

## Franchising Alert

# Statutory Unconscionable Conduct Reforms

September 2011

### Introduction

Alleged statutory unconscionable conduct, especially by franchisors, is common in franchise disputes.

Our court's application of ss. 51AB and 51AC of the now repealed Trade Practices Act 1974 (**TPA**) were criticised by some as being too narrow and failing to give effect to their full scope as intended by the federal legislature.

It is no surprise that statutory unconscionable conduct received widespread attention in federal and state government franchise inquiries in recent years. The federal government's Senate Economics Legislation Committee which inquired into the statutory definition of unconscionable conduct in 2009, recommended that the government set up an inquiry process to determine whether examples or a statement of principles would enhance interpretation and application of the statutory unconscionable conduct provisions.

The three person Expert Panel, which included Thomsons Lawyers Consultant David Lieberman, appointed as a result found that unconscionable conduct provisions have been appropriately enforced by our courts since their inception and that case law is still developing. The panel also noted that the provisions are not easily understood and could be clearer for business, consumers, enforcement agencies and the courts.

Relevantly, the Panel felt that inclusion of a list of examples would not be helpful. It said such a list might give rise to misguided expectations about the scope and application of a non-exhaustive list of examples. This may limit application of the provisions to those examples. Further, it would be impossible to compile a list of 'examples' that would amount to unconscionable conduct in all circumstances. Unconscionable conduct is 'fact-dependant', requiring consideration of all the circumstances. Conduct that is unconscionable in one set of circumstances may not be unconscionable in another.

Instead, the Panel recommended inclusion of a set of interpretative principles to be drawn from the development of the law to date.

### The Competition and Consumer Legislation Amendment Bill 2011 (the Bill)

In May 2010, the federal government introduced a revised version of the Bill. Following the announcement of a general election later that year, the Bill lapsed, however, it was reintroduced in the federal parliament on 16 June 2011. Both the reintroduced Bill and its corresponding Second Reading Speech are in essence identical to those introduced in May 2010.

### Key objectives of the Bill

The Bill seeks to clarify perceived vagaries in the law surrounding statutory unconscionable conduct by:

- providing a list of interpretive principles to assist courts in applying the prohibition; and
- consolidating sections 21 and 22 of the Competition and Consumer Act, 2010 (**CCA**) (previously sections 51AB and 51AC of the TPA) by removing the distinction between business and consumer transactions and adopting the longer list of factors presently applying to business transactions.

### Interpretive principles

The statement of interpretative principles provides that:

- the statutory prohibition against unconscionable conduct is not limited by the equitable or common law doctrines of unconscionable conduct and are not confined by them;
- a court should not limit its consideration of the conduct

to the formation of the contract alone, but may also consider the terms of the contract and the manner in which the contract is carried out; and

- the prohibition can apply to systems of conduct or patterns of behaviour over time, and need not be limited to an individual transaction or event.

In common law and in equity, proof of a special disadvantage, such as a language barrier hindering understanding, is generally required for an unconscionable conduct argument to succeed. The first principle seeks to make it clear that this is not a requirement under statutory unconscionable conduct.

The second principle seeks to make clear that unconscionability is concerned with both substantive unconscionability (the terms of the contract and the conduct of the parties carrying it out) as well as procedural unconscionability (the parties' conduct during pre-contractual negotiations). In common law and in equity, consideration is largely confined to the parties' conduct at the formation of the contract.

The third principle seeks to clarify that, unlike in common law and equity, an examination is not limited to a particular transaction, but applies to a system of conduct or pattern of behaviour rather.

## Statutory factors

From the time of its first enactment, the TPA and its successor, the CCA, have provided a non-exclusive list of matters that a court may have regard to in determining a contravention. Of particular relevance to the franchising sector are:

- abuse of a superior bargaining power;
- imposing unreasonable contract terms, being terms exceeding what is necessary to protect legitimate interests;
- exerting undue influence or pressure, or using unfair tactics to influence behaviour or secure unjustifiable benefits;
- price gouging;
- inconsistent treatment by discriminating between franchisees;
- contraventions of industry codes such as the Franchising Code of Conduct;
- blanket refusal to negotiate in all circumstances;
- absence of good faith in dealing;
- unreasonable refusal of consent to an assignment;
- termination based on insignificant breaches and lacking 'good cause'.

