

Mr James Mason
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: insolvency@treasury.gov.au

For enquiries please call James Mason +61 (2) 6263 4405.

Dear Treasury

Re: Treasury laws Amendment (2017 Enterprise Incentives No 2) Bill 2017

Our submission concerns the impact of ipso facto clauses on franchise agreements. We are academics in the Business School at UNSW Sydney.

Professor Jenny Buchan, PhD, LLM, LLB is a member of the ACCC's Small Business and Franchising Consultative Committee and an academic member of ARITA. Her LLM and PhD dissertations were on franchise law. Her PhD dissertation identified that it was not possible for franchisees to protect their investment in their franchise from the consequences of franchisor insolvency. Most of her research concerns the intersection of franchise law with consumer law and insolvency law.

Dr Rob Nicholls, PhD, MA, BSc (Hons) is a lecturer in business law at the UNSW Business School and a visiting research fellow at the Centre for Law, Markets and Regulation in the UNSW Law School. He is also a visiting fellow at UTS Sydney Law. His research interests focus on regulation including regulation of networked industries, the financial services sector and regulatory interactions with competition law and policy. Rob has had a thirty-year career concentrating on competition, regulation and governance.

Australia has approximately 1100 franchisors and the total sales revenue of franchisees was \$66.5 billion in 2016. Together with motor vehicle sales of \$43.4 billion and fuel retail of \$36 billion, franchising sector revenue in 2016 was \$146 billion.¹ Franchise sales revenue expressed as a percentage of gross domestic product is significantly higher in Australia than in the US, UK or New Zealand. The impact of this is that the unintended consequences of legislative change are likely to be amplified in the franchise sector.

In Australia franchise agreements are regulated through contract law and the *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (the Code).

Contract law

Currently if a franchisor enters administration the administrator has the benefit of an ipso facto clause contained in the franchise agreement. Reciprocal rights are not included in franchisee agreements for franchisees if the franchisor has a receiver appointed or enters administration or becomes insolvent. Examples of Termination clauses that appear in franchise agreements are:

- The franchisee commits an Event of Default if Franchisee or a Guarantor suffers an Insolvency Event

¹ Lorelle Frazer, Scott Weaven and Anthony Grace, 'Franchising Australia 2016' (2017).

- It is a Default if:
 - [The franchisee’s] Guarantors become insolvent (provided that if a Guarantor becomes insolvent, you and the Guarantors will be allowed 30 days to arrange with us for the provision of a new guarantor suitable to us).
 - without our approval, a controller is appointed or a secured creditor takes possession of you, Your Franchise, or a major part of the Business Assets [of the franchisee];
- Immediate termination follows if the franchisee become bankrupt, insolvent, under administration or an externally-administered body corporate

Another Australian franchise agreement states that the agreement may be terminated immediately by the franchisor if:

- (ii) the FRANCHISEE becomes bankrupt, insolvent under administration or an externally administered body corporate;

The Code

Clause 29 of the Franchising Code of Conduct 2014 further reinforces the right of a franchisor to terminate a franchise agreement if the franchisee fails. It states:

29 Termination—special circumstances

- (1) ..., a franchisor may terminate a franchise agreement ... if the agreement gives the franchisor the right to terminate the agreement should the franchisee:
 - (b) become bankrupt, insolvent under administration or an externally-administered body corporate

Notably, neither franchise agreements nor the Code provide reciprocal rights for franchisees. Franchisees provide an income stream for the franchisor’s administrator so there is no incentive for the franchisor’s administrator to distance him/her self from the franchise agreements. Franchisees become, effectively, a captive, and virtually costless source of revenue and a marketing arm for the administrator – and can be required to continue to sell outdated stock that the franchisor has selected. This is the type of conduct that occurred with the Angus and Robertson liquidation.

