

Article Information

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Fair Work Ombudsman commences proceedings against Non-Employer Franchisor for alleged underpayments by franchisee

In 2017, the *Fair Work Act 2009 (Cth)* (FW Act) was amended to provide for a specific cause of action against franchisors and holding companies, where franchisees or subsidiary companies within their networks engage in conduct in breach of the FW Act. Until now, the use of the provisions has been limited to information gathering activities,^[1] but on 7 February 2022, the Fair Work Ombudsman commenced proceedings against a franchisor for alleged underpayments by its franchisees. In this article, Emily Haar, Partner, and Joseph Hyde, Associate, unpack what the litigation means, and how this demonstrates a potential change in approach by the regulator, relevant to all employers.

On 7 February 2022, the Fair Work Ombudsman (**FWO**) filed an application in the Federal Court of Australia against 85 Degrees Coffee Australia (**85 Degrees**).

85 Degrees is a large franchisor based in Taiwan, with franchisees operating cafes across the globe. In Australia, there are 13 cafe locations dotted across metropolitan NSW and one in the ACT.

The case involves the alleged underpayment of nine workers who were directly employed by 85 Degrees' franchisees. The allegations include that the workers were underpaid their minimum rates of pay, overtime, penalty rates, casual loadings, laundry allowance, and annual leave entitlements. Such conduct, if proved, would constitute contraventions of the FW Act.

What is unique about this case is that it is the first time the FWO has utilised sections 558A and 558B to claim that 85 Degrees, an organisation that is not the employer of the relevant employees, and only has an interest as the ultimate franchisor, is "responsible", and that they "knew or could reasonably be expected to have known that the underpayments would occur", or "were likely to occur".

Sections 558A and 558B were introduced into the FW Act by the Turnbull government's *Fair Work Amendment (Protecting Vulnerable Workers) Act 2017 (Cth)* (**Amending Act**), and were largely brought into being as a reaction to the systemic 7-Eleven franchisee underpayments case.

Who is a responsible franchisor?

There has been no judicial consideration of the term "responsible franchisor" at this time. The FW Act defines a responsible franchisor as one which "has a significant degree of influence or control over the franchisee entity's affairs".

The Explanatory Memorandum to the Amending Act says that "[c]ontrol relates to the affairs of the franchisee or subsidiary broadly, not only as to minor matters that would not have any impact on the management and operational decisions of the business", and that for such franchisors, "turning a blind eye to contraventions is not an option under the new provisions".

Further, in a prelude to this current litigation, 85 Degrees and the FWO were in dispute over the validity of a notice to produce issued under section 712 of the FW Act. It was through this notice that the FWO probed whether the franchise model in place could mean that 85 Degrees was responsible for any breaches of the FW Act. The categories of documents

the FWO sought included:

- Details of the company's directorship and business structures, including detailing all persons with responsibility;
- Any franchise agreements that detail the sale of products for retail, licensing arrangements, the use of intellectual property, and royalties, rent and fees payable in respect of retail sales;
- All records of correspondence between the franchisees and 85 Degrees over the period of 1 January 2016 to 9 December 2019 in relation to the negotiation of the franchise agreements;
- Franchise or operational manuals issued by 85 Degrees to the franchisees;
- Any records or documents relating to audits or reviews conducted by 85 Degrees in respect of the franchisees;
- All written advice received by 85 Degrees in relation to the franchisee's compliance with workplace laws, and 85 Degrees' compliance in respect of its franchise network;
- All records or documents, including board minutes, meeting minutes, and emails, that relate to the franchisee's or 85 Degrees' suspected compliance (or not) with workplace laws;
- All records or documents that relate to complaints, detail steps taken to prevent non-compliance, records that identify the franchisees' employees' hours, classification and duties, sales records. [2]

The categories of documents are broad and have the potential to unveil significant internal workings of the organisation. Non-compliance with a notice to produce can attract civil penalties of its own. Even in situations where further litigation does not ultimately eventuate, the time and effort in responding to requests and directions from the FWO can be extensive.

Franchisors can be held responsible for contraventions of FW Act by franchisees

Unlike the commonly used accessorial liability provisions contained at section 550 of the FW Act, a franchisor need not be "involved" in the contravention to quite the same degree.

Under section 550, someone is *involved* if they:

- aided, abetted, counselled or procured the contravention; and/or
- induced the contravention; and/or
- conspired with other to effect the contravention; and/or
- were knowingly concerned in or party to the contravention - whether by act or omission.

Section 550 has seen the FWO successfully prosecute company directors, sole traders, payroll and human resources managers, companies and people involved in supply chains involving the procurement of labour, and even independent accountants retained by a contravening business to run their payroll function.

In essence, the accessorial liability provisions allow the FWO, unions, and individuals, to bring the person they say actually contravened the FW Act to account. While the business or company that is liable to pay wages will usually be responsible for back paying the underpayment, [3] additional penalties may be ordered against the accessory individually.

