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Practice Areas:

Corporate and Transactional

Antitrust, Competition and Trade Regulation

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Franchising Update

By Chris Nikou, Murray Deakin and Anna Trist

To begin 2014, we remind franchisors of the Government's response to the changes to the Franchising Code recommended last year. On 6 January 2014, Small Business Minister Bruce Billson advised that the Coalition advocated penalties to help enforcement of the Franchising Code of Conduct (Franchising Code). We look forward to seeing how the new government will deal with other recommendations made by the 2013 Wein Report.

Enclosed is an interesting discussion regarding whether a franchisee's outlet licence is, legally, a retail premises lease as well as looking at important changes to the Google AdWords Trade Mark Policy.

This edition will help you navigate through the guidelines published by the Australian Competition and Consumer Commission (ACCC) on its use of infringement notices and sets out an update from the ACCC regarding their focus on supply arrangements.

In February 2014, changes to the franchising laws in South Korea will take effect, we have also included a summary of these changes.

Summary of Government Response to Franchising Code Changes

Rec #	Recommendation Overview	Previous Government's Position
1	Disclosure on notice of intention to renew	Accepted in principle
2	Short form disclosure for single-grant foreign franchisors	Accepted
3	Disclosure of online sales	Accepted
4	Removal of Annexure 2 disclosure	Accepted
5	Provision of risk statement to potential franchisees	Accepted
6a	Termination of franchise agreement in the event of franchisor insolvency	Accepted in principle
6b	Franchisees recognised as creditors in the event of franchisor insolvency	Accepted in principle
7	Prohibition on franchisors imposing unreasonable unforeseen capital expenditure	Accepted in principle
8	Prescription of marketing funds to be held in trust, audited, co-owned outlets to contribute, etc.	Accepted in part

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Rec #	Recommendation Overview	Previous Government's Position
9	Inclusion of an express obligation of good faith in the Code	Accepted in part
10	Prohibiting franchisors from forcing franchisees to opt out of ex-franchisee contact list	Accepted
11	Franchisor consent to resale subject to all information being supplied by franchisee	Accepted in principle
12	Removing enforceability of restraint of trade clauses under certain conditions	Accepted
13	Recognition of alternative dispute resolution in addition to Office of Franchising Mediation Advisor	Accepted
14	Prohibition of franchisor dispute resolutions costs imposed on franchisees and litigation in jurisdiction where franchisee operates	Accepted in principle
15a	Civil pecuniary penalties for breaches of the Code	* Accepted in Principle by the current Government
15b	ACCC to issue infringement notices for Code breaches	Accepted
15c	Wider random audit powers for the ACCC	Accepted
15d	Disqualification as company director for serious breach of the Code	Noted
15e	Court-ordered royalty holidays or payments to marketing funds	Noted
16	Analysis of minimum terms for motor vehicle dealerships	Accepted
17	No more reviews of the Code for minimum five years	Accepted in principle
18	Improve clarity of policy intent in the Code, and adopt minor technical changes	Accepted

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Is a Franchisee's Outlet Licence a Retail Premises Lease?

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

In a recent decision from the Supreme Court of Victoria, Croft J held that an arbitration clause in a retail lease does not oust the Tribunal's jurisdiction.

A detailed discussion of this issue can be found on Robert Hay's blog here and here.

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

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

- taking a head lease from the land owner
- 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 (Subway), 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 sublease.

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

For example:

- 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
- there is an interesting question over whether the head lease to the franchisor is a retail premises lease for the purposes of the RLA
- 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 subtenant, then there is no doubt that it has standing to seek relief from forfeiture.

What 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 point for practitioners to note at this stage is that a franchisee's outlet licence may well be characterised as a sublease, 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 sublease was not appealed and Croft J expressly left the question open.

Google AdWords Trade Mark Policy – Important Changes

Google has revised its AdWords trade mark policy which is currently in place in Australia, Hong Kong, China, Macau, Taiwan, New Zealand, South Korea and Brazil. These changes will come into effect on 23 April 2013. From this date, Google will no longer remove third party advertisements which are triggered by keywords purchased for a competitor's trade mark, unless the trade mark appears in the text of the resulting advertisement.

Google AdWords are key words which are available for purchase through Google. When a person conducts a Google search using a keyword which has been purchased by a trader, then the trader's website and a small advertisement will appear in the sponsored link section on the search results page.

Under the current Google AdWords complaint procedure, if a competitor is using your trade mark without your approval as a keyword as part of its Google AdWords program then you can file a complaint with Google to have the advertisement removed. For instance, to take a hypothetical example, if Hugo Boss was to purchase 'Gucci' as a key word so that a sponsored link for Hugo Boss appeared when a consumer conducted a Google search using the search term 'Gucci', Gucci could have the sponsored link removed through the Google AdWords complaint procedure. This is the case whether or not the word 'Gucci' appears in the advertisement within the sponsored link section of the search results or not.

