The Applicability of Unfair Contract Terms Legislation to Franchise Contracts

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BRIEF ABSTRACT

In 2010, the Commonwealth Parliament implemented a new Australian Consumer Law (ACL).[1] This law, for the first time in Australia, regulates unfair terms in standard form contracts, but is limited to contracts classed as consumer contracts.[2] This article argues that it is appropriate to extend the unfair contract terms (UCT) provisions of the ACL beyond the definition of consumer under the ACL to encompass franchisees as consumers in a business context, and it explains the flaws in the principal arguments against the protection of franchisees under the UCT legislation. As discussion of the scope of UCT often centres on the 'business' versus 'consumer' distinction, this article explains why this distinction detracts from the proper focus of analysis, a focus that consists of the two principal elements of the UCT provisions: unfair terms and standard-form contracts.

INTRODUCTION

In 2010, the Australian government introduced national consumer protection laws that, for the first time, include unfair contract terms (UCT) provisions preventing enforcement of terms deemed to be 'unfair' in standard-form consumer contracts, including telecommunications, financial services, utilities, e-commerce, travel and professional services.[3] The new measures represent an important step in

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1 The *ACL* is contained in schedule 2 of the *Competition and Consumer Act 2010* (Cth). The states and territories have agreed to introduce and enact mirror legislation applying the *ACL*. Council of Australian Governments, *Intergovernmental Agreement for the Australian Consumer Law* (2009) cl 3.2.

2 *ACL* pt 2-3.

3 The provisions are contained in the *Australian Consumer Law ('ACL') within the Competition and Consumer Act 2010 (Cth) and the Australian Securities and Investment Commission Act 2001 (Cth), Schedule 2* to the *Australian Competition and Consumer Act 2010 (*replacing *the Trade Practices Act 1974)*.

the development of the national economic landscape to one in which economic efficiency and consumer confidence is founded on quality and trust between the contracting parties.

Despite this development in the regulation of business-to-consumer transactions, however, the new UCT regime does not apply to business-to-business interactions.[4] Opponents to the extension of UCT legislation to franchising claim that it should not apply because franchisees are not consumers. This article argues that not only do franchisees play the role of consumers, but also the consumer/business distinction is not the proper focus of debate over the scope of the legislation. Rather, it suggests that the essence of UCT, and the proper focus of debate, is the existence of unfair terms in standard-form contracts.

Unfair terms are defined in the legislation as terms that would cause significant imbalance in the parties' rights and obligations, are not reasonably necessary in order to protect the legitimate interests of the drafting party and result in detriment to the other party.[5] The standard-form contract, according to the legislation, is one where the drafting party has all or most of the bargaining power, and that party generally prepares the contract before any discussion relating to the transaction occurs between the parties, leaving the other party to either accept or reject the terms of the contract without substantive negotiation.[6] Franchising is the paradigmatic example of this arrangement; unfair terms in standard-form franchise agreements like those listed in section 25 of the ACL represent the norm, rather than the exception, in franchising. The primary reason, then, why franchisees should be covered under the UCT provisions is that they are in precisely the situations that the legislation targets.

Debate over the Elements and Application of UCT Legislation in Australia

Content control legislation describes a set of prescriptive regulatory tools that are commonly used to regulate standard-form contracts, to protect the interests of a weaker contracting party who may not have the benefit of negotiating terms. Legislation dealing with UCT is a form of content control legislation, mandating compulsory rules with respect to particular terms deemed to be unfair; it is often applied to transactions with consumers in a particular trade or sector.[7] While content control in general and UCT in particular have largely been limited to consumer protection, they can also extend to the protection of business participants, such as those in franchising.[8] The application of the UCT legislation is, however, limited

4 Section 3 of the *Competition and Consumer Act 2010* (Cth) defines a 'consumer'.

5 *ACL* s 24.

6 *ACL* s 27.

7 *Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts* [1993] OJ L 95/29 (where 'Council' means the Council of the European Communities). See also Hugh Collins, *Regulating Contracts* (Oxford University Press, 1999) 236.

8 Though uncommon, contractual content control has been used in several jurisdictions that regulate business, including the United Kingdom's *Unfair Contract Terms Act 1977*, which

to consumer contracts as defined in the ACL s 23(3) with a focus on the use of the goods or services:

> A consumer contract is a contract for: (a) a supply of goods or services; or (b) a sale or grant of an interest in land; to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption.[9]

This issue has a history in Australia. In 1997, the Reid Report advocated unfair contract prohibitions to replace standards of unconscionability.[10] The proposal encountered opposition at the time and the government chose to develop the doctrine of unconscionable conduct, contrary to the Report's recommendations.[11] A similar dynamic was repeated when UCT provisions in the ACL were proposed to be applicable to business. While both Labor and the Coalition initially seemed in favour, the Labor government withdrew its support and the inclusion of franchising as a protected interest under the UCT provisions of the new ACL was abandoned.[12]

Today, the matter is far from settled. In January 2013, the Abbott Coalition proposed to extend the UCT provisions to small business to 'ensure that big

prevents the unreasonable exclusion or limitation of liability for matters such as negligence or defective products. The German Civil Code (*Bürgerliches Gesetzbuch*) § 305 deals with contracts having 'standard business terms', § 306 prohibits circumvention, § 307 sets out when a standard business term is invalid (including if it is not clear and comprehensible), § 308 and § 309 provide a 'black list' of terms that are invalid in standard business terms but subject to § 310, which provides absolute protection for consumers but qualified protection for business having 'due regard to the customs and practices applying in business transactions'. South Africa's *Consumer Protection Act* regulates UCT in various sectors of business including franchising. See also Elizabeth Crawford Spencer, *The Regulation of Franchising in the New Global Economy* (Edward Elgar, 2011), for a discussion of UCT and other means of content control for regulating the franchise sector.

