Submission by the
Franchise Council of Australia
To
The Treasury Department

In relation to the possible extension of unfair contract term protections to small business.

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1. **Introduction**

The Franchise Council of Australia welcomes the opportunity to provide this submission to Government in relation to the proposed extension of unfair contract term protections to small business.

The FCA is the peak industry body for the Australian franchise sector. There are approximately 1180 business format franchise systems in Australia, with an estimated 73,000 outlets turning over $131 billion, and employing more than 400,000 people[1]. Importantly, over 95% of franchisors, and almost all franchisees, would come within the definition of a small business. So the FCA represents over 73,000 small businesses.

This is important in the context of the current deliberations, as the FCA quite probably represents more small businesses than any other organization. Moreover there is strong evidence in Australia and globally to suggest that franchising remains almost the sole business mechanism that enables small business to compete effectively against larger businesses. Franchised businesses are market leaders in many industry sectors notwithstanding that they have to compete with large corporations. Automotive retail, bakeries, casual dining, fast food, coffee shops, convenience stores, real estate, tyre retail, bedding, furniture retail, postal services and home services are just a few examples.

The FCA represents not only small business, but successful small business. As such we consider we are ideally placed to provide informed and meaningful input into the regulatory deliberations on this issue. In addition our collaborative approach of endeavoring to work with Government to achieve the best implementation of policy decisions sits in stark contrast to the overly critical rhetoric of some small business organisations.

We are very familiar with the issues that have motivated the Federal Government to commit to its current policy, and we support the policy intent. That said, it is important to think through all of the consequences, and not see or represent the legislation as some regulatory panacea that will somehow insulate the small business sector from the effects of fair market competition. The FCA supports free market competition, and opposes regulation that imposes unnecessary compliance burdens and red tape.

If carefully targeted, unfair contracts legislation could help small business secure access to markets, and operate in markets where they would otherwise be at a contractual disadvantage. There are some significant implementation and drafting challenges, and it is important that any reforms do not create uncertainty, impose unnecessary compliance cost or red tape. Similarly it is important that the reforms do not disadvantage small businesses in the context of access to finance or capital.

The FCA appreciates the opportunity to provide this input into the formulation of policy, and the development of a workable and constructive implementation framework. We would welcome the opportunity to discuss this submission with you in further detail.

[1] Franchising Australia Survey

1. Submission and Reasoning

1.1 Isolating the real problems

The consultation paper describes the support from sections of the small business community for Government intervention to address small business vulnerability and disadvantage, noting that small business may face similar issues to consumers in relation to standard form contracts and unfair contract terms. At the same time, the consultation paper correctly observes that most countries have regarded the principles of freedom of contract in business transactions as being largely sacrosanct, and indeed critical to the efficient operation of the market. Similarly standard form contracts are correctly seen as strongly supporting business efficiency.

Although it sounds relatively simple to just expand the current unfair contract terms provisions to standard form contracts involving "small business", it is not quite that simple. Indeed the blanket introduction of an unfair contracts regime applying to all business contracts could create major problems for the Australian economy. It could create contractual uncertainty where none currently exists, could impose substantial compliance costs on all businesses and could fundamentally disadvantage in a commercial sense the small businesses it is intended to assist.

Small businesses are not the same as consumers under the Australian Consumer Law, as they sell or acquire goods or services in the context of running a business for the purpose of making a profit. The law around the world has traditionally respected the sanctity of the principles of freedom of contract, only intervening when the contract does not truly reflect a bargain fairly reached between the contracting parties. The law in relation to concepts such as fraud, undue influence and good faith and the statutory prohibitions on misleading or deceptive conduct and unconscionable conduct aim to enhance the contractual process, and can be seen in various iterations around the world. The consultation paper correctly notes that the vast majority of countries have stopped well short of enacting laws concerning the "fairness" of contracts, so Australia needs to tread carefully to ensure Australian companies are not disadvantaged or the Australian economy adversely impacted.

The consultation paper also notes that Governments have sought to support the contractual process in circumstances where one party has inappropriate market power. Competition laws seek to ensure the full and fair operation of the market. This principle underlies the Australian Competition and Consumer Act.

The FCA has carefully considered these issues in the context of the Government's policy intent. We have also surveyed our members in relation to some of the questions posed in the consultation paper, and present the response as Appendix 1 to this submission.

Although there is a variety of what could be considered to be "standard form contracts" used in business on a daily basis[2], it seems that when you consider the specific concerns identified by State and Federal regulators, politicians and small business groups in relation to unfair provisions in standard form contracts, the concerns essentially are that:-

- some small businesses are fundamentally disadvantaged by contractual practices of larger corporations; and
- there are certain contracts that are the subject of regular complaint, notably:-
    - retail leases in major shopping centres. These centres are now so large that they essentially have become markets in themselves;

[2] For example software licences, equipment rental agreements, finance documents, insurance contracts, agency agreements, distribution agreements, telecommunications contract, energy supply arrangements, terms and conditions of sale, IT contracts, photocopier lease agreements, trade credit terms, outsourcing agreements, car fleet rental contracts and many others. Some of these contracts have foreign companies as the other transacting party, and more and more are being executed on-line.

- supply contracts with major supermarket chains such as Coles and Woolworths. Again these organisations are so large, ubiquitous and commercially powerful that small businesses are at a substantial disadvantage in terms of equality of bargaining power;
- motor vehicle dealership agreements[3]; and
- franchise agreements.