From 23 April 2013, Google will no longer accept complaints on this basis. The effect of this change is that a company can purchase a competitor's trade mark as a keyword to have its advertisements displayed as a sponsored link where a consumer searches using this keyword as long as the competitor's trade mark does not appear in the advertisement itself. Any investigations acted on by Google prior to 23 April 2013 will no longer apply to the relevant keywords after this date.

It is important to note that Google will still continue to monitor companies using a competitor's trade mark as part of the advertisement displayed as a sponsored link. Therefore, if you find that a competitor is using your trade mark as part of an advertisement displayed as a sponsored link, then you can continue to use the Google AdWords complaint procedure to have these advertisements removed.

If you want more information about the changes to the Google AdWords policy, or if you have any queries about how these changes will affect you, then please contact us.

This article was written by Jonathan Feder, Partner, and Caroline Cossio, Senior Associate, both of the Melbourne office.

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ACCC Publishes Guidelines on its Use of Infringement Notices

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

This guidance is timely because:

- the ACCC has actively issued infringement notices to the business community, having collected approximately AUD620,000 in penalties under infringement notices up to December 2012
- the amount of penalties sought by the ACCC under infringement notices has recently increased by more than 50%.

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, including:

- unconscionable conduct provisions
- unfair practices provisions (save for certain sections, such as misleading and deceptive conduct provisions)
- certain unsolicited consumer agreement and lay-by 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.

What are the Infringement Notice Penalties?

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

- AUD10,200 for a corporation (or AUD102,000 for a listed corporation)
- AUD2,040 for an individual.

Different penalties apply in connection with substantiation notices.

Infringement notice penalties are calculated by reference to the value of penalty units set by the *Crimes Act 1914*. In 28 December 2012, the value of a penalty unit increased from AUD110 to AUD170. Therefore, the infringement notices relating to conduct prior to 28 December 2012 attracted lower penalties than what will now be recovered.

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How Active Have the ACCC Been in Issuing Infringement Notices?

Since April 2010, the ACCC has issued approximately 95 infringement notices and received approximately AUD620,000 in penalties.

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.
- **Advanced Lifestyle International Retail Pty Ltd:** three infringement notices totalling AUD19,800 in relation to false or misleading representations to consumers during in-home sales presentations for its massage wands, cushions, chairs and beds. 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 Act 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 non-systematic 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
- 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 in December 2012).

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 Act. In fact, should the ACCC be successful, the business may be liable to pay a penalty of up to AUD1.1 million for each contravention in addition to legal costs.

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 Notices 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 businesses 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.

There 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.
- **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 Act. 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, as discussed above.

- **Not pay the infringement notice penalty.** There is no legal obligation on a recipient to pay an infringement notice. However, nonpayment 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 Murray Deakin, Partner, and Joni Jacobs, Lawyer, of the Sydney office.

ACCC Releases Guide – What You Need to Know About: Competition Issues in Franchising Supplier Arrangements

The ACCC recently released a guide entitled What You Need to Know About: Competition Issues in Franchising Supplier Arrangements (Guide). A link to the full version of the Guide can be found here.

The Guide is aimed at assisting franchisors and franchisees to understand the ACCC's role in reviewing arrangements where franchisees are required to purchase goods or services from particular suppliers. It warns against third line forcing, which breaches the *Competition and Consumer Act 2010* (Cth) (Act) even if the conduct does not harm competition.

Third Line Forcing

The Guide sets out a definition of third line forcing. It provides that third line forcing occurs where a supplier (eg a franchisor) supplies goods or services (eg franchising services or the right to become a franchisee) on the condition that the customer also acquires goods or services from another person or business (unrelated to the supplier).

The Guide acknowledges that franchisors:

- set objective quality standards and allow individual franchisees to source goods or services from any supplier that meets those standards
- require franchisees to purchase goods or services from the franchisor or a related company.

Concerns arise under the Act with these kinds of arrangements only where the arrangement has the purpose or likely effect of substantially lessening competition. The ACCC has commented that competition is unlikely to be substantially affected where the franchisee's market and other suppliers' markets include a number of competing businesses. Specific legal advice should be sought regarding whether an arrangement has the purpose or likely effect of substantially lessening competition.

Notification

The guides sets out the notification process, which will provide franchisors with protection from legal action under the Act (after a notification is validly lodged with the ACCC, the franchisor has statutory protection to engage in the third line forcing conduct which protection commences after 14 days unless the ACCC takes steps to prevent this).

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A notification should be lodged by franchisors:

- who intend to require franchisees to purchase goods or services from nominated suppliers
- whose supplier arrangements may have the purpose or likely effect of substantially lessening competition.

