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Ana Haarsma is a leading franchise lawyer and a director of specialist franchise law firm Haarsma Lawyers. She specialises in franchise dispute resolution for both franchisors and franchisees and is an accredited mediator. Ana has also been involved in litigation at all levels of the Australian judicial system, including the High Court of Australia

Good faith in franchising

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The Franchising Code of Conduct (Franchising Code) is set out in schedule 1 to the *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*. The Franchising Code includes an obligation that the franchisor and the franchisee act in good faith in their dealings with the other party.

The obligation to act in good faith in franchising applies to all aspects of the relationship between a franchisor and a franchisee, including negotiations before entering into the franchise agreement.

However, the obligation is more than just a general obligation to act in good faith.

Good faith under the Franchising Code

The obligation to act in good faith in franchising is set out in clause 6(1) of the Franchising Code, which states that:

Each party to a franchise agreement must act towards another party with good faith, within the meaning of the unwritten law from time to time, in respect of any matter arising under or in relation to:

- the agreement; and
- the Code.

The obligation to act in good faith contained in the Franchising Code extends to negotiations and discussions before the entry by the parties into a franchise agreement.

Clause 6(2) of the Franchising Code provides that:

The obligation to act in good faith also applies to a person who proposes to become a party to a franchise agreement in respect of:

- any dealing or dispute relating to the proposed agreement; and
- the negotiation of the proposed agreement; and
- the Code.

However, the obligation to act in good faith does not enable a party to make a general claim that there has been a failure to act in good faith.

For example, where a franchisee complains that a franchisor has not acted in good faith the Federal Court held in *Australian Competition and Consumer Commission v Ultra Tune Australia Pty Ltd* [2019] FCA 12 (ACCC v Ultra Tune) that:

... the focus of an obligation of good faith should ordinarily be on a franchisor's use of powers and opportunities available by reason of the franchise relationship.

What is good faith?

“Good faith” is not defined in the Franchising Code.

The Franchising Code provides that:

Each party to a franchise agreement must act towards each other with good faith, within the meaning of the unwritten law ...

The “unwritten law” means the law developed in the Australian courts through case law or common law.

In *Commonwealth Bank of Australia v Barker* [2014] HCA 32, the High Court of Australia held that good faith involves:

Fairness in dealings as between contracting parties ...

Similarly, in *Paciocco v Australia and New Zealand Banking Group Limited* [2015] FCAFC 50, the Federal Court of Australia held that the obligation to act in good faith means to:

... act honestly and with a fidelity to the bargain; an obligation not to act dishonestly and not to act to undermine the bargain entered or the

substance of the contractual benefit bargained for; and an obligation to act reasonably and with fair dealing having regard to the interests of the parties (which will, inevitably, at time conflict) and to the provisions, aims and purposes of the contract, objectively ascertained.

Elements of good faith

Some elements of the obligation to act in good faith include:

- honesty
- fairness
- not acting arbitrarily
- co-operating to achieve the purpose of the franchise agreement
- reasonableness
- having regard to the interests of the other party.

While the Franchising Code does not define good faith, it provides that when assessing whether a party has acted in good faith, a court may consider if:

- a party acted honestly and not arbitrarily
- a party co-operated to achieve the purpose of the franchise agreement.

Legitimate business interests

While a party must take into account the interests of the other party, the obligation to act in good faith does not prevent a party from acting in its own legitimate commercial interests.

Consequently, a party is not required to act in the interests of the other party at the expense of its own interests.

The Australian Competition and Consumer Commission's (ACCC) view is that conduct is prohibited where it harms the franchisee, but it is not necessary for the protection of the franchisor's interests. The Federal Court of Australia has accepted that view (ACCC v Ultra Tune).

Consequently, franchisors should keep records of their business goals and objectives and reasons for decision-making, so that these records can be referred to later if needed.

Conduct that may show a lack of good faith

The ACCC in its *Franchisor Compliance Manual* has indicated that the following conduct may raise concerns under the obligation of good faith:

- A franchisor treating a franchisee differently to other franchisees because the franchisee has raised concerns about the system.
- A franchisor raising numerous minor and immaterial breaches with a franchisee in an aggressive and intimidatory manner designed to extract concessions or cessation of complaints.
- Franchisees using confidential information provided by the franchisor to compete with the franchisor.
- Franchisees using social media to post negative comments about the franchisor or their dispute with the franchisor.

Penalties under the Franchising Code

The maximum civil penalty under the Franchising Code for a failure to act in good faith is 300 penalty units, or \$66,600.00.

Case study: Ultra Tune

Australian Competition and Consumer Commission v Ultra Tune Australia Pty Ltd [2019] FCA 12

In early 2015, Mr Ahmed, agreed to purchase the Ultra Tune franchise business located in Parramatta, NSW. During the purchase process, Mr Ahmed had a number of meetings with Ultra Tune, during which a number of representations were made. These representations included representations about how long the franchise had been open, the rent payable and the purchase price.