The FCA recommends that any unfair contracts legislation only apply to contracts that provide or control access to a market. Further, the new laws should apply not just to "unfair" provisions, but to the specific clauses that may cause unfair consequences due to the implementation. These are usually not clauses that on their face appear punitive or unreasonable, but rather commercial provisions that in the circumstances are unfair or have unfair consequences and indeed conduct in relation to such provisions.

This is probably best illustrated by examples:-

1) Small business tenants of major shopping centres often complain that the term of their lease is unreasonably short to enable them to achieve a return on investment, and they are particularly vulnerable at the end of term. Landlords often impose unreasonable rental increases or require unreasonable refurbishment requirements knowing that the only choice the small business has is to vacate, losing the value of the business including the purpose built fixtures and fittings.

2) Small business suppliers to supermarket chains complain that they secure access to a supermarket network only on a short term basis and often on an exclusive basis. They gear up to supply a very large market, then find that they have to reduce prices or meet other commercial requirements to be allowed to continue to have access to that market or exclusivity.

In both cases it is the application of the commercial provisions of the contracts, rather than any particular provision that is on the face of it unfair, that causes the problem. Any legislative solution needs to recognise this fact, and address the underlying problem.

1.2 Unfair contract terms and market access

If an unfair contract term regime is introduced to apply to all business contracts or all contracts with "small business", it is likely to greatly impede normal business dealings. Although on a conceptual view the photocopier lease agreement should not be treated differently from the shopping centre lease, the reality is that small business is less concerned about having protection from unfair contract terms in the standard form photocopier lease. The "take it or leave it" consequence for small business is much less critical. The same applies to the vast majority of small business contracts.

The FCA considers that there are only two areas of genuine concern in relation to small business contracts, being in relation to shopping centre leases and supermarket supply contracts. The two features of these contracts that make them stand out are:-

1) the contracting party is a large corporation, with significant resources, access to information and market power; and

2) the contract itself determines access to a market, not just a product or a brand.

[3] Motor vehicle dealerships are of course specifically included within the definition of the Franchising Code of Conduct. However the features of a typical motor vehicle dealership – a large and often foreign franchisor, a combined franchise and product distribution arrangement and franchisees that may themselves be large corporations – mean that the issues arise in that sector are often quite different to the general franchise sector.

So the "take it or leave it" consequences of a standard form contact are profound. If you "leave it", you lose or are denied access to that market. The FCA considers that additional regulatory protection is required and should be focused in these instances.

These two examples can be contrasted with virtually every other type of business contract[4]. For example, although a finance contract is with a large corporation, the small business has the ability to choose between other providers to get the same product. The same applies (except in the case of a monopoly supplier) in the context of a distribution, agency, licence or franchise agreement, or a photocopier lease.

The FCA does not support the introduction of a comprehensive unfair contracts regime that applies to all business contracts, as this is not necessary and will create uncertainty when none currently exists, impose unnecessary compliance cost and impede normal business transactions.[5]

1.3 Franchise Agreements

The Franchise Council of Australia is very concerned that the unfair contract terms regime could apply to current and future franchise agreements. As detailed below, franchise agreements are already subject to extensive disclosure, process and contractual obligations under the Franchising Code of Conduct. To achieve the stated objective of "*enhancing and not impeding or duplicating*" existing regulatory protections, franchise agreements would either have to be exempted entirely from the regime, or an exemption granted in relation to franchise agreements where the agreement comes within the definition of a "franchise agreement" under the Franchising Code of Conduct.[6]

The FCA strongly considers that Franchise Agreements should be expressly excluded from the operation of any unfair contract terms regime.

Franchise agreements are regulated by a mandatory industry code, the Franchising Code of Conduct, prescribed as a mandatory industry code under Section 51AE of the Competition and Consumer Act. The Code provides a comprehensive framework that enhances the contractual process between franchisor and franchisee by:

- requiring extensive prior disclosure of information;
- inserting mandatory time frames to allow for considered decisions and time to obtain advice;
- including a certification process aimed at strongly encouraging parties to obtain legal and business advice;
- prohibiting the inclusion of certain provisions into a franchise agreement with the effect that those provisions are unenforceable;
- mandating certain provisions that will apply to a franchise agreement;
- specifying the process to grant, renew, transfer, extend or extend the scope of a franchise agreement;
- encouraging franchisee interaction;
- circumscribing the rights of a franchisor in areas such as transfer, termination and dispute resolution;
- including a specific cooling off right for franchisees even after they sign a franchise agreement; and
- providing specific guidance and warnings to prospective parties to the franchise agreement.

[4] See footnote 2 for a list of some of the more common business contracts on page 3.
[5] For a more detailed list of potential consequences see section 6 of this submission on page 13.
[6] Given the existence of Oil code, and the possible introduction of future mandatory industry codes, it is probably preferable to create an exemption for "any agreement regulated by a mandatory industry code" or some similar wording.

To the extent that any legitimate residual concerns in relation to the franchise sector have been identified by regulators and policy makers, these have been specifically addressed by changes to the Franchising Code of Conduct that will take effect from 1 January 2015, including changes in relation to statutory good faith and non-compete provisions where franchise agreements are not extended. In particular there are specific types of provisions which if included in a franchise agreement will be void and unenforceable. In an unfair contract term sense the Code is comprehensive, and indeed may prove a useful model for other sectors.

The relatively recent harmonisation of the unconscionable conduct provisions is also starting to regulate business conduct which can be seen by a number of Court cases and ACCC action.

The FCA strongly believes that no further action is required in relation to unfair contract terms protection in the franchise sector. Further, all further regulation of the sector should occur via the Code, rather than by some form of additional regulation.