9 *ACL* s 23(3). Note that equivalent provisions regulating unfair terms in these contracts have been introduced into the *Australian Securities and Investments Commission Act 2001* (Cth) pt 2 div 2 sub-div BA, inserted by Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010 (Cth) sch 3 item 7.

10 Recommendation 6.1 of the House of Representatives Standing Committee On Industry, Science and Technology, *Finding a Balance – towards Fair Trading in Australia*, Parl Paper No 83 (1997) 157-8 (the 'Reid Report') <http://www.aph.gov.au/binaries/house/committee/isr/fairtrad/report/covers.pdf>.

11 Eileen Alanna Webb, *From the Reid Committee to the Appointment of the Expert Panel: An Assessment of the Efficacy of Section 51AC* Trade Practices Act 1974 *(Cth) in Australian Retail Leasing* (PhD Thesis, University of Western Australia, 2010) 5.

12 Franchisees were excluded from coverage under UCT at a late stage in the legislative process. In response to an invitation to interested parties to comment on the proposed framework, Treasury received a total of 96 submissions opposing protection for small business. Reasons cited were compromise of certainty of contract (as a party to a commercial bargain could later try to get out it by alleging that the terms are unfair, increasing risk and ultimately prices), small business' capacity to understand and manage risk, and the absence of evidence of a real need or policy justification: Treasury, Australian Government, *Submissions: The Australian Consumer Law – Consultation on Draft Provisions on Unfair Contract Terms* (3 June 2009) <http://archive.treasury.gov.au/contentitem.asp?ContentID=1547&NavID>.

and small businesses get a "fair-go" and do the right thing by each other in their respective marketplaces, delivering real and lasting benefits to consumers.'[13] Similar uncertainty exists in international jurisdictions, with both New Zealand and the United Kingdom currently considering how to deal with UCT in a business context. This article examines whether it is indeed appropriate to exclude franchising as part of business-to-business contracts as an entire class of transactions from unfair contract protections. It does this by considering the essential components of the legislation and the applicability of these components to franchising.

Prior to the enactment of the ACL, there was debate among those in favour of and those against UCT for the franchise sector. The outcome was the exclusion of franchising from protections afforded by the UCT because a franchisee is a businessperson and not a 'consumer'. The distinction between business and consumer is problematic, however. To suggest that franchisees as businesspeople are not consumers is not legitimate and is even a red herring in a world where '[t]here is no universally accepted definition of consumer'.[14] To exclude business interactions from the protection of consumer legislation on this basis is artificial; business is already subject to all kinds of legislated rule making, much of it intended to curb unfair practices. Businesses are consumers, whose confidence in efficiency, fairness and certainty are important to any economy. The idea that business contracting does not require consumer-like protections reflects the classical view of commercial contracting, but pays no regard to the wide ranges of business experience, skills and other relevant attributes of many participants in business, including but not limited to franchisees.

A franchisee's position is tantamount to that of a consumer vis-à-vis the franchisor. Indeed, the entire franchise system can be seen as a product that the franchisee is purchasing and investing in. The fact that a franchisee functions as a consumer of a franchisor's intellectual property, products and services is unquestioned; it is just the categorisation of a franchise business arrangement as a consumer transaction that has given pause. The fact that a franchisor is selling a product, a license, and a franchisee is the consumer of that product, suggests that there should be some minimum protections for the consumer of that product.[15]

Ironically, the protection of small business was part of the rationale behind the definition of consumer, which 'was a direct result of the Swanson Committee's recommendations which required it to fulfill three criteria: to be certain, to redress

13 Liberal Party of Australia, *Our Plan: The Direction, Values and Policy Priorities of the Next Coalition Government* (26 January 2013) <http://australianpolitics.com/downloads/liberal/13-01-26_our-plan_liberal-party.pdf p 27>.

14 Aviva Y M Freilich, 'A Radical Solution to Problems with the Statutory Definition of Consumer: All Transactions Are Consumer Transactions' (2006) 33 *University of Western Australia Law Review* 110-111 <http://www3.commonlii.org/au/journals/UWALawRw/2006/5.pdf>.

15 No jurisdiction has yet instituted, nor has case law implied, statutory warranties for the sales of franchises.

the inequality of bargaining power between suppliers and consumers and to provide protection for small business'.[16] A paramount consideration in consolidating the seventeen different pieces of Federal, State and Territory consumer protection legislation into the ACL was the need to provide a national uniform set of consumer protections laws that were 'clear and consistent' for consumers and made compliance easier for businesses. That purpose is no less valid for business consumers than for other types of consumers.