The problems with the one-sided ipso facto clause in franchising

1. Reinforces the assumption that the franchisee could fail but the franchisor will not. There are ample examples in Australia that demonstrate this is not reality – eg Traveland, Angus and Robertson, Speeds Shoes, Kleenmaid, the list is long.
2. Most franchisees will not (and cannot) negotiate ipso facto clauses into their agreements and will not be able to protect their own assets as well as franchisors can. Franchisees are unnecessarily vulnerable to the franchisor’s failure.
3. The franchisee may be able to run a successful business without the franchisor’s brand but the franchisee’s current inability to rely on an ipso facto clause deprives franchisees of the opportunity to trade independently if their franchisor fails.
4. Conversely, if the franchisee is failing and the franchisor exercises its ipso facto clause the franchisee’s creditors are deprived of the right to sell the franchise to recoup their investment.

The Law Council of Australia voiced its concern about this to the Wein review of franchising in 2013

The Law Council of Australia, Business Law Section, SME Business Law Committee notes that '[i]n the case of an insolvent franchisee, an insolvency appointment is likely to trigger an ipso facto clause in a franchise agreement which has the effect of the franchisor without reasonable or any notice, terminating the franchise, "stepping in" to the business of the franchisee and then continuing to operating the franchise and/or re-selling it without having to account to the franchisee for any goodwill or any other value of the franchisee's assets'. submission to the review, p2.²

5. We refer you to our attached 2 articles and the 2013 Report of the Review of franchising by Alan Wein that further inform our submission. Our articles are:
 - A. Buchan J, Frazer L, Zhen Qu C and Nicholls R, 2015, '**Franchisor Insolvency in Australia: Profiles, Factors, and Impacts**' *Journal of Marketing Channels*, vol. 22, pp. 311 – 332. <http://dx.doi.org/10.1080/1046669X.2015.1113487> This article is open source and can be cited. It maps the incidence of franchisor failure and its effect on franchisees.
 - B. Buchan J and Nicholls R, '**The law of unintended consequences: The effects of voiding ipso facto clauses in business format franchise agreements**'. This article is currently under review by an Australian law so this part of our submission must remain in confidence.

Proposed solution

Our recommendation is twofold:

- 1) **Our first recommendation** is that the Franchising Code should be amended to imply ipso facto clauses into franchise agreements for the benefit of franchisees, with conditions.

'A term would be implied into all franchise agreements that if an administrator is appointed to the franchisor or to any of the entities in the franchisor's network that threaten the viability of the franchisee's business, a 2 step process will be triggered:

Step 1: when an administrator is appointed to their franchisor any franchisee may give notice to the administrator that if a satisfactory resolution (restructuring that takes into account the franchisee's interests as well as those of the franchisor's creditors, or sale to appropriate buyer) is not found within x days, it will terminate the agreement,

Step 2: if the administrator does not meet the requirements in x days, the franchisee have the right to terminate the franchise agreement, without this being a deemed breach by the franchisee and without it compromising any other rights the franchisee may pursue. The franchisees may express their losses as unsecured creditors for an amount of their initial investment, adjusted by depreciation and other appropriate considerations, plus any amounts currently owed in the franchisor's administration/ subsequent insolvency.

This approach could be adopted in relation to both franchisor and franchisee failure. This would mean the current asymmetrical provisions in the Code and all franchise agreements favouring

² See Footnote 144, Review of the Franchising Code of Conduct, Mr Alan Wein, 30 April 2013.

franchisors in the event of franchisee failure could be removed from franchise agreements, thus making them shorter. It would also eliminate the risk of franchisees being sued by the administrator or liquidator for anticipatory breach'.³

Alan Wein considered the current law in relation to franchise insolvency in some depth in his review. We refer you to Review of the Franchising Code of Conduct, Mr Alan Wein, 30 April 2013, pages 43 – 48 of that Review, attached. Mr Wein's review concluded with the following recommendation concerning insolvency.

