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Alert | Franchise & Distribution

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Australian Fair Work Act Changes – What Impact for U.S. and Other Foreign Franchisors?

Overview: Changes to and Consequences of Violating the Australian Fair Work Act 2009

Recent amendments to the Australian *Fair Work Act 2009* (the FWA or Act) have expanded the potential for franchisors (both domestic and foreign) operating in Australia to be liable if their franchisees breach certain provisions of the Act (particularly those relating to payment of wages). The amendments apply to conduct occurring after Oct. 27, 2017.

Prior to the amendments, franchisors could only be liable if they were "involved in" (e.g., knowingly concerned in) a violation of the Act by a franchisee. There has only been one case (*Fair Work Ombudsman v. Yogurberry World Square Pty Ltd* [2016] FCA 1290) in which a franchisor was held liable under these provisions with respect to violations by a franchisee, and the franchisor and franchisee were related entities.

Under the new provisions, a "responsible franchisor entity" will be liable if it (or any of its officers) knew or could reasonably be expected to have known that:

- the violation by the franchisee entity would occur; or

- a violation by the franchisee entity of the same or a similar character was likely to occur, unless, as at the time of the violation, the franchisor had taken "reasonable steps" to prevent a violation of the same or a similar character.

The maximum civil penalties are AU$12,600 Australian dollars ($9,005 at the current exchange rate) per violation for individuals and AU$63,000 ($45,023 at the current exchange rate) for corporations.

Civil penalties would ordinarily be sought by the Fair Work Ombudsman (the FWO). As alternatives to seeking civil penalties, the FWO may issue compliance notices or accept enforceable undertakings by the franchisor to resolve the conduct in question. If a franchisor is subject to a civil penalty, it may be able to recover the amount of the civil penalty from the violating franchisee or its guarantors by enforcement of indemnities under the franchise agreement.

In addition to civil penalties, compensation orders may also be sought by or on behalf of any employee who has suffered loss as a result of the breach. The amendments provide franchisors a right to indemnity from the violating franchisee for any such compensation order.

Broader Definition of "Franchise"

The new amendments adopt a broader definition of franchise than that under the Australian Franchising Code of Conduct. The definition, taken from the Corporations Act 2001 is:

> ...an arrangement under which a person earns profits or income by exploiting a right, conferred by the owner of the right, to use a trade mark or design or other intellectual property or the goodwill attached to it in connection with the supply of goods or services. An arrangement is not a franchise if the person engages the owner of the right, or an associate of the owner, to exploit the right on the person's behalf.

As a result of this broader definition, other licensors of intellectual property may also be subject to the Act if they have a significant degree of influence or control over the licensee entity's affairs. While the new amendments do not define or explain what will constitute significant influence or control, the FWO has provided guidance, including some limited advice on its interpretation. The FWO does not consider a product wholesaler who merely licenses its brand and provides promotional materials to have "significant influence or control" over a retailer or its product if the retailer may generally operate its business as it sees fit and is not subject to obligations regarding use of the promotional materials, minimum product levels, the manner of display or promotion of the product, hours of operation, or pricing.

How the Amendments Affect U.S. and Other Foreign Franchisors Entering Australia

Is a Foreign Franchisor Conducting Business in Australia?

There is a genuine risk that foreign franchisors will be subject to action by the FWO or a franchisee's employees if their Australian franchisee fails to comply with its obligations under the Act. Despite the contrary intention expressed by the Australian government as described below, the new provisions have the potential to apply to foreign franchisors if the following conditions are satisfied:

- The foreign franchisor has a significant degree of influence or control over the affairs of franchisees within Australia. This would determine whether a franchisor is a "responsible franchisor entity" under the Act.
- The Australian franchisee breaches a relevant provision of the FWA.