The leading justifications for excluding businesses such as franchisees from UCT were the interests of certainty in contracting, the capacity of franchisees to protect themselves against risk and the lack of policy justification.[17] This article takes issue with each of those arguments.First, the application of the protection would not threaten certainty of contract because the legislation directs that the offending term be severed wherever possible and that the remainder of the contract continue.[18] More to the point is the question of whose certainty would be threatened: 'Certainty is desirable in the commercial sphere but should be applicable to all players…. The weaker party has little certainty about their business environment or its continuity and the contracts they sign invariably contain wide discretions which favour the stronger party.'[19] It is well established that franchise contracts are drafted by franchisors such that all discretion and flexibility inheres with them, and franchisees must live with the uncertainty and increased risk that this entails. The argument that extending UCT to franchising will threaten certainty in contracting is really an argument that it will threaten certainty for one party, the franchisor, the drafting party, the party with the greater power, and the party that would be imposing the unfair term in the first place. The certainty that is threatened is the certainty of a franchisor being able to rely on terms that would ordinarily be regarded as unfair in scope or application. Surely, this is not the kind of certainty in contracting that legislators seek to reinforce.

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16 Freilich, above n 14, 112: Notes that the current definition of consumer in the Act is potentially unclear and uncertain….only sometimes redresses inequalities between buyer and seller. …and fails to live up to expectations that it would provide protection for small business. Emphasis added.

17 See Treasury, above n 12. See also Chapter 6 of the Reid Report, which also refuted these positions and in particular:

> The Committee considers that primary responsibility…rests with the Parliament and that the Parliament would be neglecting its duty if it failed to deal with these injustices in the vain hope that the courts might deal with them better.
>
> The Committee does not accept that the equitable doctrine of unconscionability embodied within Section 51AA of the Trade Practices Act is capable of dealing with the types of conduct complained about to this inquiry and considers that a broader provision is required…
>
> The Committee believes that it is necessary to amend the Trade Practices Act 1974 to provide a general statutory standard of fairness in commerce broader that the present equitable doctrine of unconscionability. [6.21]

18 *ACL* s 23(2): The contract continues to bind the parties if it is capable of operating without the unfair term.

19 Webb, above n 11, 433 citing the Reid Report, above n 11, [6.35], [6.70].

Secondly, small business operators such as franchisees do not necessarily have a greater capacity than consumers to understand and manage risk. A great deal has been written on the shifting of risk to franchisees and their lack of capacity to protect against, or indeed to even comprehend, that risk:

> [A] significant body of existing empirical research [refutes] the assumption that franchisees consider all relevant information before signing a franchise contract and make a well-informed choice. … New franchisees that join a franchise network normally lack prior business ownership experience [that] presents significant cognitive obstacles for novice franchisees when attempting to consider all of the relevant information before acquiring ownership of a franchise unit. Such cognitive obstacles— contrary to the franchisor advocates' view—often lead franchisees to ignore franchise disclosure documents, avoid conducting a comparison between various franchise contracts and disclosure documents, and neglect to consult with a specialized franchise attorney prior to signing the franchise contract. Given this reality, theoreticians and legislators interested in creating franchise laws that protect novice franchisees from possible opportunism by franchisors must cast doubt on the assumption that franchisees are well-informed business people and incorporate into their analyses a more representative conception of franchisee characteristics.[20]

Finally, there is an important policy justification for the inclusion of small business under the UCT legislation. The principle, stated repeatedly in the regulation of business-to-business transactions, is to support small business, the 'engine room of the economy', by ensuring that unfair practices do not destabilize the efficient conduct of ordinary business activities.[21] Whether contract terms are unfair is in no way dependent upon an arbitrary determination of the status of a person as a 'consumer' or as a 'business', and such categorisation should not be used to explain away egregious conduct or to exclude small business from the protections afforded by the appropriate legislated measures. Reliance on disclosure in the regulation of the franchise sector has been unsuccessful, as is evidenced by the ongoing inquiry and debate into market inefficiencies and unfairness. These issues are raised repeatedly yet remain unresolved, perhaps because so many recommendations made over the last 20 years to improve the regulation of the sector have not been adopted by Government. The Reid Report (1997), the Matthews Review (2006), the Senate Standing Committee Recommendations (2010), not to mention various State inquiries, considered and rejected recommendation to change.[22] The publicly

20 R Emerson and U Benoliel, 'Are Franchisees Well-Informed? Revisiting the Debate over Franchise Relationship Laws' (2013) 76(1) *Albany Law Review* 193-216, 194.

21 Reid Report, above n 10, v.

22 Reid Report, above n 10; Report to the Hon Fran Bailey MP Minister for Small Business and Tourism, *Review of the Disclosure Provisions of the Franchising Code of Conduct* (31 October 2006) ('Matthews Report') <http://www.innovation.gov.au/Section/SmallBusiness/Documents/Franchising_Code_Review_Rep ort_2006_FINAL_06120720070205134250.pdf>; Inquiry into Franchising by the Parliamentary Joint Committee on Corporations and

available submissions made to the current Wein Review into franchising suggest that the same abuses that were reported decades ago continue unabated today.[23] The fact that unfair conduct continues to impact on the performance of small business is the policy imperative for more effective regulation.

Perhaps the most significant problem with the assertion that regulatory measures such as UCT are inappropriate for a franchisee is that a franchisee's consumer attributes should not be determinative of the need for UCT protections. It was only at a late stage in the legislative process that the 'consumer-only' element was included, no doubt due to the political exigencies of the process, including the submissions to that process, predominantly from trade associations and other medium-to-large business interests. Whether a party has consumer-like attributes, however, need not constitute an essential element of the UCT provisions.[24]

Independent of the consumer requirement, the determinative elements of UCT under Australian law are 1) unfair terms and 2) a standard-form contract. To exclude franchisees from unfair contract terms protections is to ignore the compelling justifications for their inclusion. It is to focus on the wrong point, whether a franchisee is a 'consumer', and to ignore the weight of more important factors, namely that franchise contracts are standard-form agreements and that they exhibit unfair terms. Both of these factors are clearly exhibited in the franchise contracting relationship. Further, the entire list of examples of unfair contract terms in the legislation at s 25 are the kinds of terms that are commonly found in franchise contracts.

