

# Legal Update | Franchising

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## Further Information

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## Government's response to overhaul of Franchising Code disclosure provisions released

Due to concerns raised about aspects of the disclosure provisions in the Franchising Code of Conduct (Franchising Code), and whether it is working effectively (ie ensuring that franchisees are informed of information that is material to the running of a franchised business), the Government instigated a review of the disclosure provisions on 28 June 2006. A review committee established by the Government undertook the exercise and delivered their report on 31 October 2006.

Of the 34 recommendations made by the Committee, the Government only disagreed with 3.

While the Government's responses are only policy notes at this stage, it is pertinent to reflect on how these proposed changes will impact franchisors going forward.

Some of the Committee's recommendations supported by the Government include:

- providing a full account of marketing and other co-operative funds and an auditor's report of such funds
- shortening the disclosure period for materially relevant facts (for example, change in majority ownership of franchisor) from 60 days to 14 days
- disclosing financial details of the consolidated entity to which the franchisor belongs

- details and history of territory or site to be franchised to be in a separate document provided with the disclosure document
- current disclosure document to be provided whenever there is any extension of either the scope or term of the franchise agreement
- disclosing the amount or method of calculation of rebates or other financial benefits received by the franchisor or their associates
- extending the disclosure in relation to the franchised events (for example, transferred franchises) for the last 3 financial years to include the name, location and contact details of the former franchisee.

The Government's response is no doubt a win for franchisees but it is also an acknowledgment that in order to foster the Australian franchising industry (which is now estimated as an \$80 billion industry), it is important that businesses at both ends of the franchising system are able to operate with confidence and certainty. Enhancing the disclosure obligations under the Franchising Code is certainly one way of boosting franchisee confidence and certainty. It is uncertain at this stage when these recommendations will be legalised as some of the recommendations require further consultation with industry stakeholders, Middletons will keep readers updated on any further developments.

Emily Kishida | Franchising Lawyer

## Buying your competitor

In the past few years the franchising industry has experienced considerable growth, so much so that Australia has the most franchise systems per capita in the world. Industry experts have been stating for some time that the franchising industry is ripe for acquisition and consolidation.

There are already a number of examples where this has occurred, for example, Retail Food Group's (owner of Donut King and BB's café chain) \$38 million takeover offer for Brumby's Bakeries.

In the next few years more acquisitions and consolidations are likely to occur, and it is unlikely that franchisors will be immune from such activity. Accordingly, it is wise to consider these issues now no matter whether a franchisor views itself as an acquirer, a target or neither.

Middletons has extensive experience in acquisitions and mergers. For more information on how Middletons can help you with this process contact Chris Nikou, National Franchising Partner on +61 3 9640 4354.

## Costly battle for Franchisors who fail to ensure their franchisees sign renewal franchise agreements

For a franchisor, the time and cost of having an existing franchisee execute a renewal franchise agreement is far less than allowing the Court to decide whether a licence to operate the Franchised Business exists.

The Cheesecake Shop (Franchisor) issued proceedings against A Shah Enterprises (Franchisee) (*The Cheesecake Shop v A & A Shah Enterprises* [2004] NSWSC 625) seeking, among other things, to have a franchise agreement confirmed even though renewal documents were not signed after the original agreement expired.

By way of background, the original franchise agreement expired on 31 March 2001. On 26 September 2000, the Franchisor's operations manager wrote to the Franchisee advising it of the pending expiry of the franchise agreement and whether it wished to exercise their option to renew the franchise agreement. Renewal franchise documents were supplied by the Franchisor to the Franchisee but the franchise agreement was not signed by the Franchisee.

The Franchisee continued to operate the franchise on expiry of the original franchise agreement.

Due to alleged breaches by the Franchisee, the franchise relationship began to sour between 2002 and 2003 and as a result, the Franchisor issued the Franchisee breach notices. On 20 August 2003, the Franchisee's solicitor wrote to the Franchisor stating, among other things, that the franchise agreement expired on 31 March 2001 and the Franchisee did not consider itself bound by the franchise agreement.

The Franchisor argued that either the franchise agreement was still in existence or an option for a renewal franchise agreement had been exercised or that the parties had continued to conduct themselves on the basis that the franchise agreement continued in which event it could terminate the franchise agreement on reasonable notice for breach by the Franchisee of the breach notices. In other words, the Franchisor said the agreement was in place because the Franchisee was still using all the rights of the franchise.

While the Court determined that the franchise agreement had not been renewed by the Franchisee, the court was of the opinion that the Franchisor's claim should succeed as the parties were in 'some relationship'. The Court held that the Franchisee was operating a cheesecake shop and the Franchisor was allowing the Franchisee to do so; accordingly, the conduct of the parties was such that a continuing operation of the franchise agreement must have been taken to exist and as it had no fixed term, it was a licence terminable on reasonable notice.