The list is not exhaustive.

## What are the consequences for franchisors?

1. The unconscionable conduct provisions in the CCA have undergone a general refinement in language but otherwise reflect much the same intent as under the TPA.
2. The interpretive principles will, however, broaden the landscape and increase successful reliance on alleged contravention of statutory unconscionable conduct provisions.
3. New enforcement powers and remedies introduced will further strengthen prosecution and prevention of unconscionable conduct and force franchise participants to exercise increased caution.
4. Contraventions now attract civil pecuniary penalties of up to \$1.1m for a corporation and up to \$220,000 for individuals.
5. The following enforcement powers and remedies relevant to franchising now apply:
  - 5.1 Court enforceable undertakings by franchisors;
  - 5.2 Issuing of substantiation notices by the ACCC. This is a useful tool in the regulator's armoury and provides an efficient method of determining whether a full scale investigation is warranted;
  - 5.3 Issuing of public warning notices (name and shame notices) by the ACCC. Such a notice may well damage a franchisor's reputation and limit its ability to grow its system;
  - 5.4 The ACCC can, and has already issued, infringement notices where it reasonably suspects a contravention. Although payment is not an admission of liability, it will still appear on a public register to the likely detriment of a franchisor;
  - 5.5 The ACCC can also apply to court for an injunction against a franchisor to restrict its ability to engage in certain practices;
  - 5.6 Likewise, the ACCC can apply to court for damages and other compulsory orders;
  - 5.7 A type of class action has now been introduced allowing the ACCC to apply for orders, including damages on behalf of a group of franchisees even though they are not party to a proceeding;

- 5.8 Orders can also be obtained to disqualify a person from managing a corporation;
- 5.9 The ACCC can conduct random audits. This means that franchisor documentation is required to be kept under the Code. It needs to be comprehensive and kept up to date at all times.

The list is not exhaustive.

6. Increased enforcement powers and remedies are likely to go a long way to increase pressure on franchise participants to avoid contraventions.
7. In an attempt to limit risk and exposure, franchisors will at least have to:
  - 7.1 Exercise care when using their superior bargaining position to avoid an abuse thereof;
  - 7.2 Remove clauses in their franchise documentation that may go beyond what is reasonably necessary to protect their legitimate interests;
  - 7.3 Ensure that their franchise documentation is drafted in plain English and is easy to understand;
  - 7.4 Avoid exerting undue influence or use questionable tactics in an attempt to secure benefits or influence franchisee behaviour without sufficient justification;
  - 7.5 Ensure that franchisees in their system are treated equally, and when exceptions are warranted, that there are valid reasons that are well documented;
  - 7.6 Although good faith is not defined in the Code or the CCA, always acting in good faith is implied by the common law. The best way of doing so is to ensure that all decisions are well founded, properly documented and taken without an ulterior motive;
  - 7.7 By its nature, franchising demands retention of a level of flexibility to enable the franchisor to

implement system and other changes from time to time. Inevitably, this will vest discretion in the franchisor. Care is required to exercise that discretion reasonably;

- 7.8 It is common for commercial agreements to contain a clause preventing parties from relying on anything not recorded in the written agreement. The Code specifically prohibits a clause of this nature in a franchise agreement. To reduce risks, franchise participants should document all verbal and other exchanges;
- 7.9 A franchisor should also obtain a prior representations statement from a prospective franchisee. Apart from being valuable evidence to prove what the prospective franchisee relied upon when entering into the agreement, it is also a useful tool to identify and address potential misunderstandings prior to entering into a franchise agreement.

## Conclusion

In all likelihood, an increase in franchise disputes with alleged unconscionable conduct at the heart of the dispute will be seen.

Parties to a franchise agreement will have to upgrade their documentation and general housekeeping significantly if they want to ensure effective compliance with the Code changes introduced in recent years and reduce the significant risks of often inadvertent contraventions of the CCA.

Thomsons Lawyers is well positioned to guide franchise participants and to assist them in upgrading their Code and CCA compliance regimes.

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