1.4 Franchise agreements differ from consumer contracts

The consultation paper draws heavily from policy underlying the introduction of the unfair contract terms protection regime in relation to consumer contracts.

Franchise agreements executed in accordance with the Code requirements are fundamentally different from consumer contracts in many important respects. Further, the Code also already includes a number of consumer protection remedies. The FCA makes the following additional observations in this context:-

1. The decision by a franchisee to enter into a franchise agreement is considered, and is made in the context of a highly competitive market for franchisees. There are typically several similar options for a franchisee even if the franchisee is very industry specific in terms of its business preferences. Prospective franchisees can, and do, compare business opportunities. Indeed the Code requirement for a disclosure document to be identical in terms of layout, format and headings is designed to facilitate comparison;

2. There is a comprehensive disclosure regime aimed at ensuring that the franchisee is able to make an informed decision. That includes a mandatory requirement to list existing and former franchisees, and provide contact details;

3. The Code contains specific provisions that strongly encourage franchisees to seek legal and business advice, and many do so. Some franchise systems make it a mandatory requirement;

4. The Code process provides not only a 14 day period during which a franchisee can consider its position, read the documentation and obtain advice, but includes a 7 day cooling off period during which the franchisee can change its mind and terminate the franchise agreement.

5. The Code already contains specific prohibitions in relation to some provisions in franchise agreements, notably in relation to franchisee associations, termination, transfer, dispute resolution, waivers of prior representations and general releases from liability. In addition certain types of consents required must only be obtained after the agreement is entered into and at the relevant time that consent is required.

6. These prohibitions will be significantly expanded on 1 July 2015. These changes will render void or unenforceable certain provisions in a franchise agreement entered on or after that date. These include terms which exclude or limit the obligation to act in good faith, any term which attributes to the franchisee the franchisor's costs of settling a dispute, any term which compels a franchisee to bring an action or proceeding in a jurisdiction other than where the franchisees business is located;

7. As a consequence the Code already contains specific consequences for inclusion of terms which the Commonwealth believes should not be contained in a franchise agreement. In many respects the express prohibition of those terms already acts as an automatic unfair contract term protection without the necessity to establish the term is either unfair or that the franchise agreement is a standard form contract;

8. Based on the definitions contained in the Discussion Paper, the FCA estimates that at least 95% of franchisors, and almost all franchisees, would be small businesses. So the presumption of big business dealing with small business does not apply;

9. A franchise agreement does not fit naturally with an analysis based on whether the contract "causes a significant imbalance in the parties' rights and obligations". To achieve the consistency in product or service offering customers expect across a franchise network, and thereby allow small businesses to compete effectively against large corporations, the franchise agreement needs to contain a large number of provisions regulating the conduct of the franchisee. On one view this could be seen as a "significant imbalance", but that is the essence of the franchise relationship.

10. Similarly it is not easy to determine what type of provision would be "not reasonably necessary to protect the legitimate interests of a party", as that is likely to depend not so much on the provision but how it might be exercised.

11. On one characterisation most provisions of a franchise agreement could "cause detriment" to a franchisee, including provisions in a franchise agreement that are expressly or implicitly authorised by the Code. For example the Code provides that a notice period to be allowed to remedy any breach need not be more than 30 days, yet that provision in a different type of contract could be argued to be "unfair".

The FCA does not dispute that in some contractual circumstances small business is in a similar position to a consumer. However the FCA considers that where, as in franchising, legislators have specifically turned their minds to these issues the industry solution should apply exclusively.

1.5 Why is the FCA concerned about coverage of franchise agreements?

The FCA's concerns can be summarised as follows:

1) Notwithstanding the comments above outlining the differences between a franchise agreement and a consumer contract, a typical franchise agreement may fall squarely within any definition of a standard form contract, as having standard arrangements is the essence of franchising;
2) The Franchising Code process in fact brings franchise agreements even more squarely within any definition. Clause 10 of the Code requires a franchisor to provide to a prospective franchisee with a disclosure document and a franchise agreement "in the form in which it is to be executed". So in essence the Code almost mandates, or at least encourages, the use of a contract with standard terms.

3) In some franchise systems there is not a lot in a franchise agreement that a franchisor would typically be prepared to negotiate, so it could easily be characterised that it is provided on a "take it or leave it" basis. But this is not the correct characterisation because the consequence to a prospective franchisee at the time of entering the agreement is not the denial of access to a market; it is simply denial of access to a brand. The vast majority of franchise networks themselves operate in highly competitive markets, and there is substantial competition between franchise systems for prospective franchisees. So there are minimal consequences to the franchisee of choosing to "leave it".

4) In some systems the franchisor is prepared, and does negotiate, the terms of the franchise agreement. Accordingly, to what degree does that franchisor need to negotiate before the ultimate agreement is not considered a standard form contract?

5) The franchise agreement is the essence of the business relationship, and in most cases the key intangible asset of both the franchisee and the franchisor. Third parties such as financiers and landlords transact with franchisors and franchisees on the assumption that the franchisee agreement as signed is binding on all parties.

