). The Debt Deduction rules apply to Australian companies with overseas investment, foreign entities with investments in Australian and any business with a permanent operation in Australia. The Debt Deduction rules are triggered when the entity's debt-to-equity ratio exceeds certain limits.

29. Are there any requirements for payments in connection with the franchise agreement to be made in the local currency?

The Franchisor's Disclosure Document will list all fees associated with the franchise and the manner and currency in which they are to be paid. That said, an Australian franchisee would largely expect to see fees quoted in AUD to assist in the franchisee's due diligence process when assessing the franchise opportunity. Where a franchisor requests that the fees are payable in another currency, the Disclosure Document should also specify which party is to take the foreign exchange risk and equally, whether the franchisor or franchisee will be liable for fees for receipt and/or transfer of funds in foreign currencies.

30. Must the franchise agreement be governed by local law?

All franchises in Australia must be structured and granted under a franchise agreement that is governed by Australian law and is compliant with the Franchising Code of Conduct contained within the Consumer & Competition Act 2010 (Cth). Any franchising agreement that is not so governed would potentially be unenforceable or only enforceable in so far as it meets the requirements of the Franchising Code of Conduct.

Depending on the nature of the goods and/or services offered in the franchise network, there may also be State

 © 2022 Legalease Ltd

or Territory supplementary laws and regulations which dictate requirements for operation, licensing, safety and others. One such example is that each Australian State and Territory has its own food health and safety legislation and regulatory regimes.

The franchise agreement must detail all local laws relevant to the franchise for which the franchisor will hold the franchisee accountable.

31. What dispute resolution procedures are available to franchisors and franchisees? Are there any advantages to out of court procedures such as arbitration, in particular if the franchise agreement is subject to a foreign governing law?

It is customary in Australia and often enshrined in the franchise agreement that parties are required to undertaken certain commercial negotiation in the event of a disagreement as to liability and/or performance. Where such preliminary discussions are unsuccessful, the Franchising Code of Conduct then mandates alternative dispute resolution (ADR) procedures, which may include mediation, conciliation and/or arbitration. A party is barred from commencing Court action until the ADR has been conducted except where an urgent injunction is required to prevent further loss and damage.

There is little advantage to the use of arbitration in Australia in franchising disputes given the excellent standard of judicial intervention in commercial disputes. The primary reason that arbitration may be listed as the sole recourse in the franchise agreement is to maintain confidentiality.

32. Does local law allow class actions by multiple franchisees?

Class action litigation has only recently arrived in Australia, having been imported from the US legal system. It has proven appealing in the franchising sector as a means to assist franchisees in conducting litigation against franchisors for breaches of the Consumer & Competition Act 2010 (C&C Act) which contains the Competition and Consumer (Industry Codes—Franchising) Regulation 2014, known as the 'Franchising Code of Conduct' or Franchising Code. 7 Eleven was successfully sued by franchisees in 2021 (and later settled for AUD $98 million) and currently Mercedes Benz is defending an AUD $650 million class action by its franchisees. Class actions by franchisees is a serious risk for franchisor's who fail to comply with both the spirit and the letter of the law under the Franchising Code.

33. Must the franchise agreement and disclosure documents be in the local language?

A commercial contract in Australia does not strictly need to be drafted in the English language to be considered binding on the parties. The complications would arise however in the event of a default/breach or a disagreement as to construction of the rights and/or obligations. Any subsequent translation into English for the Courts (which strictly require English language documentation) would of itself then be subject to disputes as to accuracy. To that end, it is customary in Australia to draft commercial contracts in either the English language alone or under a bilingual methodology, noting that the English language text would always take primacy over the second language in the event of construction disputes.

34. Is it possible to sign the franchise agreement using an electronic signature (rather than a wet ink signature)?

The standard method of contract execution in Australia is via "wet ink" signatures or PDF signatures implanted onto a document. Some clients prefer to have circular signatures i.e. the franchisor signs after the franchisee on the same page but on the whole counterpart signatures are utilised whereby each party signs a blank signature page and the solicitors exchange signed pages at an agreed time (so long as the appropriate permissible clauses have been included in the Franchise Agreement).

