Abstract: The challenge of upholding employment standards regulation within franchise networks was laid bare by the investigation into 7-Eleven. However, as the Migrant Workers’ Taskforce recently observed ‘7-Eleven is unlikely to be alone in being associated with significant wage exploitation of its franchisee employers.’ This article seeks to unpack the apparent link between business format franchising and underpayment contraventions in the Australian context. It combines an examination of relevant case law from the past decade, with a review of other critical inquiries, investigations and research relating to specific brands and the franchising sector more generally. The final part of this article considers how, and to what extent, key provisions in the recent Fair Work Amendment (Protecting Vulnerable Workers) Act 2017 (Cth) may influence the ascription of risk and responsibility within the franchising relationship.

I Introduction

Historically, business format franchising was promoted as a sure-fire way for firms to expand their brand and market share; all while maintaining control of a dispersed network of franchisee businesses. However, settled perceptions of the purported benefits, and benign effects, of franchising have been fractured by the fall-out from the 7-Eleven investigation. As is now well-known, this notorious case came about after it was revealed that hundreds of vulnerable workers across the franchise network had been systemically underpaid. Initially, the franchise sector sought to portray the 7-Eleven case as an anomaly. But since this story first broke in 2015, some of the country’s most familiar brands, including Pizza Hut, Caltex, Domino’s Pizza and United Petroleum, have been embroiled in similar scandals.

Many franchisees caught up in these investigations have sought to justify their unlawful behaviour on the premise that the underlying business model — devised by the franchisor and imposed on the franchisee — was not financially viable. Not surprisingly, such claims have been fiercely disputed by

6 A Ferguson, ‘Caltex Cleans Up in Worker Compo “Hoax”’, Sydney Morning Herald, 15 September 2017. Almost 50% of confidential submissions received as part of the Parliamentary Inquiry into the Franchising Code of Conduct raised concerns regarding the viability of the underlying business model. See Parliamentary Joint
the relevant franchisor. Further, franchisors — almost universally — have indicated that while they support compliant workplaces, they are not to blame for franchisee violations of employment laws. Rather, in their view, it is the franchisee, the direct employer, who should bear sole responsibility for the wrongdoing.

This article will seek to unpack the link between the franchising model and contraventions of employment standards. It will begin by looking at the extent to which business format franchising has taken hold in Australia. It will then draw on the broader literature to examine the challenges posed by the franchising model for upholding and enforcing employment standards regulation. Next, it will survey relevant case law from the past decade which has considered contraventions of wage and hours regulation in a franchising context. This systematic review reveals that, prior to the enforcement crisis of 2015, the courts tended to accept that, as the relevant employer entity, the franchisee was primarily liable. Limited consideration was given to the role played by the franchisor.

Perhaps even more revealing than the relevant case law are the findings of the comprehensive inquiry into the 7-Eleven franchise network undertaken by the Office of the Fair Work Ombudsman (FWO) in 2016. Indeed, the damming findings of the FWO’s inquiry, combined with growing community outrage over the lack of franchisor accountability, ultimately led to far-reaching reform under the auspices of the Fair Work Amendment (Protecting Vulnerable Workers) Act 2017 (Cth) (PVW Act), as well as an extensive Parliamentary Inquiry into the Franchising Code of Conduct (Franchising Inquiry).

The final part of this article will explore how, and to what extent, key provisions in this amending legislation may influence the ascription of risk and responsibility within the franchising relationship.

II Enforcement Challenges Presented by the Franchising Model

The latest available data estimates that there are currently 1120 franchisors, 79,000 franchising units and around 470,000 employees working within business format franchises in Australia. This makes Australia one of the most highly franchised nations in the world. Franchising is a quintessential example of a ‘fissured’ work arrangement in that the model ‘allows a many-tentacled organisation to fragment its workforce.’ In this respect, Felstead argues that:

beneath an apparent diversification of business ownership, there lurks within franchising (as within other business relationships) less obvious but more important debates about who controls what, why and how. Indeed, the vertical disintegration of production and the rapid growth of ‘independent’ businesses, such
as franchised ones, may conceal far more than it reveals about who really is in control.\textsuperscript{14}

With the exception of company-owned franchise units, a franchisor and a franchisee are typically independent entities bound together by contractual ties.\textsuperscript{15} Regulatory frameworks often assume that these contracting parties are autonomous economic actors operating at arm’s length. However, franchising is increasingly recognised as being symbiotic and relational and characterised by ‘social subordination and economic dependence’.\textsuperscript{16} In line with this, Riley has previously described a franchisee — particularly those who are purportedly self-employed — as an ‘indentured entrepreneur.’\textsuperscript{17}

Indeed, there are a number of striking parallels between employment and franchising relationships — the most obvious is the entrenched power asymmetry which characterises both types of contractual relationships. The structural inequality between franchisors and franchisees is embedded and reinforced by the franchise agreement — which is the primary regulatory mechanism governing the franchise relationship.\textsuperscript{18} In the name of protecting the brand and ensuring uniformity, the franchise agreement prescribes a full system for business operation, but also places many commercial risks and contractual burdens on the franchisee. At the same time, control is largely retained by the franchisor, and very few commitments are made — particularly when it comes to employment-related matters. Rather, the franchisor’s role is often highly discretionary and many terms of the agreement are deliberately geared towards ensuring consistency, and protecting and preserving the franchisor’s commercial interests and valuable goodwill.\textsuperscript{19}

The tensions and paradoxes that define the franchising relationship have a number of critical consequences for the regulation and, in particular, enforcement of minimum employment standards. For instance, franchises are founded on the transfer of risk from franchisors to franchisees. This includes not only capital and commercial risks associated with growing the network and establishing new stores, but compliance-related risks.\textsuperscript{20} Traditional legal frameworks tend to ascribe liability for employment-related contraventions to the direct employer. By shedding direct employment and shifting employer responsibilities to a pool of subordinate entities, the franchisor is effectively able to use a contractual device to distance itself from those who perform work within the franchise. This allows the franchisor to escape many employment-related responsibilities, while still maintaining a tight grip on the activities of franchisees and those working under the franchisor’s banner.