The ACCC may remove the protection from legal action provided by a notification at any time if it is satisfied that the likely public benefits will not outweigh the likely public detriments from the conduct. This action is known as 'revoking' the notification and in relation to third line forcing notifications for franchising supplier arrangements, such action is rarely taken.

What Will the ACCC Consider

The guide outlines that the ACCC will consider the public benefits and public detriments including the impact of the conduct on the entire community and not just the impact on individual franchisees.

In considering the public benefits, the ACCC looks at factors such as:

- whether there is consistency across the franchise system, which may benefit customers and increase the value of the franchise system as a whole
- more efficient operation and management of the franchise system where all franchisees operate compatible equipment and purchase the same goods
- more efficient and effective bargaining between the franchise group and its suppliers, which may result in:
    - improved non price terms of the supply contract (eg specific service levels or changes to the supplier's usual method of delivery)
    - cost and time savings as franchisees will not need to individually search for and negotiate deals with suppliers.

In considering the public detriments, the ACCC looks at factors such as:

- supplier arrangements which do not benefit the franchise group as a whole and are less efficient than if the franchisee were not subject to those restrictions
- less competition in a relevant market, such as the markets in which franchisees operate or the markets in which suppliers of goods or services to the franchisee compete.

Rebates

Often, franchisors receive a rebate from suppliers as a result of their supply arrangement.

The existence of the rebate, the ACCC has advised, does not automatically constitute a public detriment in the ACCC's assessment of a notification. In fact, the Guide provides that "there is no outright prohibition against rebate arrangements".

Under the Franchising Code of Conduct however, franchisors are obliged to disclose to franchisees:

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- whether they will receive a rebate or financial benefit from the supply of goods or services to franchisees
- the name of the business providing the rebate or financial benefit
- whether the rebate is shared directly or indirectly with franchisees.

Franchisors are not obliged to disclose the value of the financial benefit.

Franchisors are not obliged to distribute amongst franchisees the financial benefit they receive.

The ACCC may consider the matter of rebates as part of its broader assessment of public benefits and public detriments. The ACCC does not however, consider it to be their role to reach a conclusion regarding whether a supplier arrangement offers the best value for franchisees (that is a matter for franchisees to consider when conduct their due diligence in respect to the franchise system).

Conclusion

In the Guide, the ACCC encourages:

- franchisees (and prospective franchisees) to discuss with franchisor any concerns they have regarding supplier arrangements
- franchisors to consult with franchisees:
    - when putting in place supplier arrangements which restrict how franchisees purchase goods and services or change the way in which the supplier arrangements operate
    - to consider the costs and benefits for the franchise group as a whole when selecting nominated suppliers
    - and to explain to franchisees the process that the franchisor has undertaken in selecting suppliers and the reasons for any changes
    - and to monitor nominated suppliers to ensure that arrangements continue to deliver value either through lower prices or increased quality to the franchise group as a whole.
- franchisors to make supplier arrangements transparent to both prospective and existing franchisees (beyond the minimum requirements set out in the Franchising Code of Conduct).

The Guide provides a useful summary of the law in relation to supplier arrangements in franchise systems, but franchisors should seek specific legal advice in relation to their particular supplier arrangement.

This article was written by Anna Trist, Senior Associate, of the Melbourne office.

International News: Changes to the Franchising Laws in South Korea

A Presidential Decree is expected to be issued shortly to provide further guidance regarding South Korea's amendment to the *Fair Transactions in Franchise Business Act* (South Korea's franchise legislation). The amendments will be effective from February 2014.

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Generally speaking, the amendments address franchise relationship issues and require increased disclosure.

Key aspects of the amendments are:

- franchisors must share remodelling costs in some circumstances
- reducing business hours under certain circumstances (eg permitting franchisees not to operate the franchised business during night hours where the cost of operating the business exceeds the profits generated by that operation or other unavoidable circumstances exist)
- protection of a franchisee's territory (effective from August 2014)
- large franchisors to provide additional information to franchisees including information regarding projected sales revenue and the calculation methods for those projections
- increased penalties and fines against franchisor who provide false, exaggerated or misleading information (up to approximately US$285,300)
- additional protection for franchisees (by permitting franchisees to form trade associations or similar organisations to protect their rights by allowing them to consult and negotiate with the franchisor on a collective basis)
- refunds to franchisees of franchise fees in certain circumstances
- increased oversight for violation of the laws.

South Korea's franchise legislation has not been amended since 2010 (after becoming law in 2002 and being amended in 2008). The amendments are a substantial shift in South Korea's legislation towards protecting franchisees and should be considered when seeking to open a franchise system in South Korea or in any existing operation of a franchise system in South Korea.

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