Recommendation by Wein Review

1. The Code be amended to:

- a. Provide franchisees and franchisors with a right to terminate the franchise agreement in the event that any administrator of the other party does not turn the business around, or a new buyer is not found for the franchise system, within a reasonable time (for example 60 days) after the appointment of an administrator. It should be made possible for the courts to make an order extending this timeframe in appropriate cases. It should also be clear that the parties can negotiate a right to terminate at an earlier stage.
- b. Ensure the franchisees can be made unsecured creditors of the franchisor by notionally apportioning the franchise fee across the term of the franchise agreement, so that any amount referable to the unexpired portion of the franchise agreement would become a debt in the event the franchise agreement ended due to the franchisor's failure.

- 2) **Our second recommendation** is that franchise agreements should be included in the category of contracts which will be excluded from the broad stay operation on the operation of ipso facto clauses.

We are available to elaborate on our submission.

Yours faithfully



Jenny Buchan and Rob Nicholls

jm.buchan@unsw.edu.au and r.nicholls@unsw.edu.au

Business School

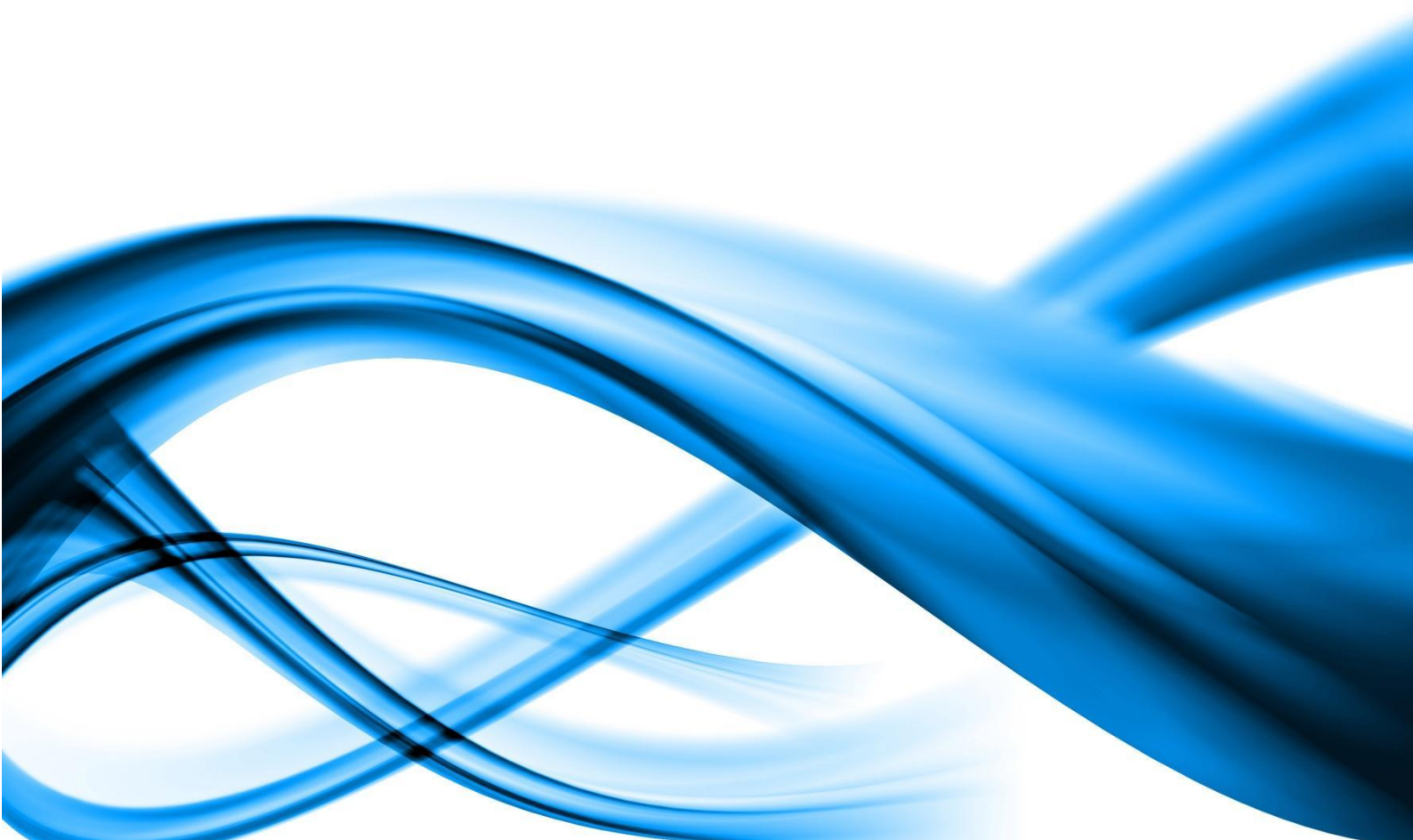
UNSW Sydney

³ Jennifer Mary Buchan, 'Franchisor Failure: An Assessment of The Adequacy of Regulatory Response'. PhD Dissertation, 2010 QUT, p 269.

Review of the Franchising Code of Conduct

Mr Alan Wein

30 April 2013



Report to: The Hon Gary Gray AO MP, Minister for Small Business
The Hon Bernie Ripoll MP, Parliamentary Secretary for Small Business

Review of the Franchising Code of Conduct

Report to: The Hon Gary Gray AO MP, Minister for Small Business

The Hon Bernie Ripoll MP, Parliamentary Secretary for Small Business

Mr Alan Wein

30 April 2013

© Commonwealth of Australia 2013

ISBN 978-1-922218-19-3



All material presented in this document is provided under a Creative Commons Attribution 3.0 Australia licence (<http://creativecommons.org/licenses/by/3.0/au/>). To the extent that copyright subsists in a third party, permission will be required from the third party to reuse the material.

The document must be attributed to Mr Alan Wein as *Review of the Franchising Code of Conduct: Report to the Hon Gary Gray AO MP, Minister for Small Business, and the Hon Bernie Ripoll MP, Parliamentary Secretary for Small Business.*