Why Franchising Should Be Covered in the Unfair Contract Terms Legislation

The UCT law is based on recommendations of the Productivity Commission in its 2007 Review of Australia's Consumer Policy Framework, where the emphasis is clearly on the unfair terms in standard-form contracting that causes detriment, to be interpreted taking into account all the circumstances of the contractual relationship. The Final Report Recommendation 7.1 states that the national law should have a provision that prohibits unfair terms and that the preferred approach would have the following features:

> [A] term is established as 'unfair' when, contrary to the requirements of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract; there would need to be material

Financial Services, *Opportunity Not Opportunism: Improving Conduct in Australian Franchising* (1 December 2008).

23 Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, *Submissions Made to the 2013 Review of the Franchising Code of Conduct* <http://www.innovation.gov.au/SmallBusiness/CodesOfConduct/Pages/Submissions-made-to-the-2013-review-of-the-Franchising-Code-of-Conduct.aspx>.

24 See Freilich, above n 14.

> detriment to consumers (individually or as a class); it would relate only to standard-form, non-negotiated contracts; …and it would require all of the circumstances of the contract to be considered, taking into account the broader interests of consumers, as well as the particular consumers affected.[25]

Looking at these factors separately, we first consider the standard-form nature of the franchise agreement.[26] In its 2008 report, the Productivity Commission in Australia found, '[u]nfair terms appear to be commonplace in standard-form contracts,'[27] and that:

> terms of the kind described as unfair… are common in many contracts across many industries … their existence is widespread globally where regulatory mechanisms do not discourage this. …In Europe, prior to the introduction of measures against them, market studies revealed the ubiquity of unfair terms in standard-form contracts. Despite the benefits of the standard-form contract in reducing transactional costs and ensuring a uniformity of terms for the delivery of goods or services, its prevalence has led to a reduction in the classical form of contract, that is a meeting of minds where both parties negotiate the terms of the contract as equals.[28]

Standard-form contracts typically allow one party to impose terms upon the other on a 'take it or leave it' basis. Where the relative bargaining position of the parties is unequal or other market forces affect the ability of one party to negotiate effectively, a real risk of unfair conduct arises.

In Australia, business-to-business contracts were originally contemplated in the UCT legislation in large part because of the ubiquity of the standard-form. The rationale was summarised in the Treasury's discussion paper:

> Standard-form contracts are used by parties irrespective of the legal status or nature of the party to whom the contract is presented, and without any effective opportunity for that party to negotiate the term. In such cases it would be invidious to suggest that the same term which may be considered unfair in relation to a contract entered into by a natural person would not be similarly unfair in relation to a business where neither of them is in a position to negotiate the term.[29]

A franchisee is vulnerable to unfair terms in standard-form contracts as much as, and often more than, a consumer would be and so should have similar legislated

25 Productivity Commission, *Review of Australia's Consumer Policy Framework*, Inquiry Report No 45 (2008) <http://www.pc.gov.au/projects/inquiry/consumer/docs/finalreport>.

26 *ACL* s 27.

27 Productivity Commission, above n 25, 430 <http://www.pc.gov.au/__data/assets/pdf_file/0008/79172/consumer2.pdf>.

28 Ibid.

29 Treasury, Australian Government, *The Australian Consumer Law: Consultation on Draft Provisions on Unfair Contract Terms* (2009) 8.

protections. In franchise contracts it is typically the case that the franchisor has most, if not all, of the bargaining power relating to the transaction.[30] A franchisee is not an effective and informed participant, but rather is involved in a standard-form contracting relationship. The contract is always prepared by the franchisor before any discussion relating to the transaction occurs between the parties; it is a requirement of the Franchising Code that a copy of the franchise agreement in the form it is to be executed is given to the prospective franchisee as part of disclosure.[31] A franchisee is, in effect, required either to accept or reject the terms of the contract without any effective means to negotiate the terms of the contract. Rarely in franchising are the terms of the contract altered to take into account the specific characteristics of another party or the particular transaction. The synergistic effects of the standard-form and relational qualities of the franchise contract lead to the erosion of bargained-for-exchange, increased imbalance of power and increased uncertainty for a franchisee.

The other essential element of UCT protection under the legislation is the finding of an unfair term.[32] As noted above, a term is unfair if it would cause significant imbalance in the parties' rights and obligations under the contract, is not reasonably necessary in order to protect the legitimate interests of the drafting party, and results in detriment to the other party.[33] In franchising, imbalance may be considered necessary,[34] but it is not, by itself, considered to be unfair. For example, the conditions upon which the franchisor will offer the use of its intellectual property (the franchise system) are, and should be, within the franchisor's discretion. The franchisor has a vested interest in maintaining the integrity and commercial viability of the franchise system, and this results in the franchisee necessarily being subject to varying degrees of control, legitimate or otherwise.