In line with this, the recent Parliamentary Inquiry into the Franchising Code of Conduct observed that:

Whilst many franchisors cited [franchisee] greed as the primary motivation for wage theft, the committee notes that the issue is far more complex and partly inherent to the business models’ structural breakdown of power and the imposition of cost controls.\textsuperscript{21}

Outlets may be owned and operated by an independent franchisee entity, or they may be owned and operated by the franchisor directly (with an employee manager). Regardless of the relevant ownership structure, the outlets are intended to appear identical and the relevant ‘legal subtleties are imperceptible


\textsuperscript{17} Riley, ‘A Blurred Boundary between Entrepreneurship and Servitude’, above n 13, at p 104.


\textsuperscript{19} Riley, ‘A Blurred Boundary between Entrepreneurship and Servitude’, above n 13.

\textsuperscript{20} A Kellner et al, “‘We are Very Focused on the Muffins’: Regulation of and Compliance with Industrial Relations in Franchises’ (2016) 58 \textit{JIR} 25 at 28.

\textsuperscript{21} Fairness in Franchising, above n 6, xiv.
to customers and the public generally.’ However, research carried out in the US context has found that these ownership structures are critical to understanding the full compliance picture. In particular, Ji and Weil have found that franchisors and franchisees have different motivations when it comes to compliance with employment standards regulation. They observe:

Franchising raises distinctive agency problems. Franchisees typically obtain their franchise by paying an up-front fee and then paying royalties to franchisors based on their revenues as opposed to profits. As a result, franchisors benefit financially from increased sales at establishments owned by franchisees as well as from the subset of restaurants they directly own and manage. Franchisees, however, seek to maximise profits of only those establishments they directly own. The resulting crosswinds create differences in the two entities’ incentives in regard to pricing, promotion, and cost control.

A number of industrial relations and management scholars have similarly noted that while ownership of the franchised unit may encourage franchisees to expend more effort than employed managers, franchisees are also more likely than franchisors to engage in opportunistic behaviours to increase profit or reduce costs. These behaviours — which all have the potential to seriously tarnish the brand — include overcharging customers, offering compromised products or services or underpaying employees. The franchisee is often insulated from the full consequences of their non-compliance because brand damage is spread across all unit operators. Moreover, court-orders can be effectively avoided through insolvency or deregistration of the employing entity. Indeed, from a regulatory perspective, positioning the franchisee as the primary wrongdoer is problematic. The experience of the labour inspectorate is illuminating in this respect. In a recent speech, Natalie James, the former head of the FWO, recounted that in the franchising sector:

We found franchisees with minimal business experience, an insufficient understanding of the law and a sense that, in their business network, indifference to those laws or even fraudulent actions to circumvent them was seen as ‘the way’ in which to succeed. The systems and culture in which they were operating failed to reinforce that compliance with work laws was an essential ingredient on the menu of expectations of the franchisor.

In addition to the contractual settings of the franchise network, the dynamics of the relevant labour market are another important factor influencing compliance attitudes and responses. Indeed, while the franchising model has been rolled out in a diverse range of sectors, the industry in which the franchise system is operating will affect not only the industrial instruments that apply, but the compliance issues that are most pronounced. For instance, franchise systems which revolve around the delivery of home services (such as cleaning by self-employed franchisees) are likely to raise issues distinct from the fast food sector (where franchisees are commonly employers of others). Notwithstanding these obvious differences, both sectors are arguably ripe for exploitation given that the work is often labour intensive and low-skilled, margins are generally thin and many temporary migrant workers and migrant franchisees are likely to be present. For example, the FWO’s recent compliance monitoring activity into the Caltex service network revealed that six in every 10 employees were on a visa (which is 10 times

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26 N James, ‘Reasonable Steps: The Regulator’s Perspective’, speech delivered at the Franchise Advisory Centre, Brisbane, 13 June 2018, at 1.
27 Ibid.
28 The latest data suggests that the largest proportion of franchises are in the retail (non-food) sector (approximately 26%), followed by accommodation and food services (approximately 19%). Franchising Australia Survey, above n 10, at 7.
the proportion of visa holders working in the labour market). In addition, over one quarter of the workers was under the age of 24 years.\textsuperscript{20}

But it is not just the proportion of vulnerable workers in franchising which is causing regulatory concern: it is the characteristics of the franchisee businesses themselves. The FWO has noted that there is an unusually high number of migrants running franchised units in certain sectors. Indeed, in a 2016 survey of franchisors, over half the sample (52%) of respondents indicated that more than 30% of their incumbent franchisees were new Australians (with 18% of franchisors confirming that they actively recruit migrants as franchisees in their brands).\textsuperscript{30} The background of the franchisee arguably makes the business owner vulnerable vis-à-vis the franchisor, but it may also serve to further compound the vulnerability of workers within that franchise unit. Again, the Caltex example is telling. Here, the workplace regulator found that nearly three quarters of franchisees subjected to an audit were from a non-English Speaking background. In this respect, James pointedly noted that the 'non-compliance rate of 76% roughly matched the proportion of migrant businesses in our sample.'\textsuperscript{31}

Notwithstanding this concerning data, as well as the wave of underpayment scandals which have been plaguing the sector, a recent survey suggested that the vast bulk of franchisors continued to be either ‘very confident’ (37%) or reasonably confident (55%) that their ‘franchisees are fully compliant with workplace laws and their obligations as an individual business.’\textsuperscript{32} It is not clear where this confidence stems from, particularly when less than one third of franchisors conducted internal checks or audits of their franchisees in relation to workplace relations compliance.\textsuperscript{33} It is also uncertain as to whether franchisor confidence levels varied over different sectors. Nonetheless, this research suggests that there is a fundamental disconnect between franchisor perceptions of the compliance landscape, and the reality.

\section{The Approach of the Courts to Employment Contraventions in Franchise Networks}

This section surveys some of the most significant cases that have considered employment-related contraventions in a franchising context from the past decade or so. It is clear from these cases, particularly in the early period, that the courts are ‘somewhat uncomfortable in dealing with a marketing system which does not fit snugly within the better known legal relationships upon which the common law has been built.’\textsuperscript{34} Indeed, the courts appear to have struggled to apply established penalty principles to franchise systems. For a start, franchisees exhibit features of both large and small businesses.\textsuperscript{35}

\textsuperscript{29} James, ‘Reasonable Steps: The Regulator’s Perspective’, above n 26, at 5. See also Fair Work Ombudsman, \textit{Caltex Compliance Activity Report}, March 2018. This report was later used by the FWO in support of their submissions on penalty and the need for general deterrence in the case of \textit{FWO v Abdul Wahid & Sons Pty Ltd [2019] FCCA 297}, at [58].

