

FOLEY'S | LIST



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Case Update:

1. *MARMAX INVESTMENTS PTY LTD V RPR MAINTENANCE PTY LTD (2015) 237 FCR 534*

- *Exclusivity of Franchise Territories*
- *Incursions into Territory by other franchisees*
- *Franchisor's liability for allowing incursions by one franchisee into another's Territory*

2. FRANCHISOR LIABILITY FOR FRANCHISEE WAGE EXPLOITATION – UPDATE

- *FWO prosecution of 7-Eleven franchisee*
- *Turnbull government reform proposal: franchisor liability under Fair Work Act*
- *Possible Franchising Code of Conduct breaches*

1. *MARMAX INVESTMENTS PTY LTD V RPR MAINTENANCE PTY LTD (2015) 237 FCR 534*

1.1. The Full Federal Court, Justices Middleton, Foster and Gleeson JJ, held that:

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- (1) A franchisor's contractual obligation to grant an exclusive franchise to its franchisee carried a correlative prohibition on the part of the franchisor not to authorize other franchisees to engage in the franchise business within the territory of the franchise.
 - (2) However it was not necessary to enable the franchisee to have the benefit of the franchise agreement to require the franchisor to take positive steps to investigate possible incursions by another franchisee, and a term to that effect would not be implied into the franchise agreement.
- 1.2. The first proposition should hardly be a surprise to franchisors. It is the second proposition which is of interest, as it provides a degree of protection of franchisors from the difficulties that might arise between franchisees in adjoining territories.
- 1.3. Spanline is the franchisor of a national network of franchises and sub-franchises. Through that network Spanline designs, manufactures and sells home extensions or additions, including patios, roof awnings or covered verandah's, glass and screened enclosures and carports.

Franchise agreements

- 1.4. RPR was a franchisee under a five year franchise agreement with Spanline from 2001 in relation to the South Coast (of New South Wales). It had an exclusive franchise in the territory. The agreement expired in January 2006. It was not replaced until August 2009.
- 1.5. In the meantime RPR sold part of its franchised territory to Marmax and entered into various agreements with Marmax and entered into a five year sub-franchise agreement in October 2003 in relation to the Illawarra area.
- 1.6. Later in 2004, RPR sold the Spanline Illawarra business to RPR. The Transfer of Business Agreement restrained RPR from interfering with the franchised business sold to Marmax by soliciting, canvassing or securing the custom of customers. However, there was *no corresponding provision restricting Marmax from interfering with RPR's business*.
- 1.7. In February 2005 Marmax entered into a franchise agreement with Spanline for the Illawarra territory.

Customers in RPR's territory

- 1.8. Customers who lived in RPR's territory came into Marmax's showroom in Marmax's territory because RPR did not have a showroom located near the Southern Highlands area. Marmax's showroom was about an hour's drive away at Nowra.

1.9. RPR complained to the franchisor, Spanline. However Spanline, concerned about its own commercial interests in keeping customers away from its competitors, gave permission to Marmax to do certain projects in RPR's territory. This was described by the court as a "side deal" which was not authorized by the relevant franchise agreements. The trial judge found that:

The effect of the permission was to vary and derogate from RPR's rights of exclusivity under the first and second RPR franchise agreements. RPR never consented to that variation. Indeed, it was totally unaware that the variation had been made unilaterally by Mr Way. And Mr Way never notified RPR of the fact that he had granted the permission to the Byrnes to do certain work in RPR's franchise territory notwithstanding that he had numerous opportunities to do so, not the least in the context of his investigations of RPR's ongoing complaints regarding Marmax's activities. Accordingly, I find that the permission was unlawful because it was not authorised by the terms of the first RPR franchise agreement (which is the agreement which was in place at the time the permission was granted). Nor was it subsequently regularised by the parties entering into the second RPR franchise agreement in August 2009 in circumstances where that agreement is silent as to the existence of the permission and RPR was totally unaware that it had been granted.

1.10. Marmax had been acting on the side deal without RPR's knowledge for more than two years.

1.11. The permission by Spanline to service customers in RPR's territory was later extended to include retaining leads that came its way by telephone and not just by customers who visited its showroom.

1.12. Marmax did over \$200,000 of work comprising approximately 50 jobs in RPR's territory over a 20 month period.

Exclusivity provisions

1.13. Spanline unsuccessfully argued that the exclusivity provisions in its franchise agreement provided an exclusive right to RPR to sell Spanline products within its franchise territory but did not prohibit another franchisee who had sold a product to a customer at a retail store located in its own territory from then installing that product in RPR's territory.

1.14. The Full Court rejected this argument primarily due to the definition of "Franchised Business" including the business of installation, the nature of the franchised business which involved installations, and reference to the building of additions and improvements in the disclosure document.