6) If franchise agreements are caught by any unfair contract terms regime there will be substantial additional compliance costs:-

   a) Franchisors will immediately need to have their franchise agreements, and probably their operations manuals, vetted to ensure they do not contain any potential "unfair terms. Not only is this likely to cost perhaps $5,000 - $20,000 per franchise system[7], depending on the complexity of documentation, but it is likely to yield an unsatisfactory result as it would in fact be virtually impossible for any lawyer to provide meaningful guidance on this issue until the issue was conclusively determined in court.

   b) The FCA expert legal group has identified and considered some typical clauses that some franchisees may consider to be unfair terms and why such terms should not be regarded as unfair[8]. These types of clauses are not always found in other forms of contract but are often required in franchise agreements because of the unique relationship that exists between a franchisor and franchisee. They have been highlighted because if an unfair contracts regime was implemented without exception then these provisions in a franchise agreement will be under greater scrutiny and likely to lead to significant disputation.

   c) Financiers lending to the sector would presumably require their own advisors to review franchise documentation to satisfy themselves that the agreement does not contain any potential unfair contact terms. However the same comments apply in relation to the challenges any lawyer would face providing guidance on this issue in a business context;

   d) Other third parties reliant on the enforceability of the franchise agreement (or the enforceability of certain terms that would be to their advantage) would either need to conduct similar due diligence, or be exposed to additional risk.

7) The vast majority of franchisors, and almost all franchisees, are small businesses. They cannot afford a legal dispute, even if they are ultimately successful. The FCA is seriously concerned at the potential for spurious claims to be made, including on a class action basis, against franchise systems. A spurious claim could easily bring many franchise networks to their knees.

8) The FCA is extremely concerned that unless franchise agreements are specifically excluded from any unfair contracts regime, or at least that the regime only applies to contracts between large business (thereby excluding the vast majority of franchisors) and small business, it is likely that:-
   a) Banks and other financiers will further curtail their lending to the small business sector;
   b) The costs of obtaining finance will substantially increase;
   c) Fewer franchising disputes will be resolved by mediation, with plaintiff lawyers preferring and possibly even encouraging their clients to litigate rather than mediate. Mediation has been one of the great success stories of the enactment of the Franchising Code of Conduct, and is lauded around the world for its efficient and cost-effective resolution of disputes.

[7] With around 1,100 franchise systems, the total cost to the sector would be somewhere around $10,000,000.
[8] See Appendix A table attached on page 16.

1.6 Motor Vehicle, Shopping Centre Lease and Supermarket Supply Agreements

Although the FCA's primary concerns relate to the impact of the proposed unfair contracts regime on the franchise sector, we offer the following comments in passing in relation to the other identified areas of specific concern.

The Wein Report[9] included a specific recommendation that Government should undertake "*an analysis of the impact of a minimum term and standard contractual terms for motor vehicle agreements should be undertake prior to a future review of the Code*". This suggested that industry specific issues in the motor vehicle sector be subject to separate examination. Mr Wein noted that complaints included unreasonably short contract terms, unreasonable refurbishment or capital expenditure requirements and changes to pricing of vehicles purchased by the dealer and re-sold to customers Although no further examination has occurred at a Federal level, the NSW Government has since moved to introduce unfair contract term protection and unjust conduct provisions into the *NSW Motor Dealers and Repairers Act 2013*. It should however be noted in fairness that motor vehicle dealer agreements are subject to the Franchising Code of Conduct, so our comments in relation to the quite comprehensive nature of franchise agreements apply equally to motor vehicle dealer agreements.

Concerns in relation to shopping centre leases and supermarket supply agreements have yet to be addressed notwithstanding that they make up the vast majority of complaints to regulators in relation to small business matters. There are also not the same provisions governing the contractual provisions of retail leases or supply contracts as apply under the Franchising Code of Conduct, notwithstanding that there have been more complaints about these areas than in relation to franchising.

It has been proposed on several occasions that an industry code of conduct similar to that applying in franchising should apply to major shopping centre leases[10] and supermarket supply arrangements, but no substantive regulatory action has been taken. There may be good reason for this, notably the difficulty of enacting such an industry code in these sectors. However the demand for change continues, and practically speaking an unfair contract protection regime is likely to be seen as a failure unless it addresses leases in major shopping centres and supply contacts with major supermarket chains.

Using the vernacular, the introduction of a broadly based unfair contract terms regime that applied to all business contracts without discrimination or exemption would be using a sledgehammer to crack a walnut. The problems that have been identified are nowhere near as ubiquitous as were identified prior to the introduction of the Australian Consumer Law provisions, which correctly limited the regime to consumer transactions. The unfair contract terms protection regime should be limited to contracts that restrict market access or at the very least be limited to contracts between 'large' business and small business.

1.7 Implementation concerns

The establishment of a very broad unfair contracts regime has the potential to damage the Australian small business sector. If such a regime creates contractual uncertainty, businesses (large or small) will be reluctant to deal with small businesses, and small business access to finance will become even more difficult. Foreign businesses, not subject to the unfair contracts regime, will be preferred to dealing with equivalent local businesses. Disputation is likely to rise, with dispute resolution forums clogged by disputes over contractual provisions and conduct that one party or the other considers are "unfair". There is also a risk that fewer disputes will be handled via mediation and resolved by mediation as most businesses will content that the clause or conduct in question is fair.

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[9] Recommendation 16

[10] Productivity Commission Inquiry Reports - 2011 Economic Structure and Performance of the Australian Retail Industry, and 2008 The Market for Retail Tenancy Leases in Australia

A number of the FCA's implementation concerns are expressed in the responses to the Key Focus Questions contained in the consultation paper. In summary, if the Government intends to proceed with an unfair contracts regime the FCA considers that the regime should:-

- Only apply to contracts between large business and small business;
- Ideally only apply where a contract limits access to a market, as in the case of a major shopping centre lease or a supermarket lease; and
- Specifically exempt franchise agreements and agreements covered by any other mandatory industry code[11].