\textsuperscript{30} Franchising Australia Survey, above n 10, at 46.

\textsuperscript{31} James, ‘Reasonable Steps: The Regulator’s Perspective’, above n 26, at 4. The Migrant Workers’ Taskforce Report separately observed that a number of FWO-initiated litigation matters share a ‘common characteristic’, that is, employers from a particular culturally and linguistically diverse background or country of origin exploit temporary visa holders of the same ethnicity/source country. Migrant Workers’ Taskforce Report, above n 1, p. 34.

\textsuperscript{32} Franchising Australia Survey, above n 10, at 30.

\textsuperscript{33} Franchising Australia Survey, above n 10, at 28–9. Further, 70% of franchisor respondents provided information in their operations, 57% conducted training and provided updates and around 40% gave advice on relevant pay rates, as well as other HR/IR matters: Franchising Australia Survey, above n 10, at 28–9.

\textsuperscript{34} W Pengilley, ‘What is a Franchising Agreement?’ in Elizabeth Spencer (Ed), \textit{Relational Rights and Responsibilities: Perspectives on Contractual Arrangements in Franchising}, Bond University Press, 2011, p 1 at p 5.

\textsuperscript{35} See, eg, \textit{Fair Work Ombudsman v WY Pty Ltd [2016] FCCA 3432} (8 December 2016), where the court noted at [40]: ‘Whilst this may not be a particularly large business, it is not a small business either. It was operating three separate commercial outlets at the time. It did have … the assistance of the franchisor to assist in these matters’. See also \textit{Fair Work Ombudsman v Hiyi Pty Ltd [2016] FCCA 1634} (21 April 2016) (Hiyi) at [56].
Further, the franchising model creates complicated and paradoxical management systems characterised by a confounding mix of control, autonomy, standardisation and adaptation.\textsuperscript{36} This makes it more difficult to disentangle the respective roles of the franchisor and the franchisee and more challenging to assess the culpability (or otherwise) of the franchisee in assessing the appropriate penalty.\textsuperscript{37} Moreover, it is broadly recognised that it is difficult to displace accepted attribution principles, which are premised on established contract doctrine and accepted corporate fictions.\textsuperscript{38}

Historically, in cases involving employment-related contraventions occurring in franchises, courts have generally confirmed the validity of the franchise arrangements and commonly accepted the terms of the franchise contract, including boilerplate clauses that state that the franchising relationship is essentially one of independent contractors.\textsuperscript{39} With the exception of company-owned franchisees,\textsuperscript{40} there have been no cases where the courts have been willing to pierce the corporate veil in order to find that the franchisor is the relevant employer of the affected employees – either on a sole or joint basis.\textsuperscript{41} It should be noted, however, that there appear to be no cases that have been initiated by purportedly self-employed franchisees — where there may be a stronger argument that the franchisor (and not the principal contractor) is the putative employer.

The vast bulk of the cases relating to underpayments occurring in franchise systems have been brought against franchisee entities that have employed others. The engagement of employees by the franchisee, combined with incorporation of the employer, inevitably weakens the argument that the franchisee is themselves employed under a contract of service at common law.\textsuperscript{42} Further, in almost all of the cases that have been determined thus far,\textsuperscript{43} the relevant franchisor was either not named as a party to these proceedings, or the court has concluded that there was insufficient evidence to draw any inference about the part played by the franchisor.\textsuperscript{44} Therefore, judicial consideration of the franchisor’s role has often been quite limited.

However, on a number of occasions, judges have been willing to explore some of the more complex issues raised by employment-related contraventions in franchising networks; albeit there have been mixed views on whether the advice, assistance or involvement of the franchisor should be taken into account in determining the appropriate penalty, if not the substantive liability, of the franchisee. This issue is especially thorny in cases where it appears that the franchisor’s conduct may be directly linked to the relevant contraventions.

For example, in \textit{Fair Work Ombudsman v Chamdale Pte Ltd},\textsuperscript{45} a Hungry Jack’s franchisee relied on incorrect information provided by the franchisor with respect to the applicable classifications and pay rates under the relevant industrial instrument. As a result of this misinformation, the franchisee was found to have underpaid employees a total of more than $100,000 over a four year period. While the franchisor’s failure appears to have mitigated against the imposition of a larger penalty upon the franchisee, the court did not find that this wholly excused the contraventions.\textsuperscript{46} Rather, the judge

\textsuperscript{36} Kellner et al, ‘Regulation of and Compliance with Industrial Relations in Franchises’, above n 20, at 26–27.
\textsuperscript{37} \textit{Fair Work Ombudsman v Primeage Pty Ltd} [2015] FCCA 139 (17 October 2014).
\textsuperscript{39} Terry and Huan, above n 22, at 390.
\textsuperscript{43} But see \textit{Fair Work Ombudsman v Yogurberry World Square} [2016] FCA 1290 (2 November 2016) (Yogurberry) discussed below.
\textsuperscript{45} [2011] FMCA 1021 (16 November 2011).
\textsuperscript{46} Ibid, at [36].
concluded that ultimately it was the franchisee, ‘as an employer’, which ‘was required to meet its lawful obligations’.47

A similar argument was run in recent cases involving the Han’s Café franchise — a WA-based chain.48 In both cases, albeit to varying degrees, the franchisee respondent sought to explain that the contraventions arose partly because the relevant managers were ‘unfamiliar with Australian culture and employment laws’,49 and partly because these managers relied on the franchisor in relation to payroll matters, including confirmation of the relevant pay rate.50 Indeed, in a separate enforcement proceeding, the franchisor — who ran a number of company-owned outlets under the Han’s Café banner — was itself penalised for underpayment of its own staff.51 But, in both matters involving the franchisee respondents, Siopis J held that the franchisee director/manager knew that the pay rates were not correct, mainly due to previous interactions with the FWO.52 The contribution of the franchisor to the contraventions was therefore disregarded and the underpayment of employees by the franchisees was either deemed ‘deliberate’ or ‘conduct in reckless disregard of the workplace laws’.53

The fact that the franchisor played a direct hand in the relevant contraventions was given even less weight in *Fair Work Ombudsman v Contracting Solutions Australia Pty Ltd*.54 In this case, a ‘Wetzel’s Pretzel’ franchisee approached the master franchisor after Sunday trading hours were introduced in South Australia in 2003. The franchisee was concerned that the new Sunday penalty rates would adversely affect the profitability of his business. The master franchisor advised the franchisee that hiring teenage retail assistants as independent contractors — via an Odco-style arrangement involving a third party labour hire agency — would be ‘beneficial’.55 for the franchisee’s bottom line. While this advice was clearly reckless, and possibly unlawful, the franchisor was not held accountable in any way and its advice did not appear to affect the penalty amount that was ultimately imposed.