The franchise contract is, by its very nature, heavily weighted in favour of the franchisor. A survey of contract terms in franchising provides examples of imbalance of eights and obligations in the contractual relationship.[35] The 'scope of grant' clause delineates and effectively limits the rights of a franchisee, while specifically reserving rights, such as use of the intellectual property and discretion to a franchisor. Most grants are not exclusive and there is often little or no protection for a franchisee against a franchisor's right to encroach. A franchisor's contractual

30 There are exceptions. In some cases franchisees are experienced, substantial and savvy businesspeople. These attributes would be taken into account in the kind of contextual analysis this article advocates.

31 *Trade Practices (Industry Codes — Franchising) Regulations 1998* (Cth) pt 2 div 2.2 s 10(c) ('Franchising Code of Conduct').

32 *ACL* s 24.

33 *ACL* s 24.

34 Inquiry into Franchising by the Parliamentary Joint Committee on Corporations and Financial Services, above n 22, 8.3.

35 Elizabeth Spencer (2008) *The Regulation of the Franchise Relationship in Australia: A Contractual Analysis*, (PhD Dissertation, Bond University, 2008) <http://epublications.bond.edu.au/theses/spencer>.

obligation to promote the brand typically accords to a franchisor discretion that contributes to the risk of franchisor opportunism and to uncertain conditions for its franchisees; franchisees pay but have no say in franchisor promotional activities and do not have any assurance that the money they contribute will be directly applied for their benefit. Other examples of contract terms where the balance is usually in favour of a franchisor, with concomitant uncertainty for a franchisee, include terms of supply, franchisee minimum performance and reporting, transfer, termination and collective agreement clauses. The result is that

> [f]ranchise contracts reflect and reinforce asymmetries already inherent in the franchise relationship. The relational and standard-form qualities of the contract, independently and in combination, contribute to greater power to a franchisor and greater uncertainty and risk for a franchisee.[36]

Often these terms are legitimate in the interests of the franchisor's control over and responsibility for the system as a whole. While the terms contained in the franchise contract may be necessary in the interests of the system as a whole, however, it is the use (or abuse) of the discretionary powers contained in the franchise contract that result in the provision not being reasonably necessary to protect the legitimate interests of the franchisor.

For example, many franchise contracts require that the franchisee conform to the brand and image of the franchise system at its own expense, including any change to or update of the brand. An argument that the franchisor's requirement to update the premises is unreasonable arises where the expense results in the franchised business becoming financially unviable. A related issue arises when the franchisee is unable to afford (or obtain financing) for such an update, leading the franchisor to terminate the franchise contract for non-compliance. In an attempt to reduce the potential for unfair conduct, disclosure requirements have been extensively amended under the Code.[37] However, disclosing the potential of, for example, a possible future payment is unlikely to reduce risk of opportunism, while it does often increase confusion.

Because of a franchisor's responsibility to maintain the brand, so to have discretion and control in the interests of the system as a whole, a franchise agreement cannot be determined to be 'unfair' simply because a significant power imbalance exists. The best franchise systems use this power judiciously and such use generally accrues to the benefit of all parties. It is the unchecked exercise of discretion that causes detriment to franchisees. Detriment can take the form of, for example, encroachment of company stores on franchisees' territories, franchisor opportunism, inadequate franchisor support and inadequate investment (shirking)

36 Spencer, above n 8.

37 Franchising Code of Conduct, above n 31, annexure 1, 13A.1. Whether the franchisor will require the franchisee, through the franchise agreement, the operations manual (or equivalent), or any other means, to undertake unforeseen significant capital expenditure that was not disclosed by the franchisor before the franchisee entered into the franchise agreement.

by the franchisor in brand maintenance. It may be related to site selection issues, conflicts with respect to training and technical issues, and/or vulnerability at renewal, sale or termination.[38]

What needs to be addressed is franchisor exercise of this legitimate discretion/power in ways that unduly harm the interests of individual franchisees with a more particular calculus of when the use of power is legitimate and when it is not. The question in each case is whether the harm to a franchisee in the exercise of the power afforded by the term can be justified by the benefit to a franchisor or the brand, and also whether this harm is beyond the reasonable expectations of the parties, not only in entering the contract, but also because these contracts are long-term, relational contracts.

The test under s 24(1)(b) is whether the imbalance is 'reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term.' In order to comply, terms must be drafted carefully to ensure that they are no broader than is reasonably necessary. The balancing that is required can only be achieved by considering the relationship as a whole and weighing the relative merits and benefits of actions detrimental to a franchisee. The benefit of s 24(2) in directing courts to consider the 'contract as a whole' makes this provision indispensable in the franchising context. As franchise contracts are widely drafted in favor of the franchisor's discretion, almost every term imposed upon a franchisee (whether through the contract itself or, just as commonly, by way of an associated document such as an operations manual) may be associated with a potential detriment to a franchisee, but will not always cause that detriment.

In contrast to discrete contracts, relational franchise contracts are noted for being flexible to the point of being vague, necessitating contextual interpretation of the contract 'as a whole' and not confined to the 'black letter' rules. [39] Franchise business relationships are controlled by mechanisms outside the letter of the contract, an almost incalculable interaction of variables that may exist in a dynamic business environment between two (or more) parties who are seeking to advance their disparate interests. In order to comprehend the scope of the contractual obligations, a Court must be able to look first at the contract terms, which are, as has been stated, primarily in favor of the franchisor; but a Court must also be able to consider the actions of the parties and any extrinsic or associated material that modifies, clarifies or implements the broad intentions of the parties as set out in the franchise agreement. In some ways such an approach is the antithesis of classical contract law, yet the well-documented failings of the current regime underscore the need for this approach.