Such an approach will address the challenges of considering a franchise agreement in the context of the definition of a "standard form contract", and focus the legislative solution on the areas of legitimate concern without imposing widespread compliance cost and uncertainty. It also enables Australia to remain consistent with the long line of legal precedent in Australia and globally that specifically indicates that "fairness" is typically not a basis for reviewing any contract made freely between businesses.

Unless the legislation is carefully targeted it will not achieve the policy objectives, but simply impose unnecessary compliance cost and red tape. Importantly, the FCA as a representative of successful small business considers that in the vast majority of cases small business is able to deal adequately with standard form contracts when they are presented on a "take it or leave it" basis. In a competitive market the "leave it" option is quite viable. Problems only arise when the "leave it" option is not a realistic option.

The challenges in drafting an unfair contract terms protection regime are articulated in the consultation paper. The only additional comments we make are:-

- When determining what is "unfair" in the context of a business-to-business dealing, it is more important to note that the courts regard the principle of freedom of contract as central to contract law. Similarly to provide contractual certainty a party is typically deemed to have read and understood anything the party has signed. These fundamental rules provide the framework for day to day business dealings, and must continue to exist relatively unimpeded;

- It is important to consider what is to happen if a contractual provision is determined to be unfair. Is the clause or the contract invalidated automatically? Or does the determination simply enable a party to apply to a court for such a remedy as the court determines to be appropriate in all the circumstances?

- It is important to consider how the limitation periods would apply to any claims. Does the time period run from the date of signing the contract? Or does it relate to the time of exercising any right or acting pursuant to a provision?

- The key is what does "take it or leave it" mean. A business ought to be entitled to determine whether or not they will deal with another business without infringing the law. However if a party must sign a "take it or leave it" contract to access, or continue to have access to, a market, that is something quite different.

The FCA is also concerned to ensure that the changes apply in future rather than retrospectively to contracts entered into before the unfair contract terms protection provisions commence. It is also vital for clarity about if or how a pre existing contract may subsequently become subject to the regime if it is varied, extended, renewed, transferred or novated.

[11] Eg: Oil code. This also allows for industries to develop their own industry code as to what constitutes unfair terms in their sector.

Key Focus Questions

The FCA provides the following responses to the Key Focus Questions contained in the consultation paper[12]. We have surveyed our members on some of these issues to provide some additional empirical information. We have not repeated the question, but have used the question numbering in the Key Focus Questions for ease of referencing our responses.

1) In a broad sense standard form contracts are very common in business.

    a) The following list is not intended to be exhaustive, but indicates the extent to which standard form contracts are used in business. Standard form contracts can include software licences, equipment rental agreements, finance documents, insurance contracts, agency agreements, distribution agreements, telecommunications contract, energy supply arrangements, terms and conditions of sale, IT contracts, photocopier lease agreements, trade credit terms, outsourcing agreements, car fleet rental contracts, consultancy agreements, confidentiality and non-disclosure agreements and many others. Some of these contracts have foreign companies as the other transacting party, and more and more are being executed on-line.
    b) Most businesses have a set of standard trading terms for the goods or services they sell to other businesses, and their suppliers have their "standard terms". However these documents are more akin to templates than "take it or leave it" contracts.
    c) In the franchise sector the most common standard form contracts are with financiers, equipment rental companies, telecommunication or energy suppliers, supply contracts with supermarket chains and leases with major shopping centre proprietors. Of these contracts, it is really only the supermarket supply contracts and retail leases that ought to give policy concerns. Supermarkets and major shopping centres are markets in themselves, so their standard form contracts affect market entry. A party has no economic choice but to sign if it wants to enter that market. All other standard form contracts are provided in the context of a competitive market.
    d) Franchise agreements could be considered standard form contracts in that they are provided in template format to franchisees, and they contain a large number of provisions that are consistent across a franchise network. However that consistency is the essence of franchising, and the Franchising Code of Conduct framework facilitates a negotiation and execution process intended to ensure parties make an informed decision in relation to the execution of the franchise agreement.
    e) The benefits of standard form contracts are set out in the consultation paper, and include process efficiency, cost-effectiveness and enhanced transaction. Without them business would grind to a halt. This becomes pretty self-evident when you consider the list of standard form contracts included in 1a) above.
    f) In the FCA's opinion, the only material disadvantage of standard form contracts that merits a legislative response is when they restrict access to a market, not just a particular brand or product. This is an important distinction that sets apart from other standard form contracts a lease contract with a large shopping centre or a supply contract with a major supermarket chain. If standard form contracts presented on a "take it or leave it" basis affect market access, there are sound policy reasons for them to be subject to an unfair contracts regime. If the standard form contracts only restrict access to a brand or a product, the small business is able to choose other competitive offerings and there is no material public detriment.

2) As a general rule standard form contracts are designed to promote transaction efficiency, and avoid the need to negotiate every deal from scratch. The two fundamental considerations that influence the design of terms and conditions are the past experience of the drafting entity and their lawyer, and the likelihood that the other party will find them acceptable. In that context we note:-
    a) In business transactions, especially franchise agreements, standard form contracts are only the starting point, so there is a strong incentive for the terms to be reasonable. Otherwise the other party will not agree to them, and the efficiency (and prospective franchisee) is lost.

[12] See page 3-4 of the consultation paper.

b) Where an organization has substantial market power the motivation might be slightly different, in that the drafting party may use these contracts to extract a better deal than might otherwise occur if negotiations are full and fair.
c) Lawyers draft most standard form contracts, so the documents reflect the collective experience of the law firm in terms of issues that could arise, and should therefore be addressed. (If it were left to the parties to document the "deal" as they see it, the parties would not turn their mind to most of the provisions found in standard form contracts. They simply would not think of the issues covered. The vast majority of clauses are "boilerplate".)