In September 2015, on the basis that the deposit was refundable, as required by the Franchising Code, Mr Ahmed paid the deposit of \$33,000.00.

During the training period, Mr Ahmed was provided with the disclosure document and the franchise agreement, which he felt contained figures which were inconsistent with the representations.

Mr Ahmed subsequently decided not to proceed with the franchise and on 30 September 2015, requested that the deposit less the training costs be refunded.

Ultra Tune refused to refund the deposit on the basis that the money had been used to pay for signage and equipment and was now non-refundable.

In 2017, the ACCC commenced proceedings against Ultra Tune for a number of matters including the failure to comply with the good faith obligations contained in the Franchising Code.

The Federal Court found the following:

- Ultra Tune failed to explain why the orders for the equipment and signage could not have been stopped or why the equipment and signage could not be used by another franchisee or resold by Ultra Tune to another franchisee.
- Ultra Tune had sought a large deposit without giving Mr Ahmed a reasonable time to consider the purchase of the franchise business, particularly given the representations made to him.

The Federal Court also found that Ultra Tune breached its obligation to act in good faith by:

- failing to honestly disclose information about the franchise
- making misrepresentations to Mr Ahmed about how long the franchise had been open, the rent payable and the purchase price
- putting pressure on Mr Ahmed to pay \$33,000.00 before providing documentation relevant to the purchase of the franchise
- requiring the payment of \$33,000.00 and subsequently treating it as a non-refundable deposit without making it apparent to Mr Ahmed that the money would be treated as non-refundable



The quote

While a party must take into account the interests of the other party, the obligation to act in good faith does not prevent a party from acting in its own legitimate commercial interests.

- making a decision to expend the \$33,000.00 on signage and equipment without the need for urgency
- failing to repay Mr Ahmed the deposit.

The Federal Court ordered that Ultra Tune pay a penalty of \$54,000.00 (the maximum at the time) for the breach of the obligation to act in good faith.

Case study: Pizza Hut

Diab Pty Ltd v YUM! Restaurants Australia Pty Ltd [2016]

FCA 43

Clause C1 of the franchise agreement entered into between YUM! Restaurants Australia Pty Ltd (Yum) and its franchisees contained a standard pricing clause which provided that the:

Franchisee will not permit any Approved Product to be sold at the Outlet at any price exceeding the maximum retail prices advised by the Franchisor to the Franchisee from time to time.

In June 2014, Pizza Hut introduced a new pricing model. In particular, Pizza Hut advised its franchisees that certain pizzas were to be offered for \$4.95, which was a decrease in previous pricing.

Under Clause C1 of the franchise agreement, the Pizza Hut franchisees were not able to sell the \$4.95 pizzas for a higher price.

A number of Pizza Hut franchisees alleged that the pricing was unprofitable and that Yum had breached its obligation to act in good faith in implementing the pricing.

The Federal Court did not agree, and considered ‘the purpose’ of the franchise agreement.

In doing so, in addition to clause C1 of the franchise agreement, the court considered clause 6.2 of the franchise agreement which provided that the:

Franchisee will participate in such national and regional advertising, promotions, research and tests as Franchisor from time to time requires and Franchisee will not have any claim or action against Franchisor in connection with the level of success of any such advertising, promotion, research or test.

In respect of the purpose of the franchise agreement, the Federal Court found:

An obligation to ensure profits for each Franchisee with respect to a given promotion, including the setting of a maximum price which is particularly low, is not only inconsistent with clause 6.2, it is also commercially unrealistic in the context of different factors ensuring profit.

In addition, the Federal Court considered whether Yum acted “honestly and fairly” and found with regard to Yum’s CEO:

He may have demonstrated poor business judgment, particularly with the benefit of hindsight. However, that does not equate to a lack of fidelity to the bargain or to unconscionable behaviour.

The Federal Court also considered whether Yum acted “reasonably”:

He made what he considered to be the best decision from the point of the view of Yum and the future profitability of the Franchisees. He and the Yum executives, rightly or wrongly but reasonably, believed in a first mover advantage.

COVID-19 and good faith in franchising

In its coronavirus (COVID-19) information release for businesses, the ACCC highlighted the need for franchisors to be aware of their obligation to act in good faith during the pandemic.

When considering whether a franchisor is acting in good faith, the ACCC suggests that potential questions to ask include:

- Is the franchisor making timely decisions?
- Is the franchisor consulting with franchisees regarding issues or proposed changes?
- Is the franchisor imposing conditions on franchisees that are not necessary to protect its interests?
- Is the franchisor genuinely attempting to resolve the dispute?
- Is the franchisor acting for some ulterior purpose?

The federal government has also indicated that franchisors should be working with franchisees to waive, reduce or defer franchise fees while their businesses are affected by the COVID-19 restrictions. **FS**