In determining whether a contract term is unfair, it is also necessary to consider whether the obligations contained in the contract are 'transparent.' Section 24(3)

38 For a discussion of these issues and the alignment of franchisor and franchisee interests, see Spencer, above n 35.

39 Spencer, above n 8.

of the ACL provides that a term is transparent where it uses plain language, is legible, presented clearly and readily available to affected parties. This requirement indicates a physical and linguistic accessibility, but does not appear to extend to accessibility in terms of comprehension, which is where the greater problem lies.

Transparency is problematic in franchising given that it is not possible to fully define a business relationship that may endure for decades. Where the franchisor has control over the drafting of the contract and withholds (often with good reason) full pre-contractual disclosure of the business model, it is not possible for a prospective franchisee, without any experience in the industry, to understand the full implications of the franchisor's system. The fact that the franchisor, through its intellectual property and systems, provides the means for the franchisee to 'bootstrap' itself to a level of competence it could not otherwise achieve within a set time frame reinforces the notion that, at the time of entering the contract, the average franchisee lacks a full comprehension of the franchisor's business model. Without a contextual framework of this business model with which to compare franchise contracts, full transparency at the point of entry into the franchise obligation is not possible. To further complicate matters, the meaning of many terms may not be discernible from the wording of the contract itself, but rather may require consideration of ancillary or associated documents or arrangements, such as leases or operations manuals. Similarly, even where a term may appear to be readily interpreted in the contract, the obligations contained in an associated document may call into question the 'fairness' of the clause.

Transparency in the contract itself cannot be assumed in a franchise relationship. It may even be counterproductive to fix the meaning of a particular term, as such a measure would prevent the franchise system from adapting to changes in business conditions. It is far more likely that contractual obligations regarding operational matters will not be fully detailed or if they are, such as in an operations manual, then such terms will not form part of the formal contract. Transparency depends upon context; the wide discretions that franchisors grant to themselves cannot be, by their very nature, transparent, although the conditions that give rise to the exercise of the discretion may be ascertainable.

Certain transparencies are considered necessary and have been incorporated into the compulsory disclosure document, as representing the minimum necessary information for a prospective franchisee to make an informed decision about entering into a franchise system.[40] If disclosure of any item is not complete in itself then, at least, such disclosure is intended to prompt the seeking of further information. However, disclosure can never be fully transparent. Consider, as one example, s 13A of the Franchising Code of Conduct, which raises the question of how an unforeseen expense can be disclosed if it is genuinely unforeseen.[41]

40 Franchising Code of Conduct, above n 31, Annexure 1.
41 Ibid s 13A.

The Competition and Consumer Act s 25: Examples of Unfair Contract Terms

The examples of potentially unfair contract terms legislation listed in s 25 are virtually all commonly used in franchising contracts and constitute perhaps the most convincing evidence of all that franchise contracts contain potentially unfair contract terms. Table 1 sets out the examples contained in the ACL s 25 alongside typical terms in franchise agreements and so demonstrates that franchise agreements meet almost every example the legislation provides of potentially unfair terms.

Table 1: ACL s 25′s42 Grey List as Compared with Typical Franchise Terms

Example in *ACL* s 25[43]	**Nature of term in franchise agreements**
(a) a term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract;	Most franchise contract terms are written to bind franchisees and to ensure flexibility for franchisors. They specify performance of precise franchisee obligations, eg 'a franchisee must', while franchisor obligations are drafted in permissive terms, eg 'a franchisor may.' Consider also unilateral amendment clauses. In most franchise agreements, the obligations of the franchisor are vague and/or limited and without recourse being specified for breach, whereas franchisee obligations are comprehensive and breach will give rise to wide discretions on the part of the franchisor to limit performance (eg withhold supply) or avoid the agreement.

42 *ACL* s 25.

(b) a term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract;	A term of this nature is in fact enshrined in the Franchising Code at clauses 21-23, whereby the right of the franchisor to terminate for specified breaches is protected (and provides the process to prosecute other breaches), whereas there is no reciprocal right for franchisees. Most franchise agreements only permit 'one way' terminations, ie by the franchisor, and do not address a franchisee's right to terminate for a breach by a franchisor (although it is worth remembering that the franchisor's obligations are limited, making a breach less likely).
(c) a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract;	A common example is the requirement that a franchisee continue to make royalty payments until the end of the then current term, even if the franchise agreement has been terminated due to conditions caused by the franchisor, such as franchisor insolvency. This issue may have an even wider impact as a result of the comments of the High Court in *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30 (6 September 2012), which recasts the 'doctrine of penalties' into wider terms.
(d) a term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract;	Franchisors commonly enjoy a right to alter unilaterally the terms of the contract. They can also effectively alter the nature of the contractual agreement through the Operations Manual and other means. This issue is so common that in the 2010 changes to the Code a specific disclosure requirement was included regarding the ability of the franchisor to vary unilaterally the franchise agreement and the extent to which they had done so within the preceding three years.