3) Businesses will review standard form contracts, as contracts are an everyday part of business life. However they may or may not seek legal assistance:-
   a) Businesses understand that they operate in a "buyer beware" market, and will be deemed to have read and understood anything they sign. They know that ignorance of the law is no excuse. Similarly business understands that being in business is itself a risk. Profit is a return on risk, and all businesses need to take some degree of risk. So any decision as to review a contract or obtain legal assistance is a considered decision.
   b) Negotiations are held and contracts are made every day in business, and business people soon acquire basic contracting skills and experience. Business people constantly review contracts, including standard form contracts.
   c) The key factors that determine whether legal assistance is obtained in an organization with limited resources will be the contractual skill and experience of management, the relative importance and value of the transaction, the length of the contract, the complexity of any documentation, the cost of legal input and the perceived risk. Exclusivity is only really a factor if it relates to market access.
   d) In the context of franchise agreements, the Code process strongly encourages franchisees to seek legal and business advice prior to signing a franchise agreement. Franchisees have to provide a certificate that they have received, read and had a reasonable opportunity to understand the franchise agreement, and that they have either obtained legal and business advice, or chosen not to do so.

4) The factors that determine whether a business will try to negotiate standard form contracts include those that determine whether they seek legal input. (See paragraph 3(b) and (c) above.) Assuming that the contract is materially important:-
   a) Businesses will typically read the contract, and consider whether it is fundamentally in order;
   b) Businesses will also consider whether there is an opportunity to negotiate improved terms;
   c) Normal competitive factors will be considered, including whether the contract affects the party's competitive position;
   d) The normal approach is to negotiate unless either the terms are acceptable, the concerns are immaterial in the context of the overall business or the contract is presented on a "take it or leave it" basis AND the contract is essential to provide access to a particular market or access a unique product or service.
5) The only legitimate concern in relation to standard form contracts is when they determine access to a market. If a standard term contract is presented on a "take it or leave it" basis, it is the consequence of not "leaving it" that is the concern and leads to potential abuse. In that case it is the contract itself that is the problem. The process is largely irrelevant. This is best illustrated by an example comparing 2 "take it or leave it" contracts:-
   a) A contract with a landlord of a major shopping centre, or with a major supermarket chain – if the small business does not accept the terms the impact on the small business is fundamental, as access to a market is denied;
   b) A franchise agreement to operate a business under a particular brand and system – if the small business does not accept, it has other alternatives open to it to still enable it to sell similar goods or services. Market access is not denied, just access to a particular brand and product.

6) See section three of the FCA's submission. Unlike consumers, businesses deal with contracts as an everyday part of business life. Businesses understand that they operate in a "buyer beware" market, and will be deemed to have read and understood anything they sign. They know that ignorance of the law is no excuse. Similarly business understands that being in business is itself a risk. Profit is a return on risk, and all businesses need to take some degree of risk.

7) This question highlights the crux of the problem. The "terms" that businesses encounter are often not of themselves obviously unfair, as they are core commercial terms. The problem is the consequences, particularly where the consequences involve denial of access to a market unless the terms are accepted. This is best demonstrated by a comparative example:-

   a) A typical lease offered to a small business in a major shopping centre is 5 years. Larger businesses can negotiate a longer term. 5 years is too short a period to allow the tenant to obtain a return on investment. At the end of the 5 years it is common for the landlord to seek a very large rental increase, having secured ongoing rental increases during the term of at least CPI. The small business tenant has little bargaining power – it can pay the new high rental, or it can walk away from its establishment cost and lose access to the market.
   b) A small business dealing with a supermarket is offered a supply contract, typically on a short term basis. It gears up to supply. The supply contract is "re-negotiated" at the end of the short term. The small business supplier is in an invidious position – the supermarket chain is a large part of the market (due to the dominance of the Coles and Woolworths networks in particular), so the supplier is forced to agree to the new terms (which invariably involve reduced prices) if it wishes to have access to the market.
   c) In a contrary example, a bank offers small business a loan with unacceptable terms. The small business has abundant choice, and can move banks. If a bank seeks to re-negotiate the terms during the contract, or at the end, the small business can seek alternative finance. Bank finance contracts typically contain some of the most onerous terms of any contract. For example the bank will have the ability to immediately demand payment on default, the ability to appoint a receiver and the right to demand frequent financial reports. However these potentially "unfair" terms are not commercially unfair, as the small business is not denied access to a market as it can source funds elsewhere.
   d) The Franchising Code of Conduct is about to be amended to provide that if a franchisee wishes to extend a franchise agreement when it expires, and is otherwise compliant, the franchisor must either extend the contract, pay compensation of forego the protection offered by any non-compete provision in the franchise agreement. This is a perfect example of how the law in franchising has been amended to address a specific issue in exactly the correct manner.
   e) The examples above illustrate the fundamental issue – that it is only where unfair contract terms control or deny access to a market that small business is materially disadvantaged in a manner that justifies legislative intervention.
   f) Moreover, any focus on legislation solely on "unfair terms" will miss the point. The terms themselves are not obviously unfair, as they are core commercial terms such as duration of the agreement, price and price variation. The problem only arises when a contract controls or restricts access to a market.