1.15. The Full Court construed the exclusivity provisions as imposing a prohibition on a franchisee of the installation of Spanline products on residential dwellings outside the franchisee's territory. It also found that Spanline was prohibited from licensing another franchisee (Marmax) from establishing or operating a Spanline business in RPR's territory, and

“a correlative promise on the part of Spanline not to authorise other franchisees to engage in the franchise business within the territory of the franchise”.

No duty to take positive steps to maintain exclusivity

1.16. However, the Full Court found that Spanline was not required to take positive steps to ensure that the exclusivity was maintained. The implied duty to do all things necessary to give the other party the benefit of the contract:

“required Spanline to refrain from taking positive steps that would infringe upon or cause a third party to infringe upon the exclusive franchise granted to RPR. To require Spanline to do more, such as to take positive steps to investigate possible incursions by Marmax upon the rights of RPR, would exceed the requirement of necessity. It could not be said that the absence of a requirement to investigate such conduct would render the RPR franchise agreement nugatory, worthless or seriously undermined.”

Good faith and fair dealing not breached

1.17. Although the Full Court considered whether implied terms of reasonableness and good faith in an agreement between franchisor and franchisee (*Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558) might give rise to an obligation to maintain exclusivity, it referred to the further judicial explanation of such terms that they would “*not restrict a party acting so as to promote its own 'legitimate interests', 'will never impose an obligation 'which would be inconsistent with other terms of the contractual relationship' and that 'the implied covenant of good faith is breached only when one party seeks to prevent the contract's performance or to withhold its benefits'.*”

1.18. The Full Court held that the implied duty of good faith did not require anything more of Spanline than the duty to cooperate.

Customer choice and preference no defence for Marmax

1.19. Marmax argued that the sub-franchise agreement between it and RPR was not breached because the exclusivity provision was intended only to protect the setting up of competing businesses. It said that the franchisor had no control over “customer preference and choice” (of franchisee) and that “one would infer that

the parties understood that there would be customer choice". The Full Court rejected that argument for the same reasons as above in relation to the franchise agreement imposing prohibitions on Spanline.

Franchisor not obliged to investigate franchisee's complaints

1.20. An interesting aspect of the case is the consideration of the franchisor's response to the complaints by RPR of incursion by Marmax into its territory, and the availability of the franchisor's database to conduct an investigation. The trial judge made factual findings adverse to Spanline, that its purported investigation of RPR's complaints about Marmax's activities were "seriously deficient", as follows:

*"Spanline seemed to take the view that it was incumbent upon the Marrons to adduce the necessary evidence to establish a breach and that Spanline should not conduct its own independent inquiries other than to ask the Byrnes to respond to each individual complaint. It was plainly open to Spanline to search the SMARTS database and also conduct an audit of Marmax's relevant business records. A search of the SMARTS database would have revealed jobs entered in that database by Marmax in respect of customers who lived in RPR's territory including, but not limited to, particular jobs which were known to RPR and about which it complained. Spanline had access to that relevant information — RPR did not. The SMARTS database was searched by a Spanline employee at Mr Way's request in mid-2009 following receipt of the initial complaints from RPR. That search revealed that Marmax had done 13 jobs in RPR's territory up to that time, which was more than the number of jobs complained of by RPR at that point. Yet Mr Way did nothing with that information, primarily because he believed that he could not see anything that "looked suspicious" at that stage. As I indicated in [86] above, this was an unsatisfactory and unreasonable assessment in the circumstances. **And despite the numerous subsequent complaints by RPR it appears that Spanline made no further effort to search the SMARTS database for relevant material. Nor did it conduct an audit of Marmax's business records which presumably would have revealed relevant information and placed Spanline in an informed position to determine what further action it, as franchisor, should take against Marmax.***

1.21. Spanline asserted there was no breach of contract and it was not required to use its SMARTS database to determine the scope of Marmax's activities. The Full Court agreed that the above omissions did not amount to breaches of the RPR franchise agreement but the adverse findings of the trial judge stood.

- 1.22. Implicit in this is recognition of the commercial arm's length relationship between franchisor and franchisee, such that the franchisor is not required to go beyond the obligations on it under its franchise agreement, even if it has the ability to discover evidence in its possession of infringement of an exclusive territory. This is consistent with the Full Court's conclusions referred to above in paragraphs 1.16 and 1.17 that no positive steps were required to maintain exclusivity and an implied term of good faith and reasonableness is not breached unless a party seeks to prevent the contract's performance or to withhold its benefits.

Side deal was unlawful breach of franchise agreement

- 1.23. The Full Court held that the "side deal" by the franchisor was contrary to the "correlative obligation" referred to above in paragraph 1.15, which was an implied term of the RPR second franchise agreement.