This recent litigation serves as another reminder that businesses, and the individuals who have responsibility to run them, must be aware of their payroll's function and compliance, and be satisfied that appropriate systems and processes are in place to best prevent any contraventions.

Potential defence - franchisor has taken reasonable steps to prevent a contravention by the franchisee

The provisions in the FW Act relating to franchisors include a statutory defence to any contravention of section 558B. A franchisor will not be held responsible for the contraventions of their franchisees if the franchisor is able to prove that they took "*reasonable steps to prevent (the) contravention*". In determining if a franchisor took reasonable steps to prevent a contravention by their franchisee, a Court may consider the following factors:

- the size and resources of the franchise or body corporate;
- the ability of the person to influence or control the contravening employer;
- any steps taken to ensure the contravening employer understands requirements under applicable provisions;
- arrangements for assessing compliance;
- arrangements for receiving and addressing complaints about alleged underpayments; and
- the extent to which the arrangements with the contravening employer encourage compliance with the FW Act or other workplace laws.

Where to from here?

85 Degrees previously operated its cafes in Australia directly, during which time they had dealings with the FWO including entering into an enforceable undertaking, [4] and recently being ordered to pay a significant pecuniary penalty of \$475,200

for “serious contraventions” of the FW Act.^[5] 85 Degrees has since moved away from direct ownership of its cafes to a franchise model with an exclusive supply arrangement.^[6]

It is against this history that the FWO says 85 Degrees “had been on notice for many years about compliance issues – [it] should reasonably have known some of its franchisees would underpay their workers and breach record-keeping and pay slip requirements.”^[7]

Because this matter is in its early stages, we will have to wait and see whether any judicial clarity emerges on the limits of a franchisor’s or holding company’s responsibility for businesses within their networks, or if 85 Degrees are able to successfully invoke any statutory defences.

Given that many franchise models and corporate structures provide for significant control by the franchisor or holding company, such as branding, consistency of product, operating procedures, territories, and in some cases wage rates including through franchise enterprise agreements, this development in the FWO’s enforcement strategy means that franchisors need to be managing their risk of being found to be responsible for, or needing to have oversight of, their franchisees’ payroll and workplace compliance. Similar considerations apply for organisations in corporate groups, even where not formally in a franchise structure.

The risks of getting it wrong are significant, with maximum penalties of 60 penalty units (\$16,500) for individuals, and 300 penalty units (\$82,500) for bodies corporate. “Serious” contraventions risk penalties of 10 times those amounts.

The High Court of Australia recently expressed in their judgment in *Pattinson* that penalties must be reasonably sufficient to deter similar conduct from occurring, both by the same party, but also by other similar organisations.

As the concept of “wage theft” becomes more unpalatable to the Australian public, greater general deterrence may be considered appropriate in the course of setting civil penalties. With potential Commonwealth “wage theft” legislation on the horizon, ensuring your organisation’s (and your related entities’ and franchisees’) affairs are in order will be a key governance matter in the short to medium term.

Piper Alderman’s Employment Relations team are available to assist your organisation with wage compliance matters, including engaging with regulators where required.

^[1] Fair Work Ombudsman v United Petroleum Pty Ltd [2020] FCA 590 (7 May 2020); 85 Degrees Coffee Australia Pty Ltd v Fair Work Inspector Rodwell [2020] FCA 1190 (18 August 2020).

^[2] *85 Degrees Coffee Australia Pty Ltd v Fair Work Inspector Rodwell* [2020] FCA 1190 (18 August 2020), [7].

^[3] The Explanatory Memorandum to the *Fair Work Bill 2009* stated that section 550 does not create joint and several liability as against the accessory; however, the courts have doubted whether they are constrained by these comments given the FW Act does not limit that *only* penalties may be ordered against an accessory, see for example; *Fair Work Ombudsman v Step Ahead Security Services Pty Ltd & Anor* [2016] FCCA 1482, [56]; *Scotto v Scala Bros Pty Ltd* [2014] FCCA 2374.

^[4] “Taiwanese backpackers and international student from China short-changed \$43,000”, Fair Work Ombudsman, <<https://www.fairwork.gov.au/newsroom/media-releases/2015-media-releases/july-2015/20150707-85-degrees-coffee-eu-pr-ess-release>>, accessed 14 February 2023.

^[5] *Fair Work Ombudsman v 85 Degrees Coffee Australia Pty Ltd* [2022] FCA 1317 (4 November 2022).

^[6] *Ibid*, [3].

^[7] Sandra Parker, as quoted in ‘85 Degrees franchisor faces Court’, Fair Work Ombudsman, <<https://www.fairwork.gov.au/newsroom/media-releases/2023-media-releases/february-2023/20230209-85-degrees-franchisor-litigation-media-release>>, accessed 14 February 2023.