8) As a general rule business suffers no material disadvantage from "unfair terms". However where terms of a contract control or restrict access to a market – such as a major shopping centre, or a supermarket chain – major consequences arise that often threaten the very viability of the small business. Common examples that the FCA has seen include:-
   a) Franchisees and franchisors (depending on which is the tenant) being denied lease renewals, only to find a competitor secures a lease for the same premises when the franchisee leaves;
   b) Tenants having to pay massive rental increases at end of term;

c) Tenants having to comply with unreasonably onerous refurbishment or relocation requirements;
d) Tenants simply going broke due to excessive rental costs, particularly in times of general economic downturn;
e) Suppliers being given access to supermarket chains, only to be deleted at very short notice and without due regard to the investment the suppliers have needed to commence initial supply;
f) Suppliers having to reduce prices from those initially agreed to retain access to supermarket supply without due regard for the consequences to the supplier.

9) Market choice is the fundamental protection available to small business, and it is usually more than adequate. Small business has ample opportunity to negotiate contract terms in a competitive market. It is only where market access is a function of the contract that there is currently inadequate protection. Legislation to restrict "unfair terms" globally will be unnecessarily broad, and will probably miss the key point. A better focus would be to define the term as a commercial term (as opposed to an "unfair" term) that controls or restricts access to a market.

10) The FCA believes that there are already substantial regulatory protections in place:-
a) The Competition and Consumer Act prohibitions on misleading or deceptive conduct and unconscionable provide strong protection to small business.
b) The ACCC is in our experience a very effective regulator and has strong investigative and enforcement powers.
c) State Small Business Commissioners are actively involved, and will investigate claims and assist small business.
d) The proposed Federal Business and Family Enterprises Ombudsman will further augment the regulatory framework.
e) In the franchise sector the Franchising Code of Conduct contains a wide range of provisions that aim to supplement the contractual process. The Code is about to be amended to include a specific provision to provide that if a franchisee wishes to extend a franchise agreement when it expires, and is otherwise compliant, the franchisor must either extend the contract, pay compensation of forego the protection offered by any non-compete provision in the franchise agreement. This is a perfect example of how the law in franchising has been amended to address a specific issue in exactly the correct manner.

11) The FCA's preferred position with respect to potentially further regulating franchise agreements is Option 1 as outlined on page 2 of the consultation paper. However the FCA notes and respects the Government's commitment to Option 3. If legislation is to be introduced, it should be limited to contacts between large business and small business, not between small business and small business, and situations where the contract controls or restricts access to a market. Alternatively, franchise agreements regulated by the Code should be exempted from any legislation. We note that major shopping centres and large supermarket chains are now of a size that they fairly should be considered as markets unto themselves. Our reasoning is set out in our detailed submission. In relation to any specific concerns, the FCA would be pleased to continue to work with Government to develop additional industry responses, including education. In that respect the FCA notes the recent establishment of the Australian Franchise Registry, and proposals to have the new franchising Risk Statement that is to form part of the 2015 amendments to the Code translated into multiple languages.

12) The FCA does not believe information disclosure would serve any meaningful purpose in the context of "unfair contract terms". Perhaps the most compelling reason is that the retail tenancies sector already contains comprehensive disclosure obligations, yet is the source of by far the majority of complaints by small business to the ACCC and State Small Business Commissioners. As noted above, the problem is not information; it is market access and market power.

13) See the FCA's detailed comments in the body of this submission. The FCA considers that any legislation should be kept relatively narrow, relate only to contracts between small businesses and large businesses and focus on the core problem – market access and market power. The prohibition could read something like (definitions excluded for the purposes of illustration):-

> *"Where a contract between a small business and a large business has the purpose or effect of controlling access to a market for the sale of goods or service supplied by a small business:-*
>
> - *the contract must be for a reasonable period having regard to the investment required to be made by the small business;*
> - *the contract must not be unfairly terminated by the larger business; and*
> - *the larger business cannot unfairly increase the cost to the small business or the price paid to the small business during the term of the contract."*

14) The FCA considers the wording above to be preferable to simply extending the ambit of existing consumer laws, for the following reasons:-
    a) Such an extension will not fix the core problems;
    b) Such an extension is far broader than necessary, and will therefore add much more compliance costs and red tape;
    c) Small business is not correctly characterized as a "consumer", as it acquires goods and services in the context of the pursuit of profit, and in a competitive market;
    d) No other country in the world has introduced legislation that so fundamentally affects the contractual position of the parties. It is important in a global economy that Australian laws are not out of step with the rest of the world.

15) Yes. This is best illustrated by an example of an acquisition and a supply that ought both be covered:-
    a) Supply of goods or services to a national supermarket chain;
    b) Payment of rental by a small business to secure access to a tenancy in a major shopping centre.

In addition to those provisions which are specifically prohibited (or to be prohibited from 1 January 2015) under the Code, the FCA expert legal group has identified and considered some of the other types of typical clauses that franchisees may consider to be unfair terms.

You will see the comments about their nature and why the FCA submit that they should not be subject to an unfair contract terms protection regime. These sorts of clauses are not always found in other forms of contract but are often required because of the unique relationship that exists between a franchisor and franchisee. They have been highlighted because if an unfair contract terms protection regime was implemented then these provisions in a franchise agreement will be under greater scrutiny.

