

## WHAT FRANCHISE BUYERS NEED TO KNOW ABOUT UNFAIR CONTRACTS

If you are looking to purchase a franchise (whether a new or existing business), at some point you will be presented with a contract or 'franchise agreement'. This will form the basis of your rights and obligations as a franchisee and that of the franchisor. It is an important document as it governs the business relationship.

The franchise agreement will have been drafted by a lawyer engaged by the franchisor for this purpose and generally speaking, it will favour the franchisor in most respects. What you must do could be extensive and will usually form the bulk of the agreement. If there is a section on franchisor obligations, this will probably fit on one page.

Until recently, provided they honoured the franchise code, franchisor's had free reign over their contracts and fairness to the franchisee party wasn't a major focus, particularly for established and successful franchises. With the introduction of the 'unfair contracts' regime now applicable to small business (including most franchises), there is now an overarching fairness test.

So how does it work?

From 12 November 2016, changes have been made to the *Competition and Consumer Act 2010* ('CCA') and the *Australian Securities and Investments Commission Act 2001* ('ASIC Act') which means that unfair terms in standard form small business contracts can be declared void.

The contract must be entered into or renewed on or after 12 November 2016.

Generally speaking, a 'standard form small business contract' is a contract:

- Which supplies goods or services or the sale or grant of an interest in land; and
- Where at least one of the parties is a business employing fewer than 20 people; and
- Where the upfront price payable under the contract does not exceed \$300,000 if the term is less than one year or the upfront price does not exceed \$1,000,000 if the term is more than one year. Note that these fee limits rely on fees being ascertainable at the time the contract is entered into. In franchise agreements, this is not always the case because a percentage of revenue may be used to calculate royalties so these will not be included in the calculation and most small business franchises will be within the threshold.

An unfair term is a term that:

- causes a significant imbalance in the parties' rights and obligations under the contract;
- would cause detriment to a party if it were to be relied upon by the other; and
- is not reasonably necessary to protect the commercial interests of the party who would be advantaged by the term.

A court will only declare a contract term unfair if all three aspects above are satisfied. The rest of the contract will continue to bind the parties to the extent that it is still operative without the unfair term.

Some of the common terms in franchise agreements with the potential to be considered unfair include:

- Clauses permitting franchisors to make unilateral variations to the agreement, i.e. where the franchisee has not agreed to the variation.
- Expansive restraint of trade provisions on franchisees following the end of the franchise agreement.
- Termination rights in favour of franchisors although we note that the franchise code already limits the circumstances in which franchises may be terminated.
- Clauses imposing obligations on franchisees to pay franchisor damages and other penalties particularly if they are over and above what would be reasonable compensation for the loss.
- Clauses unduly limiting a franchisee's right to sell the business and/or imposing significant penalties or payment to franchisor in such circumstances.
- Clauses in favour of the franchisor regarding ownership of customer records, depending on the context.
- Clauses imposing rights to impose significant expenditure on a franchisee where it cannot be justified although we note there is already some protection from the franchise code in this area.

Sometimes it is the type of clause which will cause a problem. For instance, a clause requiring the franchisee to do something 'as directed by the franchisor'. Also, clauses providing the franchisor with 'absolute or unfettered discretion' over a particular matter.

Last month, we saw the ACCC make its first formal resolution of an unfair contracts small business matter with Sensis, Australia's largest print directory publisher including the Yellow Pages and White Pages. Following a large number of customer complaints, an investigation into the customer contracts used by Sensis Pty Ltd resulted in contractual terms about automatic renewal of the contract and unilateral termination rights in favour of Sensis being deemed unfair. Sensis Pty Ltd provided a court-enforceable undertaking and agreed to change some terms in its contracts signed with small businesses. Interestingly, the ACCC did not just look at the content of the contractual terms in isolation, but also the process adopted in by Sensis including the level of disclosure to customers and transparency of the terms.

Unfair contracts law is not a substitute for reading contracts and knowing what they say before you sign. Enforcement of rights still requires a legal claim with courts or tribunals and all the usual uncertainty and difficulties with making legal claims apply. Normal mitigation of risk through careful review and robust negotiation of contracts is always encouraged.

What it does do though is encourage franchisors to look at the contracts they are putting up and ask the question of what is fair and reasonable. This is having the immediate effect franchisors removing particularly questionable clauses. The risk of terms being struck out or read down is a strong motivator. Over time we expect this will cause a shift in the way franchisors approach their contract drafting. Already we are experiencing a demand for franchise agreement drafting which is concise, fairly balanced and written in plain English.

With more balanced agreements, franchisors can eliminate the risk of terms being deemed unfair through legal process but also aid the process of signing new franchise deals because 'reasonableness' promotes confidence and the opposite is also true.