Australian law requires specialist clauses in the Franchise Agreement for the use of software e-signatures, that is to say the use of software that does not required a party to actually sign the document but rather click a box, thus having the software determine, time, date and IP address of the signatories. So long as procedures are correctly followed, the electronic signatures are binding on the parties.

35. Can franchise agreements be stored electronically and the paper version be destroyed?

In alignment with general Australian law, binding agreements should always be stored in their original wherever possible. The Franchising Code of Conduct in

 © 2022 Legalease Ltd

particular, does require franchisors and franchisees to store the original signed version of a Franchise Agreement. If that is what we would call a "wet ink" signed paper version, then either the parties or their solicitors would store these documents in a specialist fire proof contracts safe. If the original version was executed electronically via PDF signed versions, then the emails delivering the executed Franchise Agreements also become storable. If the Franchise Agreement is signed via an electronic signature software, then that file becomes the original time stamped version and must be retained.

We would always discourage parties from destroying original versions of the executed contracts as, in the event that a dispute arises, those versions will need to be tendered as evidence to the Court.

36. Please provide a brief overview of current legal developments in your country that are likely to have an impact on franchising in your country.

The Franchising Code of Conduct (Franchising Code) recently underwent significant formal review by the Australian government in 2021 and the recommendations were adopted and will finish coming into effect in November 2022. It is not anticipated that there will be a further significant review of the Franchising Code for some years although it should be noted that the franchising regulator, the Australian Competition & Consumer Commission (ACCC) remains able to make determinations and mandate actions outside of any legislative review cycle.

A new federal Australian government was sworn in in 2022 under a "Better Competition" election platform. To that end, the Australian government is currently undergoing a legislative review of penalties for engaging in anti-competitive conduct under the Competition and Consumer Act 2010 (C&C Act) and the Australian Consumer Law (ACL). The recommendations currently out for industry submission would see financial penalties increase substantially (corporate penalties for example at $50 million or between 10-30% of turnover during the period in question).

37. In your opinion, what are the key lessons to be learned by franchisors as a consequence of the COVID-19 crisis?

Franchisors and franchisees should always have a collaborative, constructive and flexible relationship and the global pandemic made that all the more important. Whilst it is always easier to jointly face trading challenges of the scale presented by COVID-19, even the best Franchise Network business continuity plan could not have anticipated the mandated lockdowns that decimated retail, restaurants and travel but which created significant growth in delivery services, online shopping and technology.

We would always recommend that franchisors have robust crisis management and business continuity plans that are dovetailed with the franchisee plans within the franchise network. This is particularly the case as the Franchising Code obligations on a franchisor to act with franchisees in a manner that is not misleading, not unconscionable and always in good faith are in no way waived or diluted in times of crisis. If anything, the application of the obligations was expanded.

The franchising regulator, the Australian Competition & Consumer Commission (ACCC) was a vocal advocate for franchisees during the global pandemic and issued clear guidance on their expectations that franchisors would:

- reduce franchise fees if the services to franchisees had reduced;
- support the viability of franchisee businesses by continuously reviewing their franchise system's processes and supply arrangements, making adjustments and being flexible with requirements;
- proactively review what services and costs they pass on to franchisees and should consider whether it would be appropriate to cancel them or suspend them so savings can be passed on. This may include suspending or cancelling conferences and marketing services, and the related costs for franchisees.
- renegotiate appropriate temporary arrangements with key suppliers and commercial landlords and pass on any discounts or reductions to franchisees;
- immediately notify franchisees of any changes to disclosure or financial information; and
- preventing franchisors from unilaterally charging new or increased fees for services outside the existing Franchise Agreements.

In summary, it is our view that franchisors would be best placed to focus on building flexibility into their franchise agreements, ensuring agile methodologies to enable rapid pivoting to face challenges head on (such as online sales and deliveries) and working closely with their franchisees to share financials (preferably on interconnected software systems).

 © 2022 Legalease Ltd

Contributors

Brigid O'Neill
Practice Director
brigid.oneill@dcstrategy.com



Neda Whelan
Head of Franchising
neda.whelan@dcstrategy.com



 © 2022 Legalease Ltd