Letter to the Minister and Parliamentary Secretary

The Hon Gary Gray AO MP
Minister for Small Business
PO Box 6022
Parliament House
Canberra ACT 2600

The Hon Bernie Ripoll MP
Parliamentary Secretary for Small Business
PO Box 6022
Parliament House
Canberra ACT 2600

Dear Minister Gray and Parliamentary Secretary Ripoll

It is with great pleasure that I present to you this report, detailing my findings following a review of the Franchising Code of Conduct, in accordance with the terms of reference formally provided to me by former Minister for Small Business, the Hon Brendan O'Connor MP, on 4 January 2013.

We have a good franchise industry model in Australia and I have sought to improve upon that model with the recommendations put forward in this review. Generally, the Code operates effectively within a very dynamic and difficult economic environment. However, like most industries, there are changes that could be made to improve upon what is already a robust model.

I wish to ensure the industry has a strong regulatory framework, that mandates best practice where required, to ensure outcomes that all reasonable parties would agree produce fairness and enhance confidence in commercial dealings. On the other hand, I also wish to simplify some aspects of the industry's regulation, to ensure less red tape and improve clarity in compliance requirements. I would also like to see franchisors and franchisees have the benefits of pre-entry and ongoing education. I believe there is a strong role for the industry to play in this respect.

I have been assisted in my task by the outstanding contributions from all segments of stakeholders in the franchise sector. Contributions have been received from federal and state governments, regulatory bodies and commissioners, franchisees and franchisors, franchising and professional advisory industry bodies, legal and accounting professionals, and academics with an interest in the review. The review and my recommendations have been supported by a extensive public submission and consultation process with stakeholders. This has assisted me in understanding the information presented to the review, which has resulted in the recommendations I have put forward.

I am also grateful for the outstanding support provided by the secretariat from the Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education.