(e) a term that permits, or has the effect of permitting, one party (but not another party) to renew or not renew the contract;	Although many franchise agreements do contain a renewal 'right', on closer examination the renewal is better described as a first option for the franchisee to continue the business on the terms of the franchisor's then current franchise agreement, which may be substantially different from the existing terms. If the franchisee does not accept the 'then current' form of the franchise agreement, the franchisor can choose not to grant the 'extension'. The terms of the 'then current' franchise agreement are solely within the discretion of the franchisor, giving them the effective means of denying a renewal without having to provide reasons for denying a request. Again, the impact of this issue has resulted in changes to the Code by the 2010 inclusion of disclosure requirements about renewal.
(f) a term that permits, or has the effect of permitting, one party to vary the upfront price payable under the contract without the right of another party to terminate the contract;	Most franchise agreements give the franchisor the ability to alter royalty rates, product charges, contributions to co-operative/marketing funds and to impose new fees and charges as the franchise system is modified over time. In one sense, this ability is at the heart of the franchise offering (to adapt the business model to its most efficient form as the business environment changes), however it can also change the 'headline' price of the franchise dramatically. Another instance, the subject of ongoing controversy, is the ability of franchisors to require capital amounts to be spent during the franchise without having previously disclosed them. Although Code disclosure now requires the franchisor to identify 'unforseen capital expenditure', the obvious problem is that if the expense is genuinely unforeseen, it cannot be disclosed. This has not limited the ability of franchisors to require significant and sometimes crippling expenditure by franchisees in order to comply with their obligations under the franchise agreement or as a condition of renewal.

(g) a term that permits, or has the effect of permitting, one party unilaterally to vary the characteristics of the goods or services to be supplied, or the interest in land to be sold or granted, under the contract;	Terms of this nature are almost universally included in franchise agreements, but again they are directly relevant to the value of the franchise concept. Franchise systems must 'adapt or die' and it is equally in the interest of franchisees that the franchise system be modified to take advantage of new products or services as part of the franchise brand.
(h) a term that permits, or has the effect of permitting, one party unilaterally to determine whether the contract has been breached or to interpret its meaning;	Franchise agreements generally specify the franchisee's breaches and contain no reference to breaches by the franchisor. Generic obligations – such as to comply with the Operations Manual as published from time to time, or not to bring the system into disrepute – are entirely within the control and interpretation of the franchisor.
(i) a term that limits, or has the effect of limiting, one party's vicarious liability for its agents;	Many franchise agreements contain limitations upon liability for the actions of their agents, servants, contractors or employees and specify the extent of the remedy available (such as the re-supply of goods or services only and excluding any consequential or associated loss or damage).
(j) a term that permits, or has the effect of permitting, one party to assign the contract to the detriment of another party without that other party's consent;	Franchisors usually reserve the right to assign their interest in the agreement (or the system) without reference to the franchisee. The rights of franchisees to assign the agreement are circumscribed and subject to extensive franchisor discretion. The extent of this issue is such that it forms a specific section in the Code disclosure document.

(k) a term that limits, or has the effect of limiting, one party's right to sue another party;	Franchise agreements often include choice of jurisdiction that is non-negotiable and require that the franchisee must pay the franchisors legal costs (sometimes regardless of the outcome). 2010 amendments to the Code now require disclosure with respect to this issue. Many agreements also purport to limit the franchisor's liability, however, the Code proscribes a general release from being included in an agreement.
(l) a term that limits, or has the effect of limiting, the evidence one party can adduce in proceedings relating to the contract;	Often found in franchising in the form of a 'Prior Representations Deed', a separate document to the franchise agreement that purports to specify the representations made to the franchisee prior to entering into the franchise to those matters specifically stated in the Deed and limiting any action to those matters only (or if none are included, which is common, to plead the Deed in bar to any action for misrepresentation). Most, if not all, franchise agreements include an 'all terms' clause that provides that the agreement (together with any Deed, if applicable) represents the entire agreement between the parties and that the franchisee entered into the franchise agreement without relying upon any representations made by the franchisor, its servants, agents or employees.
(m) a term that imposes, or has the effect of imposing, the evidential burden on one party in proceedings relating to the contract;	The 'Prior Representation Deed' shifts the onus to the franchisee to establish that some representation was made that was not included in the Deed (and to explain why it was not included – which is often relevant to reliance).

Franchise contracting was, at the eleventh hour, excluded from the application of the ACL. Paradoxically, all of the examples of potentially unfair contract terms provided in the legislation are commonly found in franchise agreements. This can be taken as evidence that the use of potentially unfair contract terms is rife in franchising, and so needs to be controlled. It also can be taken as evidence that such terms are legitimate and normal in the franchising context. The fact is, both are correct. Terms such as those listed in s 25 are legitimate and commonly used terms in franchising. It is also true that they lend themselves to abuse and

commonly do cause imbalance that overreaches what is reasonably necessary to protect the franchisor's legitimate interests, resulting in detriment to some, often many, franchisees.

Section 25's grey list of examples suggests that franchise contracts may not be amenable to protection by this legislation in its current form. For business consumers, a broader approach could streamline the UCT provision and relieve it from unnecessary detail that defeats its purpose.[43] It may be that 'a term will be reasonably necessary to protect the legitimate interests of the trader only where the term represents a proportionate response to the risk it addresses.' Such an approach 'may require courts to consider other possible ways of protecting the trader's interests that would be less burdensome to the consumer.'[44]

A franchisor has a legitimate interest in employing the terms of the sorts that are offered as examples in s 25. Therefore, if the UCT legislation were to apply to franchise agreements, the burden should not be shifted to a franchisor. Australian Consumer Law s 24(4), which provides that '[f]or the purposes of subsection (1)(b), a term of a consumer contract is presumed not to be reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, unless that party proves otherwise', is not appropriate for the regulation of franchising. The burden of proof in the franchise context properly remains with the franchisee to show that the term is not reasonably necessary to serve the legitimate interests of the franchisor.