Although the courts appear to be quite reluctant to pin blame on the franchisor, many of the named respondents in enforcement proceedings have sought to justify their unlawful behaviour by referring to the actions taken by head office. For example, in the recent decision of *Fair Work Ombudsman v Skyter Trade Pty Ltd*,56 a Pizza Hut franchisee (Skyter Trade Pty Ltd), and its sole director and shareholder (Dong Zhao), were found to have contravened the sham contracting provisions of the Fair Work Act 2009 (Cth) (FW Act) by misclassifying a delivery driver as an independent contractor. Mr Zhao submitted that on the basis of a Profit & Loss Projection provided by the franchisor, he had borrowed a significant amount to invest in the franchise. These loan repayments remained a ‘major financial burden’,57 particularly as the business has suffered a loss each year since its original purchase. According to the second respondent, the profitability of the business had further declined due to the franchisor’s decision to force all of its outlets into a ‘price war’ by selling cheap pizzas below food cost, as well as increased competition coming from a new Domino’s pizza franchise in the region.58 In a separate submission, the FWO argued that sham contracting and other types of underpayment contraventions were relatively common in this particular franchise network, and the penalties should

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47 Ibid, at [31]. A similar submission was made (and rejected) in the case of *Fair Work Ombudsman v Stacborn Pty Ltd* [2012] FMCA 899 (28 September 2012) at [44].
48 *Fair Work Ombudsman v Phua & Foo Pty Ltd* [2018] FCA 137 (22 February 2018) (Phua & Foo); *Fair Work Ombudsman v Tac Pham Pty Ltd* [2018] FCA 120 (20 February 2018) (Tac Pham).
49 Phua & Foo, above n 48, at [25]; Tac Pham, above n 48, at [96].
50 Phua & Foo, above n 48 at [25], [54]; Tac Pham, above n 48, at [18].
51 *Fair Work Ombudsman v Han Investments Pty Ltd* [2017] FCA 623 (31 May 2017).
52 See, eg, Phua & Foo, above n 48 at [62]; Tac Pham, above n 48, at [41]–[44].
53 Phua & Foo, above n 48 at [54]; Tac Pham, above n 48, at [99].
55 Ibid, at [35].
56 [2018] FCCA 1483 (8 June 2018) (*Skyter Trade*).
57 Ibid, at [63].
58 Ibid, at [64]. See also *Virk Pty Ltd (in liq) v YUM! Restaurants Australia Pty Ltd* [2017] FCAFC 190 (28 November 2017).
reflect the need for general deterrence in the ‘Pizza Hut franchise industry’. Jarrett J declined to make any direct comment on these submissions. However, his Honour did find that, in light of the training and information provided by the franchisor as part of the induction process, including explicit advice from the franchisor that franchisees should avoid engaging contractors, the franchisee’s conduct was ‘deliberate’.

A number of the same themes emerged in the string of cases relating to the 7-Eleven network. In many (but not all) of the cases, the court found that the franchisee, and their respective owners, had devised and implemented an elaborate record-keeping methodology which was principally designed to disguise the fact that their employees were not being paid in accordance with the relevant modern award. By deliberately manipulating the data that was entered onto the payroll system administered by the franchisor, 7-Eleven Stores Pty Ltd (7-Eleven Stores), the underpayments were effectively obscured from head office, as well as the regulator.

Notwithstanding the public furore over the ‘serious and systematic contraventions of the most basic of the employees’ workplace rights’, none of the proceedings initiated by the FWO, or others, named the franchisor as a direct party. However, in at least some of the cases, franchisees sought to run the argument that the franchisor’s conduct prompted or perpetuated the contraventions. For example, in *Fair Work Ombudsman v Amritsaria Four Pty Ltd (Amritsaria)*, the franchisee respondents emphasised that, under the standard form 7-Eleven franchise agreement, they were required to operate the business 24 hours per day, seven days a week and obliged ‘to pay 57% of gross profit to the franchisor and that wages and other overheads are deducted after that payment.’ While the respondents ‘did not suggest that those matters justified or excused the contraventions’, they sought to argue that such matters were relevant in considering the deliberateness (or otherwise) of the contraventions.

However, other franchisees have not been so circumspect on this front. For example, in *Hiyi*, the franchisee, and the other named directors, made extensive submissions to the effect that the 7-Eleven franchising model, under which they were previously required to run the business, was ‘extremely detrimental to them’ and ‘made it very difficult … to pay [the] employees the appropriate minimum wage entitlements.’ In *Hiyi*, the court was prepared to accept that the previous franchising model of the 7-Eleven head office (including the original profit-sharing arrangements) ‘placed significant restrictions on the on the capacity of the respondents to generate an income from the operation of the