2. Appendix A

Common conduct	Comments
Unilateral right to vary the manual	Most franchise agreements contain a right for the franchisor to impose a set of procedures and guidelines in an operations manual that must be observed by the franchisee. This is coupled with an absolute right to unilaterally change the terms of an Operations Manual – whilst that term in usually not unfair, any subsequent action by a franchisor to use it to vary the Operations Manual to impose new obligations may be unfair. However it is the conduct or the nature of the change sought to be embodied in the variation to the Operations Manual, rather than the term that gives the franchisor the power to do so that is the problem. The Code requires disclosure of the circumstances of when this right to unilaterally vary has occurred or will occur in the future in item 17A of the Annexure 1 disclosure document. A franchisee is therefore directed to this right, made aware of its existence, its prior use by a franchisor and future circumstances where it will be applied. Disclosure of this type of information before entering into a contract is not normally required for other contracts.
Refurbishment	Seeking to impose refurbishment obligations which do not allow the franchisee to recoup the cost of the refurbishment (and a return on that investment) during the term or renewal term. This is a growing area of conflict in franchise systems where franchisors expect franchisees to incur significant capital expenditure at end of term as a condition of renewal to bring the business to the then current standards. Many franchisees dispute that a full refurbishment is required given the cost and expense and prefer to embark on limited upgrades. The Code will shortly be changed to restrict the ability of a franchisor to impose undisclosed significant capital expenditure other than in limited circumstances including providing a business justification statement (clause 31(e) of the Exposure draft of the new code).
Termination at will	By including a right for the franchisor to terminate without cause on notice (a so called "termination at will" right) in the franchise agreement. This type of right even if it is expressed to be mutual (and exercisable by either party) can be considered to be an unfair contractual term where the investment made by the franchisee is significant and is not able to be recouped or a return on the investment obtained unless the full term is allowed to run. Usually there is no compensation tied to this right and if exercised by the franchisor can have a serious financial consequence to the franchisee (particularly if the agreement includes a post termination restraint of trade (such as a non compete covenant) that would continue to be binding on the franchisee and guarantors). This type of clause (expressly recognised by clause 22 of the

	Franchising Code of Conduct) is more prevalent in motor vehicle dealership agreements than mainstream franchise agreements. The Code recognises that these rights do exist and the Code does NOT prohibit them from being included in a franchise agreement, it simply requires a manufacturer or distributor to give reasonable notice (usually not less than 6 months) and reasons to be given if the right is exercised. If this clause was considered unfair they it would be void and more appropriate to be contained as a prohibition in the Code rather than ACL protections. It may also require an amendment to clause 22 of the Code;
Compulsory Acquisition rights and valuation	It is often argued by franchisees that rights afforded to a franchisor to elect to acquire assets at the end of term at less than their market value is an unfair contract term as it allows the franchisor to acquire all of the essential business assets that will allow it to operate as a going concern (which would have a greater going concern value than what they paid for it). Goodwill is not normally paid to an outgoing franchisee unless the business is acquired as a going concern. However full disclosure of these rights is made to a prospective franchisee in both the franchise agreement and disclosure document. The Code requires disclosure of end of term arrangements in Item 17C of Annexure 1. It requires disclosure of any "exit payment" and how it is determined or earned as well as other arrangements concerning the purchase of stock and other assets. The Code will be amended in January to include a right of a franchisee to claim or be paid compensation for non renewal of a franchise if a franchisor wants to enforce a restraint of trade covenant. The Government accepted the recommendation of Alan Wein in respect to enforcement of restraints of trade and did not take steps to mandate any obligation for a franchisor to pay compensation for non renewal (or for termination) was necessary to include in the Code. This issue has been canvassed in reviews and not found to be required to be included in the Code. If clauses of this kind were unfair then the appropriate relief should have been included in the Code.
Liquidated damages clauses	Clauses in franchise agreements are similar to other contracts where a breach may lead to an obligation to compensate the innocent party for damages. However the Code requires disclosure of end of term arrangements in Item 17C of Annexure 1. It requires disclosure of any "exit payment". Therefore a prospective franchisee is well aware of such a clause and can seek to negotiate a variation.
Attribution of legal costs	Clauses seeking to attribute legal costs to the franchisee are also considered to be unfair. The Code currently requires disclosure of this obligation and is being amended to prevent this attribution from happening in the future. The Code also requires parties to be responsible for their own costs of attending mediation. So whilst such a clause may seem to be unfair, the Code deals with the issue.

Non renewal	Most franchise agreements are for a fixed term and may contain an option or right to apply for a renewal for a renewal term. Sometimes these periods are concurrent with a lease term. In some cases if no lease renewal is offered in the lease the term may simply be a single fixed term and any renewal dependent on securing a new lease at end of term. Franchisees often argue that they should be entitled to seek an extension of their franchise agreement (or new agreement) at end of term if they have otherwise complied with the terms of their agreement. The Code has dealt with this issue and now will provide an alternative form of relief to a franchisee for non renewal (in terms of compensation or the inability to enforce an otherwise valid restraint of trade). So whilst either the deliberate omission of a right to renew clause or the inclusion of a clause that expressly contains an acknowledgment that there is no obligation to renew may appear unfair to a franchisee there is a remedy afforded to a franchisee that either involves a form of compensation being paid or non enforceability of a restraint of trade. The Code should be left to deal with renewal and non renewal issues.
Supplier arrangements	It is common for franchisors to seek to approach the ACCC for approval of supplier arrangements, including tying and resale arrangements which are usually granted. Franchisees often argue that these supplier arrangements and their obligation to acquire goods or services from approved suppliers are "unfair" for a variety of reasons including that the franchisor or its associate receives a rebate or financial benefit from supplies made to the franchise network. These claims of unfairness are despite the fact that the franchisor is obliged to obtain (and has sought) protections under the CCA to include such a term in its franchise agreement and the arrangements are usually pro competitive. It is not clear if a clause that requires compliance by a franchisee to comply with supply arrangements could therefore be an "unfair contract term" and subject to the UCT protections even if it were allowed to stand through the notification/authorisation process by the ACCC.