Yours sincerely



Mr Alan Wein
30 April 2013

Contents

Letter to the Minister and Parliamentary Secretary.....	i
Terms of reference.....	v
Executive summary	vi
Background	vi
Summary of recommendations	viii
Part One – Setting the scene	1
Introduction	1
The 2013 review.....	4
Key requirements of Australia’s competition and fair trading laws	6
State franchising regulation.....	13
Part Two – Disclosure.....	19
Introduction	19
Procedures relating to disclosure	19
Disclosure by foreign and master franchisors	23
Increasing numbers of franchisees from a non-English speaking background.....	26
The role of professional advice and education for prospective franchisees	28
Gaps in the current disclosure requirements	32
Efficacy of disclosure amendments as a whole	35
Part Three – Franchisor Failure.....	43
Introduction	43
Evidence considered during the review.....	44
Observations.....	46
Part Four: Transparency of financial information in a franchise	49
Introduction	49
Unforeseen capital expenditure	49
Rebates paid to the franchisor for supply to franchisees	53
Marketing funds.....	54
Profitability of the franchise and the disclosure of earnings information.....	58
Disclosure of payments to third parties.....	60
Part Five – Good faith	63
Introduction	63

Evidence considered during the review.....	66
Observations.....	80
Part Six –Transfer, renewal and end of term arrangements	83
Introduction	83
Transfer and novation.....	83
Renewal and end of term arrangements.....	87
Part Seven – Dispute resolution.....	110
Introduction	110
The 2010 Amendments to the Code.....	111
Use of other services to mediate.....	114
Alternative dispute resolution mechanisms	116
Confidentiality of dispute resolution	120
Franchisor attribution of legal costs to franchisees.....	121
Part Eight – Enforcement.....	124
Introduction	124
Evidence considered during the review.....	128
Observations.....	145
Recommendation.....	151
Part Nine – Particular issues for franchisees in the motor vehicle industry.....	152
Introduction	152
Evidence considered during the review.....	153
Observations.....	159
Recommendation.....	160
Part Ten – Future review of the Code.....	161
Introduction	161
Evidence considered during the review.....	161
Observations.....	161
Recommendation.....	162
Part Eleven – Technical or minor changes to the drafting of provisions of the Code	163
Introduction	163
Evidence considered during the review.....	163
Observations.....	164
Recommendation.....	165
Glossary.....	166

Appendix A: Previous reviews of franchising policy	167
Appendix B: Part IVB of the <i>Competition and Consumer Act 2010</i>	185
Appendix C: Differences between the Long Form and Short Form Disclosure Documents	190
Appendix D: Technical or minor changes to the drafting of provisions of the Franchising Code	192
Appendix E: Consultation.....	201
Appendix F: Summary of publicity relating to the review	206
Appendix G: ACCC Compliance and Enforcement Policy	208

Terms of reference

Introduction

In 2008, the Franchising Code of Conduct (the Code) was amended following a review chaired by Mr Graeme Matthews (*Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006).

Following an inquiry into franchising by the Parliamentary Joint Committee on Corporations and Financial Services (*Opportunity not opportunism: improving conduct in Australian franchising*, December 2008), and a report from a Government Expert Panel (*Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, February 2010), the Government made amendments to the Code in 2010.

As part of its response to the Parliamentary Joint Committee report, the Government undertook to review in 2013, the efficacy of the 2008 and any 2010 amendments to the Code.

In making this commitment, the Government stated that a 2013 review ‘would allow for a review after an adequate number of contracts, established after the amendments were implemented, have run their course (and that) the franchising sector deserves some certainty and stability before instigating another review’.

Terms of Reference for the Review

The reviewer is required to inquire into the efficacy of the amendments to the Code contained in the:

- *Trade Practices (Industry Codes – Franchising) Amendment Regulation 2007 (No 1)*; and
- *Trade Practices (Industry Codes – Franchising) Amendment Regulation 2010 (No 1)*.

Further, the reviewer is required to inquire into:

- good faith in franchising;
- the rights of franchisees at the end of the term of their franchise agreements, including recognition for any contribution they have made to the building of the franchise; and
- the operation of the provisions of the *Competition and Consumer Act 2010* as they relate to enforcement of the Code.