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59 *Skyter Trade*, above n 56, at [57]. See also *Fair Work Ombudsman, Pizza Hut Franchisee Delivery Drivers — Compliance Activity Findings* (January 2017).
60 *Skyter Trade*, above n 56, at [54].
61 According to latest reports, since 2009, the FWO has commenced 11 civil remedy proceedings against 7-Eleven franchisees. In eight of these matters, total penalties have been in excess of $100,000. See Migrant Workers’ Taskforce Report, above n 1, p. 44.
62 See, eg, *Fair Work Ombudsman v JS Top Pty Ltd* [2017] FCCA 1689 (21 July 2017) (*JS Top*) at [40]. See also *Fair Work Ombudsman v Amritsaria Four Pty Ltd* [2016] FCCA 968 (29 April 2016) (*Amritsaria*); *Fair Work Ombudsman v Mai Pty Ltd* [2016] FCCA 1481 (17 June 2016) (*Mai*); *Hiyi*, above n 35. But see *Fair Work Ombudsman v Viplus Pty Ltd* [2018] FCCA 741 (29 March 2018) (*Viplus*), where it was found that ‘the respondents did not seek to cover up their underpayments and other non-compliance, nor did they falsify any records’: at [75].
63 *JS Top*, above n 62, at [41]; *Mai*, above n 62, at [8].
64 See, eg, *Viplus*, above n 62; *Mai*, above n 62. Cf *Fair Work Ombudsman v S & A Enterprises (Qld) Pty Ltd* [2017] FCCA 3332 (11 December 2017); *JS Top*, above n 62. In this latter case, there was no submission that the franchisee’s ‘failure to pay appropriate wages was driven by poor cash flow or an inability to meet the expenses of the business’: at [50].
65 *Amritsaria*, above n 62.
66 Ibid, at [65].
67 Ibid, at [66].
68 *Hiyi*, above n 35.
69 Ibid, at [37].
70 Ibid, at [24].
Nevertheless, the court found that the terms of the franchising agreement did not exempt the respondents from their obligation to ensure that their employees were paid in accordance with the minimum entitlements prescribed by the FW Act and the modern award. According to Jones J, the respondents entered into the franchise agreement voluntarily and they should have done sufficient due diligence on the profitability (or otherwise) of the business before purchasing the franchise. Ultimately, the court concluded that, at most, the terms of the previous franchise agreement bears on a consideration of the appropriate level of penalty, albeit the judge was at pains to emphasise that significant weight would not be placed on this factor.

Overall, the review of proceedings involving the 7-Eleven network has revealed a broad judicial consensus that the franchisor was not at fault. Many of the judges accepted that the franchisor had sought to prevent the contraventions by providing franchisees with initial and ongoing training and information regarding employment matters, including wage rates and record-keeping requirements. In at least one matter, the franchisor was even commended for its compliance efforts, notwithstanding the fact that such steps were taken either in response to the public outcry or under the auspices of a proactive compliance deed with the FWO. In particular, Jarrett J in *Fair Work Ombudsman v JS Top Pty Ltd* referred to a new record-keeping system that had been implemented by 7-Eleven head office in 2016, which required employees to sign in and sign off their shifts using a fingerprint scanner. The judge reflected on these changes, amongst others, and commented: ‘That the franchisor has moved to ensure the wage security of the franchisee’s employees is praiseworthy. That it has had to do so is immeasurably depressing.’

Indeed, in light of the workplace relations support provided by 7-Eleven head office, the courts tended to lay the blame for the unlawful conduct squarely at the feet of the franchisee. For example, in one of the first cases involving 7-Eleven, *Fair Work Ombudsman v Bosen Pty Ltd*, the court observed that:

> This was a deliberate and calculated campaign to pay the Employees less than what they were legally entitled to and to obtain free labour and therefore a competitive advantage in the marketplace. They were not breaches brought about by naïve ignorance. The Defendants’ ignored training and regular updates and must have been wilfully blind to the well-known legal obligations of every small business operator.

This position was more forcefully put by Jarrett J in *Fair Work Ombudsman v Mai Pty Ltd*, where his Honour reflected on the franchisee’s ‘contemptuous disregard of workplace laws,’ the high number of vulnerable workers in the retail sector and the evidence suggesting that deceptive record-keeping practices were widespread and systematic in the 7-Eleven franchise system. Together, the court found that this supported ‘an inference that there is a significant risk of non-compliance in the network’ and that there was ‘significant need for general deterrence in these proceedings’. His Honour went on to observe:

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71 Ibid, at [38].  
72 Ibid, at [39].  
73 Ibid.  
74 *JS Top*, above n 62, at [42]; *Viplus*, above n 62, at [53]; *Mai*, above n 62, at [105]–[106].  
75 Proactive Compliance Deed between the Commonwealth of Australia (as represented by the Office of the Fair Work Ombudsman) and 7-Eleven Stores Pty Ltd (6 December 2016).  
76 *JS Top*, above n 62, at [46].  
77 Ibid.  
79 Ibid, at [39].  
80 *Mai*, above n 62.  
81 Ibid, at [8].  
82 Ibid, at [139]. See also *Fair Work Ombudsman v Xia Jing Qi Pty Ltd & Anor* [2019] FCCA 83.  
83 Ibid, at [139].  
84 Ibid, at [142]. See also *Hiyi*, above n 35, at [74].
It is appropriate that I pay regard to the message sent to employers and the community generally by the imposition of an appropriate penalty, to make it clear that employers must comply with minimum standards. The imposition of a penalty in this matter will assist in ensuring other employers in the retail sector, and particularly within 7-Eleven, are compliant with their obligations.\textsuperscript{85}

However, in one of the most recent cases in the franchising context, the judge departed from the general tendency to focus only on the wrongdoing of the franchisee. In \textit{Fair Work Ombudsman v G & Z United Pty Ltd},\textsuperscript{86} Baird J noted the need for general deterrence in relation to employers that engage award-reliant workers. But her Honour then went on to observe that a ‘message…should also bite on unsupportive franchisors, and their satellite organisations, and those entities that benefit from opportunistically terminating franchises.’\textsuperscript{87} The judge’s comments in this regard are noteworthy in two important respects. First, it explicitly recognises that franchisors have a critical role to play in promoting and ensuring compliance in their networks and failure to do so should be subject to penalty and formal admonishment. These comments are also remarkable in that they implicitly recognise that franchisors are often in a privileged position where they may seek to exploit or profit from power imbalance inherent within the franchising relationship and this can have dire consequences for franchisees (and those that they may have employed).