Marmax not in breach – no franchise agreement in force

- 1.24. The Full Court found that there was no breach of the sub-franchise agreement by doing work in RPR's territory during the period September 2007 to July 2008, but this conclusion was due to its conclusions as to the termination of the sub-franchise agreement by reason of the first Marmax franchise agreement in February 2005 and the transfer of Illawarra business agreement, whereby RPR impliedly agreed to relinquish its pre-existing right to conduct a Spanline franchise in the Illawarra area, upon Spanline and Marmax entering into a direct franchise agreement: see [195], and at [197] the Full Court said:

*"In our view, the sub-franchise agreement did not survive the commencement of the Marmax franchise agreement, because the transfer of Illawarra business agreement operated to rescind the sub-franchise agreement from the time that it ceased to be the source of Marmax's entitlement to operate the business that it purchased from RPR. **RPR could not both sell the business to Marmax and sub-franchise it to Marmax.** The sub-franchise agreement contained numerous provisions that were intended to protect RPR's rights as a franchisor, which rights were sold to Marmax. An obvious example is the right to a transfer of the business name "Spanline Home Additions Illawarra" upon termination of the sub-franchise agreement. That right is plainly inconsistent with the transfer of Illawarra business agreement and could not have been intended to survive the transfer of Illawarra business agreement. Thus, the nature of the transfer of Illawarra business agreement and the inconsistency of its terms with the sub-franchise agreement give rise to an implication that the sub-franchise agreement would be terminated or rescinded upon the commencement of a direct franchise agreement.*

2. FRANCHISOR LIABILITY FOR FRANCHISEE WAGE EXPLOITATION – UPDATE

- *FWO prosecution of 7-Eleven franchisee*
- *Turnbull government reform proposal: franchisor liability under Fair Work Act*
- *Possible Franchising Code of Conduct breaches*

FWO prosecution of 7-Eleven franchisee

2.1. Much has been written over the past year about the 7-Eleven underpayment of wages scandal. On 1 July 2016 a 7-Eleven franchisee was ordered to pay a \$150,000 penalty for deliberately underpaying its employees and using a regime of reverse calculation to cover its tracks.

2.2. In *Fair Work Ombudsman v Hiji Pty Ltd* [2016] FCCA 1634, the 7-Eleven franchisee being prosecuted made submissions on penalty that they “they operated under a franchising model which was extremely detrimental to them”. The Court heard submissions about this model, and the subsequent changes to the model, ...as follows:

“...it was a term of the Franchise Agreement with 7-Eleven Head Office that:

- a. 7-Eleven Head Office were to receive 57% of the total *gross* income made at the Parkville Store; and
- b. the Parkville Store would remain open for 24 hours per day.

...the franchise model “*made it very difficult ...to pay ... employees the appropriate minimum wage entitlements...*”

2.3. It was further submitted that:

“...7-Eleven Head Office has subsequently revised the terms of their franchising model...and has provided a revised franchise agreement to all franchise owners...in recognition of the flaws in the franchise model under which the Parkville Store operated.

...as part of the terms of the Revised Agreement:

(a) 7-Eleven Head Office has given ...a minimum income guarantee of at least \$340,000 per annum. This is enough to pay all of the relevant minimum entitlements to staff, as well as providing...the ability to service ...loans and provide ... a wage to live off;

(b) 7-Eleven Head Office has also altered the profit sharing arrangements. For stores who earn less than \$500,000 per annum, the profits are split 50/50.

(c) 7-Eleven Head Office is now responsible for paying employees and processing the relevant pay advices, payroll and superannuation entitlements.”

2.4. They further submitted that by reason of 7-Eleven Head Office’s proposal of a new franchising model, 7-Eleven Head Office has acknowledged how difficult it was for franchise owners (including the Respondents) to ensure that minimum wage entitlements were met under the old franchising regime...”.

2.5. Judge Jones accepted “that the previous franchising model of the 7-Eleven Head Office placed significant restrictions on the capacity of the Respondents to generate an income from the operation of the franchise. It is apparent that the revised franchise agreement establishes a business model for the Respondents which, into the future, ensures a minimum income for the Respondents for the purpose of the payment of minimum entitlements to employees of its Spencer Street store, improves the profit arrangement as between the 7-Eleven Head Office and the Respondents and removes the capacity of the Respondents to manipulate the payroll system”.

2.6. However Her Honour said she was “not prepared to infer the motivation of the 7-Eleven Head Office in entering into this new arrangement”.

2.7. Her Honour also did not accept that the terms of the previous franchising agreement excused the Respondents from ensuring that employees employed at the Parkville store were paid in accordance with the minimum entitlements under the Act and the Award, but considered that at most, the previous franchise agreement “bears on a consideration of the level of penalty”. Her Honour did not however, give this factor “the significant weight” sought by the franchisee.