- The foreign franchisor (or any of its officers) knew or could reasonably be expected to have known that:
  - the violation by the franchisee would occur; or
  - a violation by the franchisee of the same or a similar character was likely to occur.
- The foreign franchisor did not take reasonable steps to prevent a violation of the same or a similar character.

The Australian government's Explanatory Memorandum published with the amendments includes the following statement:

> The Fair Work Act does not extend to impose franchisor obligations on corporations operating completely outside Australia. That is, companies that do not have any operations in Australia and have simply entered into a master franchisor relationship with an Australian company (even if the Australian company is a subsidiary of the foreign company).

This statement should be useful to any foreign franchisor with outlets operating in Australia under a master franchise agreement, a multi-unit development agreement, or even through an Australian subsidiary franchisee in seeking to demonstrate to an Australian court that the new provisions do not apply to foreign franchisors. Unfortunately for these franchisors, however, the Act does not expressly address this issue, and the basis for the above statement is unclear. The FWO has in the past acted (for breaches of other provisions of the Act) against foreign entities with no trading activities in Australia where the FWO felt the foreign entity had an "appropriate connection" with Australia. Accordingly, the FWO may attempt to argue that, despite the above statement from the government's Explanatory Memorandum, a grant of franchise rights into Australia establishes an appropriate connection for the FWO to act against a foreign franchisor.

If a foreign franchisor finds itself subject to a claim under the Act, it will greatly assist the franchisor's defense if it can demonstrate to an Australian court that it is not conducting business within Australia. The Corporations Act 2001 provides some guidance on when an entity will be conducting business in Australia. It provides that a business entity conducts business in Australia if it has a place of business in Australia. It also identifies certain matters (e.g., maintaining a bank account in Australia) that will not in and of themselves be determinative of conducting business in Australia. Foreign franchisors should consult with experienced counsel to ensure any proposed activities under their franchise arrangements do not constitute "conducting business" within Australia.

Possible Defenses Available to a Foreign Franchisor Where the Act is Found to Apply

If an Australian court found that the Act applies to foreign franchisors operating wholly outside Australia with franchised outlets in Australia, franchisors would need to be prepared to defend themselves against any such claims on the basis that they either:

- did not anticipate, and could not reasonably have been expected to have anticipated, the violation (or a violation of the same or a similar character); or
- took reasonable steps to prevent the violation (or a violation of the same or a similar character).

If a foreign franchisor has left workplace law compliance to its Australian franchisee(s) and has no knowledge of violations of these laws by its franchisee(s), the first of the above arguments may be available. However, it is recommended that foreign franchisors take some steps, such as those set out later in this Alert, to prevent violations.

The following are common franchise arrangements used by foreign franchisors entering Australia, and the defenses that may be available to a foreign franchisor utilizing one of these arrangements.

Multi-Unit Development and Master Franchise Arrangements

In addition to the above defenses, where a foreign franchisor grants multi-unit development or master franchise rights, the following additional defenses should be available to a franchisor who is alleged to have violated the new provisions under the Act:

- A developer or master franchisee may be a more sophisticated prospect than a single-unit franchisee. Therefore, it may be reasonable for a foreign franchisor to expect that the developer or master franchisee would have thoroughly and properly addressed workplace compliance. This defense would be relevant to demonstrate both whether the franchisor should have anticipated a breach and the steps, if any, that the franchisor should reasonably have taken to ensure compliance by the developer or master franchisee.
- Most multi-unit development and master franchise agreements permit or require the developer or master franchisee to adapt the franchise system for use in Australia and to ensure compliance with Australian laws. The inclusion of such provisions in the agreement would assist the franchisor in demonstrating that it could not reasonably have been expected to anticipate the violation and that it had taken reasonable steps to ensure compliance.
- A multi-unit development or master franchise arrangement is often an agreement with a single franchisee entity (although a developer may establish controlled entities to operate individual units). A single franchisee entity would provide the foreign franchisor with a single point of enquiry when addressing workplace employment issues. From a practical perspective, this would be easier for the franchisor to manage than a network of direct unit franchisees, as it would likely be reasonable for the franchisor to accept confirmation from the developer or master franchisee without enquiring into compliance by each unit that each of its units is operated in a consistent manner.
- A "responsible franchisor entity" has "a significant degree of influence or control over the franchisee entity's affairs." This definition under the Act is broad enough such that a foreign franchisor that enters into a master franchise arrangement in Australia could be liable with respect to breaches of the Act by both the master franchisee and the unit franchisees, because a foreign franchisor, as provider of the franchise system, has a certain level of influence or control over both the master franchisee and the unit franchisees. However, unlike with a direct unit franchise agreement or multi-unit development agreement, the foreign franchisor does not have a direct contractual relationship with the unit franchisees under a master franchise arrangement. This lack of direct contractual privity with the unit franchisees could provide the franchisor with an additional defense if a unit franchisee were to breach the Act. In that case, the foreign franchisor could argue that it would be unreasonable for it to know or to be expected to have known that a violation by the unit franchisee would occur.

Although the above defenses are available, and the risk associated with a multi-unit development arrangement or master franchise arrangement may be more limited than that associated with direct franchising in Australia, a foreign franchisor should consider taking steps to help ensure the multi-unit developer or master franchisee complies with the Act.

Joint Venture Arrangement

Persons involved in violations of the Act can be liable alongside the principal violator. This can result in liability for directors or other persons involved in the operations of a company.

As already discussed in this Alert, liability under the Act depends on a finding that the defendant knew that the violation by the franchisee entity would occur or that a violation by the franchisee entity of the same or a similar character was likely to occur.

Accordingly, whether retention by the foreign franchisor of a minority interest in the master franchisee or multi-unit developer entity creates additional risk for the foreign franchisor will depend on whether the arrangement involves the foreign franchisor being represented on the board of the master franchisee or multi-unit developer (which is often the case in a joint venture arrangement) or will result in additional information regarding workplace issues being made available to the foreign franchisor by virtue of its involvement with the operations of the joint venture or its board representation. If the foreign franchisor does appoint a representative to the board, it may be more difficult for the foreign franchisor and that representative to argue that they did not know, and could not reasonably have been expected to have known, a violation would occur.

Steps U.S. and Foreign Franchisors May Consider to Mitigate Risks Associated with the Act

Whichever expansion model a foreign franchisor adopts for entering the Australian market, there remains potential risks of liability under the amended Act. Taking proactive measures that the franchisor may later use to help defend against any attempt by the FWO to argue application and potential violation of the Act may help mitigate these risks. Some of these measures may be relatively simple and inexpensive to implement. Examples may include the following:

- Encourage prospective franchisees to complete due diligence on the proposed franchise business, particularly regarding the labor and other operating costs.
- Ensure the franchisee has adequate funds to pay correct employee wages for the franchise business.
- Direct franchisees to resources available from the FWO's website and recommend use of the same.
- Ensure the franchise agreement requires compliance with applicable workplace laws.
- Require franchisees to regularly obtain independent professional advice on compliance with workplace laws and certify to the franchisor on an ongoing periodic basis that this has been obtained and followed.
- Require franchisees to notify the franchisor if an employee has requested the FWO's assistance, or if it is auditing them.

In addition, if the risk of the Act applying to a foreign franchisor is greater due to the particular expansion model used in the Australian market (such as with a joint venture or direct franchising), the franchisor may wish to consider taking additional measures to potentially reduce its risk, for example:

- Provide franchisees with workplace law compliance training.
- Identify and direct franchisees to use appropriate human resource management systems or software.
- Advise franchisee employees that unresolved complaints should be brought to the master franchisee's attention.
- Conduct audits of franchisee employment records for potential violations of the Act.
- Require franchisees to conduct self-audits.

Of course, which measures are considered reasonable will depend on the circumstances and the size and resources of the franchisor.

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