While these observations are rare in a judicial context, they reflect many of the findings of the recent Franchising Inquiry.\textsuperscript{88} They also echo the conclusions of the FWO’s inquiry into the 7-Eleven network. In the final report, the FWO found that the Australian franchisor was in a position to prevent workplace contraventions amongst its franchisees given that it ‘controlled the settings of the system in which franchisee employers operated’.\textsuperscript{89} The regulator also found that while 7-Eleven Stores ostensibly promoted franchisee compliance with workplace standards, it ‘did not adequately detect or address deliberate non-compliance and as a consequence compounded it’.\textsuperscript{90} More generally, James, the former head of the FWO, has underlined the limitations of deploying an employer-orientated enforcement strategy in the franchising context:

\begin{quote}
Taking up complaints with individual outlets, often finding insufficient funds to pay the workers and sometimes, franchisees themselves under significant financial pressure was not addressing the root cause of the problem. The underlying problem invariably extended beyond individual outlets.\textsuperscript{91}
\end{quote}

Notwithstanding the FWO’s damning findings in the 7-Eleven inquiry, and the FWO’s clear desire to target those beyond the direct employer entity, the FWO ultimately concluded that it did not have sufficient probative evidence to pursue 7-Eleven Stores under the accessorial liability provisions of the FW Act. More specifically, it was unable to prove that 7-Eleven Stores had actual knowledge of the essential elements of the contravention.\textsuperscript{92} Ultimately, it was the findings of the FWO’s inquiry, combined with continuing community outrage about the lack of franchisor accountability, which prompted the Coalition Government to introduce the PVW Act in early 2017.\textsuperscript{93}

Before discussing the details of these statutory reforms, it is worth mentioning one exceptional case involving underpayments in the franchise sector, namely the 2016 Federal Court decision in \textit{Fair Work}...
Ombudsman v Yogurberry World Square. This was the first, and so far, only case where the FWO has successfully sought pecuniary penalties against a franchisor under the accessorial liability provisions of the FW Act. The Franchise Council of Australia — who was staunch in its opposition to the PVW Act — sought to rely on the Yogurberry decision to argue that any extension of franchisor liability was unnecessary. In its view, the Yogurberry decision demonstrated that the existing provisions in s 550 were ‘adequate’ and no further change was required.

The fatal problem with this argument is that the circumstances of the Yogurberry case are unique and do not reflect the typical business format franchise arrangement. In this instance, the franchisee entity which operated the relevant store, and employed the Korean backpackers, and the head franchisor were part of a complex group of companies controlled by various members of the same family. This corporate nexus, overlaid with close family connections, is not generally present in the majority of franchise networks. In these circumstances, the franchisor did not contest its liability under s 550. The decision is not only confined to its facts, it is ultimately of limited assistance in understanding the scope of s 550 and its application to franchise networks.

IV A New Era in Franchising Regulation? The Protecting Vulnerable Workers Reforms

As the title of the legislation suggests, the PVW Act is consciously designed to curb ‘deliberate and systematic exploitation of workers’ in Australia. However, the scope and framing of these statutory amendments reveal that it is somewhat of a kneejerk reaction to the most glaring regulatory gaps exposed in the 7-Eleven case, including the difficulties of bringing franchisors to account. Nonetheless, the PVW Act has amended the existing statutory framework in a variety of positive ways, including the introduction of higher maximum penalties for ‘serious contraventions’ of prescribed workplace laws and shifting the onus of proof to employers where there has been a failure to keep or maintain employment records or issue payslips. While all of the reforms are relevant to enhancing the enforcement of employment standards regulation in franchises, this article will focus on arguably the most contentious aspect of the PVW Act, namely those provisions which hold franchisors liable for critical misdeeds of their franchisees.

Broadly-speaking, the new s 558B proposes to make a ‘responsible franchisor entity’ liable for prescribed contraventions committed by its franchisees where:

a) the responsible franchisor entity knew, or could reasonably be expected to have known, that contraventions would occur;

b) the responsible franchisor entity has failed to take ‘reasonable steps’ to prevent a contravention of the same or similar character by the franchisee.

94 Yogurberry, above n 43. There has been at least one other case where the director of the franchisor was found to be ‘involved in’ contraventions of one of its franchisees and held liable as an ‘accessory’ under s 550 of the FW Act: see United Voice v MDBR123 Pty Ltd [2014] FCA 1344 (11 November 2014); United Voice v MDBR123 Pty Ltd (No 2) [2015] FCA 76 (4 February 2015).

95 Franchise Council of Australia, Submission in Relation to the Possible Amendment of the Fair Work Act to Extend Liability to Franchisors and Parent Companies in Certain Situations, 2016 at 2. See also L Frazer and M Roussety, ‘Franchises Shouldn’t Share Responsibilities for Stuff Ups’, The Conversation, 16 December 2016.

96 Yogurberry, above n 43, at [2].


98 Explanatory Memorandum, Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017 (Cth) at ii.


100 FW Act, s 558B(7).
In order to understand the scope and operation of this provision, it is necessary to delve into three essential elements, namely: How is ‘responsible franchisor entity’ defined? What level of knowledge is required to be proved on the part of the franchisor? In what circumstances may the statutory defence be invoked, and what constitutes ‘reasonable steps’ in this context?

How is ‘responsible franchisor entity’ defined?

Unlike the accessorial liability provisions, which apply to all ‘persons’ who are found to be ‘involved in’ the relevant contraventions, the scope and application of proposed s 558A pivots on the definition of ‘responsible franchisor entity’ and ‘franchisee entity’. While the Explanatory Memorandum suggests that the definition of ‘responsible franchisor entity’ is generally consistent with the approach taken under the Franchising Code of Conduct, this is not strictly the case. On the one hand, the differences between these various statutory regimes have created an unhelpful level of uncertainty about which franchisors and franchisees are likely to fall within the scope of these provisions. On the other hand, the definition of franchise in the PVW Act is potentially broader than the equivalent provisions in other schemes. For example, to meet the definition of ‘responsible franchisor entity’, a key threshold requirement is to show that the franchisee is conducting a business which is substantially or materially associated with the intellectual property (the trademarks, advertising and commercial symbols) that are owned, used, licensed or specified by the franchisor. This definition does not require the franchisee to prove that they have paid an ongoing fee for operating the franchise (which can exclude commission agency arrangements). It also draws no distinction between ordinary business format franchises and fuel retail franchises (which is not the case in the competition and consumer sphere). This expansive definition is helpful given that many of the franchise networks caught by the latest round of underpayment scandals are fuel retail franchises and/or have been known to use commission agency arrangements.

However, one critical limit placed on the scope and application of these provisions is that in order for a person to be characterised as a ‘responsible franchisor entity’, it must be proved that the person ‘has a significant degree of influence or control over the franchisee entity’s affairs’. This was designed to try to allow the court to take into account the diversity of franchise arrangements and make it clear that the extended responsibilities were only intended to apply to franchisors that had a high level of involvement in the franchisee’s business. This is important given the range of franchising models currently in operation and the vast spectrum of sectors in which franchising has taken hold. Indeed, it appears to be a direct response to the regulatory challenge presented by the franchising model, namely: ‘A significant problem in one industry may be of little concern in another. Yet the law must seek to govern both in an overarching manner.’