The reviewer is required to prepare a report suitable for public release to the Minister for Small Business, the Hon Brendan O’Connor MP, within three months of the date of commencement of the review. The report is to include findings and recommendations, based on evidence presented to the reviewer and these terms of reference. In gathering evidence to support findings and recommendations for the final report, the reviewer is required to undertake appropriate consultation, including with industry and interested State and Territory stakeholders.

Executive summary

Background

The terms of reference for the current review focus on the amendments made in 2008 and 2010 to the Franchising Code of Conduct (the Code), in addition to:

- good faith in franchising;
- the rights of franchisees at the end of the term of their franchise agreements; and
- provisions for enforcement of the Code.

The review follows a commitment made by the government in 2009, in its response to an inquiry into franchising by the Parliamentary Joint Committee on Corporations and Financial Services into franchising (Joint Committee).

Many amendments to the Code were progressed in 2008 and 2010. The amendments largely mandate further disclosure in the context of franchising relationships and respond to issues of concern that were raised in the course of reviews conducted in 2006 (by a committee led by Graeme Matthews), 2008 (by the Joint Committee) and 2010 (by an expert panel). In addition to disclosure requirements, there were also other important changes such as the requirement that franchisors provide franchisees with six months' notice of their intention to renew, or not renew, a franchise agreement. In 2010, amendments to the *Competition and Consumer Act 2010* were also made to provide the Australian Competition and Consumer Commission with new and increased enforcement powers including with respect to industry codes.

Some of the changes made in 2008 or 2010 were uncontroversial and were not raised in submissions. Accordingly, not every change that was made in 2008 or 2010 is discussed in this report.

An examination of the 2008 and 2010 changes to the regulation of the franchising industry, and the other matters raised in the terms of reference, must have regard to a wide range of factors. The recommendations in this review have been considered and based upon the following criteria (in no specific order):

- evidence and statistical data;
- the need for certainty;
- a cost benefit analysis;
- the need to consider any undesirable consequences of the recommendations;
- the promotion of improved conduct and behaviour;
- improved business and economic outcomes; and
- increased confidence in the franchising industry.

The Code aims to strike a balance between mandating best practice in relation to disclosure and not unduly constraining the operation of the market. It provides protection to those who need it most without restricting economic growth. Franchise relationships are commercial business relationships, which are regarded as a special type of commercial transaction due to the nature of the parties' bargaining positions and interdependent relationship.

Regulation of an industry must give stakeholders certainty and confidence. The government's role is to provide protection for vulnerable groups and people, and to regulate against conduct and behaviour which is improper, unacceptable and unlawful. It should otherwise allow the parties to negotiate agreements between themselves, accepting all the risks, opportunities, benefits and liabilities which flow as a consequence.

This report is structured into eleven parts and seven appendices. Part One – Setting the scene provides relevant context and history, including commentary on the prospect of state franchising regulation, which was an issue raised in many submissions. Parts two to eleven of the report relate to areas of franchising regulation which were included in the terms of reference as they relate to the 2008 and 2010 amendments to the Code or were topical within the franchising industry.

The report contains a total of 18 recommendations to government. The recommendations are not overly conservative, nor do they advocate an unduly interventionist approach from the government. The evidence shows the change in views since the last review of the Code of some key industry stakeholders and, in particular, that there has been a shift in attitudes toward pecuniary penalties and the introduction of an obligation of good faith. There are recommendations relating to an obligation to act in good faith being inserted into the Code, and the introduction of relatively modest civil pecuniary penalties for breaches of the Code. There are also a number of recommendations aimed at addressing specific problematic areas, for example, the issue of franchisor failure.

On the other hand, no recommendation has been made that franchisees receive an exit payment or goodwill payment at the end of the term of their franchise agreement. This would interfere with fundamental principles of contract and property law. However, a recommendation has been made relating to the use of restraint of trade clauses in the context of franchisors not renewing franchise agreements in certain circumstances.