2.8. That the franchising model was scrutinised in a court judgment against franchisees, sounds a stern warning to franchisors. Even if a franchisor is not legally responsible for the franchisee’s unlawful actions, the brand damage of a franchising model that results in underpayment of wages of franchisee employees, is likely to continue.

Turnbull government reform proposal: franchisor liability under Fair Work Act

2.9. While legislation is not yet available, the Coalition policy response to the 7-Eleven scandal to be pursued involves making franchisors accountable by:

“introducing new provisions that will apply to franchisors and parent companies who fail to deal with exploitation by their franchisees. The Fair Work Act will be amended to make franchisors and parent companies liable for breaches of the Act by their franchisees or subsidiaries in situations where they

should reasonably have been aware of the breaches and could reasonably have taken action to prevent them from occurring. Franchisors who have taken reasonable steps to educate their franchisees, who are separate and independent businesses, about their workplace obligations and have assurance processes in place, will not be captured by these new provisions”.

Possible breach of Franchising Code of Conduct

- 2.10. In future, if the Fair Work Ombudsman does not come knocking, it is possible that a disgruntled franchisee might consider its options against a franchisor for recovery of additional (Award) wages that were payable to employees under the franchising model that were not properly disclosed to it in a disclosure document under the Franchising Code of Conduct (“Code”).¹
- 2.11. Complicity by a franchisor in underpayment of wages by its franchisees, may potentially be in breach of the Code. A franchisor is required² to provide a compliant disclosure document to any prospective franchisee or any franchisee proposing to renew or extend the scope of a franchise agreement. Clause 14.7 of the disclosure document contained in Annexure 1 of the Code requires details of each “recurring or isolated payment, that is within the knowledge or control of the franchisor or is reasonably foreseeable by the franchisor, that is payable by the franchisee to a person other than the franchisor”.
- 2.12. It would be hard to argue that Award wages, including penalty rates payable, are not within the knowledge of the franchisor or reasonably foreseeable by a franchisor, especially where the franchise is an established brand that has been operating for years.
- 2.13. Clause 14.7 of the disclosure document must provide a description of the payment, the amount of the payment or formula used to work out the payment, to whom the payment is made, and when the payment is due. If the amount cannot easily be worked out, it is acceptable to provide “the upper and lower limits of the amount”.³
- 2.14. Modern Awards in operation since 2010 contain clauses which effectively allow the amount of wages payable for employees working shift work, evenings, weekend and public holiday work to be calculated in advance, and wages are usually paid on a weekly or fortnightly basis. In other words, there ought to be an item in clause 14.7 of the disclosure document referring to the estimated wages (including superannuation payments) payable every week or fortnight in line with the hours of work and rosters utilised in the franchised business model. The relevant Award classification for employees who will be required in the business ought to be used to calculate the estimated wages and superannuation or upper or lower limits.

- 2.15. If there was no such item in the disclosure document, or the amount or limit stated was inaccurate, and the franchisee is able to demonstrate that payment of the true high wage costs associated with the business caused, or is likely to cause lack of profitability, the franchisor may also find itself in hot water.

Remedies under *Competition and Consumer Act/Australian Consumer Law*

- 2.16. If a franchisor has failed to include an accurate statement of the upper and lower limits of such wage cost in a disclosure document, to a franchisee or prospective franchisee, in breach of the Code, it may be liable to a penalty of up to \$54,000 for breaching an Industry Code, in contravention of s.51ACB of the *Competition and Consumer Act 2010* (“CCA”). A claim for misleading and deceptive conduct pursuant to s.18 of the *Australian Consumer Law* (“ACL”) contained in the CCA might also be brought due to reliance on an inaccurate statement relating to wage costs in the disclosure document. A franchisee may seek orders against the franchisor for compensation pursuant to s.87(2) of the CCA and s.236 or s.237 of the ACL.

Conclusions

- 2.17. Franchisors are on notice. A franchisee’s failure to pay correct wages to employees of a franchise is not only unlawful, it is bad for business for both franchisee and franchisor, and could see both end up in court. Damage to the franchised brand will surely follow.
- 2.18. The relevant Award provisions need to be used by franchisors to calculate the likely wages payable. Disclosure documents need to disclose at least the upper and lower limits of anticipated employee wages costs, in order to comply with the Code. Accurate disclosure of wages costs is a “good call” by franchisors.

5 October 2016

Endnotes

- 1 *Competition and Consumer (Industry Codes – Franchising) Regulation 2014, Schedule 1 – Franchising Code of Conduct.*
- 2 By clause 8 of the Code.
- 3 Clause 14.8 of the disclosure document for franchisee or prospective franchisee contained in Annexure 1 to the Code.