As noted above, reliance on disclosure in the regulation of the franchise sector has been unsuccessful; the same abuses that were reported decades ago continue today.[45] As Paterson observes, 'The insights of behavioural economics suggest that there are significant limitations on the decision-making processes of consumers relating to "rational, social, and cognitive factors", which are not necessarily improved by consumers being provided with more information about the incidental terms of their contracts.' [46]

Misleading or deceptive conduct has been a useful provision for franchisees, but it is, like disclosure, another tool targeted principally at formation of the contract. The tension between regulatory measures that operate on a procedural level as opposed to the need for substantive measures persists, are 'measures aimed at addressing the information asymmetry between traders and consumers, for

43 Webb, above n 11, 435.

44 J Paterson, 'The Australian Unfair Contract Terms Law: The Rise of Substantive Unfairness as a Grounds for Review of Standard Form Consumer Contracts' (2009) 33 *Melbourne University Law Review* 934, 945.

45 Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, *Submissions Made to the 2013 Review of the Franchising Code of Conduct* <http://www.innovation.gov.au/SmallBusiness/CodesOfConduct/Pages/Submissions-made-to-the-2013-review-of-the-Franchising-Code-of-Conduct.aspx>.

46 J Paterson, 'The Australian Unfair Contract Terms Law: The Rise of Substantive Unfairness as a Grounds for Review of Standard Form Consumer Contracts' (2009) 33 *Melbourne University Law Review* 934, 956.

example transparency in the terms of the contract or notice of unusual terms… sufficient to ensure that a term is fair'?[47]

Good faith continues in its role as the perennial bridesmaid, often considered but never chosen to fill the gap. The amendment to the Franchising Code in 2010 to the effect that the Code does not limit any obligation imposed by the unwritten law on parties to a franchise agreement to act in good faith[48] achieves little. In contrast to jurisdictions such as the United States and Germany, where good faith is a part of broader contract and commercial codes, good faith is not part of the legal traditions of the UK or Australia. The duty of good faith was not incorporated into the Trade Practices Act 1974, nor does it exist as a discrete requirement in its successor legislation, the Competition and Consumer Act 2010 (Cth). Considerations to which a court may have regard in determining unconscionable conduct include the extent to which parties acted in good faith, but the principle has languished in this context[49] and it offers little promise in the near future as '[t]he scope and content of the duty in the unwritten law to act in good faith…remain uncertain.'[50]

Conclusion

Labels offer an attractive shorthand for the task of rule making, but labels create a new layer of complexity in definition and interpretation. Instead of using the business/consumer distinction, which is ambiguous at best, to draw lines in UCT, and instead of basing its application on often-misleading shorthand for the status of the parties, this article has suggested that courts should look at the contracting relationship itself in the fullness of its context. What is important in the franchising context is to take full account of the attributes and legitimate interests of the parties, considering the balance of rights and obligations and, ultimately, fairness, in light of these factors.

An extension of UCT to franchisees provides a means to address problems in franchising that have not been solved by ongoing attempts to regulate, principally through disclosure.[51] Certainty of contracting can be promoted more equally

47 J Paterson, 'The Australian Unfair Contract Terms Law: The Rise of Substantive Unfairness as a Grounds for Review of Standard Form Consumer Contracts' (2009) 33 *Melbourne University Law Review* 934, 956.

48 Franchising Code of Conduct, above n 31, pt 2 div 2.2 s 23A.

49 *ACL* s 22(2)(l).

50 Alan Wein, Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, *Discussion Paper: Review of the Franchising Code of Conduct* (2013) <http://www.innovation.gov.au/SmallBusiness/CodesOfConduct/Documents/2013ReviewDiscussionPaper.pdf>.

51 It is widely accepted that prospective franchisees should receive sufficient and transparent disclosure in order to make an informed decision about their investment, as is reflected by the disclosure requirements of the 'Franchising Code of Conduct'. It is presumed that once disclosure has been made, the prospective franchisee is sufficiently informed to make a decision about the business, regardless of their education, experience or even capacity to understand what has been disclosed to them. Repeated inquiry into and amendments to the Code disclosure process suggest that this is not the case.

for all parties, rather than principally on behalf of the drafting party's interests. Franchisees' inability to comprehend fully the nature of the interaction ex ante and the constraints on their ability to protect themselves against risk can be addressed, and government policy to reduce risk and ensure a healthy environment for small business will be served.

This article has argued that franchisees should be covered under the UCT provisions because they fall precisely within the situations that the legislation is designed to control. Amendment would be required, however, to the form of UCT as it currently applies to consumers, such as a removal of s 24(4) for the franchise context and a streamlined formulation of the legislation to ensure that the whole of the franchise relationship is considered in context.

In asking the question of whether a term has been drafted in such a way as is reasonably necessary to protect the legitimate interests of the drafting party, this article supports a guiding principal that 'unfairness should not be assessed from the traditional contractual perspective of arm's-length commercial dealing, but through a relational approach'.[52] In weighing the interests of the franchisor and the system (franchisor and franchisees collectively) versus the cost/risk/detriment to individual franchisees, UCT legislation can and should accommodate the context of the interaction. The future of franchising could, as a result, be one where contracts are drafted with greater precision and fairness, while preserving a franchisor's legitimate need for control and discretion.

52 Webb, above n 11, 6.