The case sends a clear warning to franchisors that if they fail to ensure that renewal franchise agreements are executed by their franchisees they will run the risk of exposing themselves to a costly court battle.

Sarah Standish | Franchising Lawyer

## Quick Grabs

### International franchise markets booming

According to the Griffith University Franchising Australia 2006 Report, a quarter of all Australian franchises were operating in international markets in 2006. The proportion is much higher among the fastest growing franchises. Forty-one percent are exporters, 63.6 per cent intend to increase exports over the next 2 years, and 82.5 per cent aim to be a global franchise.

For more information on how Middletons can help you export your system overseas contact Chris Nikou, National Franchising Partner on +61 3 9640 4354.

### December quarter CPI wrap

The All Groups CPI fell 0.1 per cent in the December quarter down from an increase of 0.9 per cent in the September quarter. According to the Australian Bureau of Statistics the most significant price falls for the December quarter were automotive fuel, fruit, pharmaceuticals and audio, visual and computing equipment. The significant price fall in automotive fuel (12.4 per cent) contributed to the decrease in the CPI for the December quarter. It was reported by the Australian Bureau of Statistics that the most significant offsetting price increases were domestic travel and accommodation, vegetables, rents and house purchase. Some economists are now forecasting that the RBA could wait until May to review the monetary policy stance.

## Franchisors warned to obtain consent from franchisees on transfer of franchise system

Franchisors must ensure that their franchise agreements contain adequate provisions dealing with transfer of the franchise system in order to effectively transfer the franchise system to a third party.

In *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2006] FCAFC40 one of the issues the Federal Court was required to consider was whether, if at all, any contractual rights of a licensor under a sub-licence was effectively assigned.

Under a sub-licence, Sara Lee Apparel (Australasia) Pty Ltd (Sara Lee) granted an exclusive licence to Underworks in respect of certain trade marks (Sub-Licence). Sara Lee subsequently sold its apparel business to Pacific Dunlop and as part of that sale Sara Lee assigned to Pacific Dunlop certain contracts, which included the Sub-Licence. Pacific Dunlop then sold its business assets (which included the Sub-Licence) to some companies in the Pacific Brands group, which resulted in the Sub-Licence being assigned to Pacific Brands Sport.

Despite endeavours by Pacific Brands Sport and Sara Lee to have the Sub-Licence novated, Underworks would not agree to any novation on the terms offered. Pacific Brands Sports subsequently alleged that Underworks was in breach of the Sub-Licence and that it as an assignee of Sara Lee's rights under the Sub-Licence was entitled to (and did) terminate the Sub-Licence both at law and by virtue of an express right to terminate contained in the Sub-Licence.

The primary judge, Justice Finkelstein, concluded that while Pacific Brands Sports acquired certain rights on assignment of the Sub-Licence, for example, the right to receive royalties, it did not acquire the right or power to terminate the Sub-Licence and accordingly, could not terminate the Sub-Licence.

On appeal, Pacific Brands Sports contended that, personal rights apart, all contractual rights are prima facie assignable, including the power to terminate.

While the Federal Court dismissed Pacific Brands Sports appeal, they concluded that Justice Finkelstein had made a mistake in determining that various rights and powers under the Sub-Licence were not assignable because they were not proprietary in character. The Federal Court was of the opinion that a party's benefit of a contract is made up of that party's bundle of rights under that contract.

Accordingly, unless assignment is precluded, for example, by reason of statute, public policy or contractual prohibition, all of a party's contractual rights, being parts of a chose in action, have a proprietary character for assignment purposes and are prima facie assignable. Whether or not in a given case they or some of them are unassignable will depend upon whether there is a reason, which precludes assignment.

In this case, Pacific Brands Sports' appeal failed because the Court determined that the provisions in the Sub-Licence did not reveal an intent that Sara Lee could assign its rights without Underworks' consent. The Court considered that there were significant indications in some of the provisions of the Sub-Licence, which suggested that Sara Lee and Underworks' relationship was contemplated to be personal, and an enduring one for the term of the Sub-Licence.

The case supports the argument that a franchisor must ensure that their transfer clauses are drafted appropriately to cover matters such as novation and consent or will otherwise risk an invalid assignment. Advisers acting for the acquiring franchisor should also ensure that the sale contract contains appropriate indemnities and responsibilities from the exiting franchisor.

Emily Kishida | Franchising Lawyer

## Quick Grab

### India accedes to Madrid Protocol on trade mark protection

Indian Union Cabinet has ratified to country's accession to the Madrid Protocol. This will facilitate transfer of technology through trade marks licensing and franchising. This will also facilitate speedy registration of Indian trade marks in different markets worldwide and promote business confidence in India's intellectual property system globally.