Notably, the term ‘affairs’ is not defined in the statute itself, but the Explanatory Memorandum makes clear that it is intended to be read broadly, and is not limited to particular aspects of a franchisee’s operations. Rather, it is intended to include involvement in the franchisee’s financial, operational and corporate affairs. Business groups lobbied hard to narrow this definition so that it only applied to

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101 Explanatory Memorandum, above n 102, at [50]. The Franchising Code of Conduct is set out in sch 1 of the Competition and Consumer (Industry Codes — Franchising) Regulation 2014 (Cth) (Franchising Code). The definition of ‘responsible franchisor entity’ is also quite different from the way in which franchise has been defined under s 9 of the Corporations Act 2001 (Cth).
103 The fuel retail chain, United Petroleum, is a prime example. See Fair Work Ombudsman, United Petroleum Retail Fuel Outlets — Compliance Activity Outcomes, April 2017.
104 FW Act, s 558A(2)(b).
105 Pengilley, above n 34, p 5.
106 Explanatory Memorandum, above n 98, at [53].
franchisors that had control over ‘workplace relations matters’ relating to the franchisee. But ultimately the original definition survived. This was critical given that the wide definition of control is essential in addressing some of the legal and economic tensions which lie at the heart of franchising relationships.\textsuperscript{107} Indeed, while franchisors frequently claim that they have no influence over the wages that franchisees pay to workers, others have argued that franchisors effectively control wages ‘by controlling every other variable in the business except wages’.\textsuperscript{108}

While the provisions explicitly capture ‘subfranchisors’ and ‘officers’ within the franchisor entity, the provisions are currently premised on the assumption that the franchising relationship is generally binary. However, the recent scandals afflicting Retail Food Group — the lead firm responsible for a range of distinct brands — illustrates the limitations of this approach. Moreover, there is an argument that inserting a control element into the key definition is unhelpful and unnecessary given that it raises some of the same problems as the knowledge requirement of s 550. In particular, it can encourage ‘counterproductive liability avoidance’.\textsuperscript{109} This is where firms seek to rework their contractual relationships to avoid being held liable for employment contraventions. This may involve reducing (rather than expanding) the extent to which a franchisor monitors and directs their franchisees’ compliance practices and may lead to ‘a diversion of effort towards avoidance, rather than compliance’.\textsuperscript{110}

**What Knowledge is Required?**

Section 558B(1) represents an important extension of the current laws, and addresses some of the shortcomings of the accessorial liability provisions. In particular, as noted above, s 550 of the FW Act is problematic because of the need to prove that the person had *actual knowledge* of the essential elements of the contravention. In comparison, s 558B(1) allows the court to take into account not only what the responsible franchisor entity (or one of its officers) ‘knew’ about the contravention of the franchisee entity, but what it (or the officer) ‘could reasonably be expected to have known’. In short, the provisions capture not just actual knowledge, but constructive knowledge. The Explanatory Memorandum makes clear that knowledge will be assessed on an objective basis taking into consideration relevant circumstances, including the responsible franchisor entity’s knowledge, experience and acumen. Moreover, it is no longer the case that the applicant must prove the requisite degree of knowledge in relation to the precise contravention which the franchisee committed, but rather ‘the same or similar contravention’. This is another useful expansion on the previous liability regime.

By expanding the knowledge requirement in this way, s 558B(1) potentially overcomes one of the most challenging aspects of the accessorial liability provisions as they presently apply to fragmented work arrangements, such as franchise networks.\textsuperscript{111} In particular, the new provisions effectively lower the evidentiary threshold. This may seem like a small point, but it may make an enormous difference in practice. By way of example, the Explanatory Memorandum notes:

> A responsible franchisor entity may be aware of a series of complaints about alleged underpayments, or may be aware of a system of non-compliance that is likely to result in the franchisee entity’s employees

\textsuperscript{111} T Hardy, ‘Who Should Be Held Liable for Workplace Contraventions and on What Basis?’ (2016) 29 *AJLL* 78 at 105.
being underpaid or otherwise deprived of their entitlements … There is no need to prove the responsible franchisor entity knew exactly who was being underpaid, and on what basis.  

What constitutes reasonable steps?

The twist in the tail is the statutory defence. In particular, s 558B(3) provides that, even if the entity is deemed to fall within the scope of these provisions and is found to have the requisite knowledge, the franchisor may avoid liability if it can show that, at the time the contravention took place, the franchisor ‘had taken reasonable steps to prevent a contravention by the franchisee entity … of the same or similar character.’

In determining whether a person took such ‘reasonable steps’, the court is directed to have regard to a range of relevant matters, including:

a) the size and resources of the franchise;

b) the extent to which the person had the ability to influence or control the franchisee’s conduct;

c) any action the person took towards ensuring that the contravening employer had a reasonable knowledge and understanding of the relevant workplace laws and obligations;

d) any arrangements the person had in place for assessing the employer’s ensuing compliance with the applicable workplace obligations;

e) any arrangements the person had put in place for receiving and addressing possible complaints about alleged underpayments or other alleged contraventions of this Act within the franchise;

f) the extent to which the person’s arrangements with the contravening employer encourage or require the employer to comply with their workplace obligations.

The last factor in the above list — the extent to which the person’s arrangements encourage or require the franchisee to comply — is perhaps the most powerful. It is so broadly worded it may allow the court to consider the way in which the franchise business model, their operating procedures and policies may perpetuate (or prevent) franchisee non-compliance with workplace laws. However, it is not yet clear whether they will be inclined to take such an approach, especially in light of the general reluctance to excuse the contravening behaviour of the franchisee on this basis.

Imposing reasonable standards of diligence can be more administratively burdensome and less certain than strict liability regimes; however, the great advantage is that courts are provided with sufficient flexibility to adjust the liability standard so as to reflect the diversity of franchising arrangements. As James noted in a recent speech: ‘The term ‘reasonable’ by its very nature requires that the particular business and its circumstances determine the expectations and the sorts of actions required.’

Another point of difference between these provisions and s 550 is that the franchisor bears the evidentiary onus to prove they have taken such steps (if any). This effectively directs the court’s attention towards omissions (a failure to act) as opposed to positive conduct (aiding, abetting etc), which is a central focus under the established accessorial liability provisions. While this statutory defence is novel (at least in this context), some weaknesses remain.

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112 Explanatory Memorandum, above n 98, at [59].
113 FW Act s 558B(3) (emphasis added).
114 Use of the term ‘franchise’ in this context is somewhat confusing — it could conceivably mean ‘franchise system’, ‘franchise unit’ or ‘franchisor’. None of these terms are defined in the Act. It appears that the FWO has assumed that the court will take into account the 'size and resources of the franchisor’ — that is, the larger and more resources the network has, the more it is expected to do.’ See James, ‘Reasonable Steps: The Regulator’s Perspective’, above n 26, at 2. However, the term ‘franchise’ is used again in s 558B(4)(e)(i) which suggests that it is being used to refer to the ‘franchise system’ as opposed to the ‘franchisor’.
First, franchisors may view this provision as a ‘tick the box’ exercise and therefore make tokenistic, but not substantive, efforts to ensure compliance. Further, judicial cognitive biases, together with a level of discomfort about extending liability beyond employers, could lead judges to ‘find “cosmetic compliance” measures that are facially consistent with industry practices adequate, even though they are ineffective in preventing underlying violations.’ Second, the fact that control reappears as a relevant consideration means that again the door is open for a franchisor to manipulate the contract so as to mask the level of economic control that they may be exercising over the franchisee. Third, the provision is only invoked where the franchisor has taken ‘reasonable steps’ to prevent a contravention. The current wording means that the defence cannot necessarily be invoked where the franchisor has sought to quickly remedy or rectify a contravention after it has occurred. In practice, however, this is unlikely to cause major concerns. First, in assessing whether the franchisor has taken ‘reasonable steps’, the court is expressly directed to consider any arrangements the person has for addressing possible complaints about alleged underpayments (or other contraventions). Further, if this is the first time that a contravention has come to the attention of the franchisor, then it will be more difficult to meet the knowledge test (even on an objective basis).

Inclusion of an escape valve by way of s 558B(3) was deliberately designed to address the problem of counterproductive liability avoidance, which has potentially affected the efficacy of the accessorial liability provisions. Under this provision, if a franchisor does more to ensure compliance throughout the franchise network, they effectively lower their legal risk and reduce the chances that they will ultimately be found liable for their franchisees’ wrongdoing. However, given that these new liability provisions are intended to supplement (not substitute) the existing accessorial liability provisions, there is a risk that the franchisor may still hesitate to become too involved in overseeing employment-related matters for fear that doing so will mean that it will be easier to prove that the franchisor had actual knowledge of any contraventions that ensue. In short, while a proactive stance may save them from liability under s 558B, this same conduct may expose them to possible liability under s 550 of the FW Act. This further complicates an already difficult strategic choice for franchisors, namely whether to prioritise brand protection or liability minimisation. More importantly, it is not yet clear how the regulator, and the courts, will look to resolve this tension.

VI Conclusion

Since the momentous investigation into 7-Eleven in 2015, it appears that franchisors can no longer ‘take advantage of the ultimate ability to dissociate themselves both legally and morally from misbehaving franchisees.’ Rather, policy-makers and regulators, if not the courts, have their sights firmly fixed on the role and responsibilities of franchisors, regardless of whether they were, in fact, the direct employing entity. This shift is most apparent in recent legislative developments, namely the PVW Act.

The FWO has expressed hope that these new laws ‘will help to change the attitude of some head franchisors about the investment required’ to ensure compliance. Not surprisingly, the Franchise Council of Australia disagrees with this assessment and has previously maintained that holding franchisors accountable for workplace contraventions committed by its franchisees represents

119 Kellner et al, ‘Regulation of and Compliance with Industrial Relations in Franchises’, above n 20, at 41.
120 N James, ‘Fair Work Ombudsman Address to the Franchise Council of Australia NSW Luncheon, speech delivered at the Franchise Council Australia NSW Luncheon, Sydney, 1 September 2016, at 10.
‘regulatory over-reach’, 121 which is both unnecessary and unhelpful. 122 The lobby group has even gone so far to argue that holding franchisors liable for their franchisees’ contraventions threatens the very existence of the franchising model in Australia. 123 In a similar vein, some other commentators have contended that leveraging ethical, moral or reputational concerns of franchisors would be more appropriate in addressing worker exploitation within franchises. 124

But a survey of franchisors undertaken in early 2017 underlines the critical importance of ‘hard’ law — either to supplement or support ‘softer’ initiatives. For example, prior to the passage of the PVW Act, most of the surveyed franchisors only provided information, training and advice to their franchisees. Less than one third conducted internal audits or checks. 125 However, upon introducing these laws into Parliament, the survey further confirmed that almost one quarter of franchisors were putting ‘an action plan in place’, and just over half of the franchisor respondents were ‘investigating what needs to be done’. 126 Many franchisors were contemplating significant changes in their approach to compliance. 127 Less than 5% of all franchisors surveyed in this sample indicated they would not take any of the identified actions. 128

While the new laws have now taken effect, we are still yet to see a case put forward on the basis of these provisions. Only time will tell, and further research will reveal, whether the PVW reforms have failed to go far enough, 129 represent a ‘legislative misadventure’ 130 or have ultimately served to reshape contractual relations, recalibrate risk allocation and rework franchise business models in a way that promotes and ensures compliance with employment standards in franchise networks.

122 Frazer and Roussety, above n 95.
123 In a 2017 survey, 17% of franchisors felt they would need to fundamentally review whether they would continue with a franchise model and 4% said they would cease franchising. However, a majority of franchisor respondents effectively confirmed that they would continue to use a franchising model (notwithstanding the increased costs associated with ensuring compliance in the franchise system). FRANdata, ‘Reaction and Impacts Survey on the Australian Franchise Sector following the Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017’, 6 April 2017 (FRANdata Survey).
125 FRANdata Survey, above n 123; Franchising Australia Survey, above n 10, at 28–9.
126 FRANdata Survey, above n 123.
127 This included the introduction of ongoing compliance programs (56%), the implementation of a formal risk assessment and audit program (41%) and/or establishing a compliance rectification plan (29%): at ibid.
128 Ibid.
Author/s:
Hardy, T

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