Summary of recommendations

Disclosure

1. The Code be amended so that the provision of a notice under clause 20A of the Code, if it states the franchisor's intention to renew a franchise agreement, triggers a requirement to provide disclosure. A franchisee should not be bound by its exercise of an option to renew prior to the provision of disclosure by the franchisor.
2. The Code be amended to:
 - a. prescribe a short-form of disclosure that a foreign or master franchisor must provide to a master franchisee instead of requiring the foreign or master franchisor to provide disclosure in accordance with Annexure 1 of the Code;
 - b. ensure that only franchisees who do not also act as franchisors are provided with the full Annexure 1 disclosure document by their immediate franchisor; and
 - c. require that a copy of all short-form disclosure documents provided in accordance with (a) are provided to franchisees as an item of disclosure under Annexure 1.

The reduced disclosure document mentioned in (a) should include information such as:

- if applicable, any short-form disclosure document that has been provided to the disclosing party for the franchise;
 - the basic contact details and background of the foreign franchisor or master franchisor;
 - the essential obligations that have been delegated under the master franchise agreement;
 - information regarding intellectual property including the ownership or licensing arrangements that the franchisee will have rights to; and
 - what the impact will be on the subfranchisee if the master franchisee is terminated or not renewed.
3. The Code be amended to ensure that a franchisor is required to disclose the rights of the franchisor and franchisee to conduct and benefit from online sales, including any ability of the franchisor to conduct online sales.
 4. The Code be amended to remove Annexure 2 (Short form disclosure document for franchisee or prospective franchisee).
 5. The Code be amended to require franchisors to provide prospective franchisees with a short summary of the key risks and matters they should be aware of when going into franchising, based on the following principles:
 - a. the summary should be generic (as per the existing warnings in item 1 of Annexure 1 to the Code);
 - b. the summary should provide more detail than the current item 1 of Annexure 1 to the Code, but should not be more than one to two pages in length;
 - c. the summary should be a standalone document rather than incorporated into the disclosure document; and
 - d. the summary should be provided to franchisees at their first point of contact with a franchisor (that is, at the time of enquiring about a franchise opportunity).

Franchisor failure

6. The Code be amended to:
 - a. Provide franchisees and franchisors with a right to terminate the franchise agreement in the event that any administrator of the other party does not turn the business around, or a new buyer is not found for the franchise system, within a reasonable time (for example 60 days) after the appointment of an administrator. It should be made possible for the courts to make an order extending this timeframe in appropriate cases. It should also be clear that the parties can negotiate a right to terminate at an earlier stage.
 - b. Ensure the franchisees can be made unsecured creditors of the franchisor by notionally apportioning the franchise fee across the term of the franchise agreement, so that any amount referable to the unexpired portion of the franchise agreement would become a debt in the event the franchise agreement ended due to the franchisor's failure.

Transparency of financial information in a franchise

7. The Code be amended to prohibit franchisors from imposing unreasonable significant unforeseen capital expenditure. 'Unreasonable' and 'significant' should be defined, with a view to a franchisor being able to demonstrate a business case for capital investment in the franchised business.
8. The Code be amended with respect to the administration of marketing funds based on the following principles:
 - a. a franchisor should separately account for marketing and advertising costs;
 - b. contributions to marketing funds from individual franchisees should be held on trust for franchisees generally, with the franchisor to have wide discretion as to how to expend the funds (subject to principle 'e' below);
 - c. company-owned units must be required to contribute to the marketing and advertising fund on the same basis as franchised units;
 - d. the marketing and advertising fund should only be used for expenses which are clearly disclosed to franchisees by way of the disclosure document, and which are legitimate marketing and advertising expenses;
 - e. a once yearly independent audit should be conducted on marketing funds over a certain threshold value, with no capacity for franchisees to vote against such an audit; and
 - f. the results of the audit (where applicable) and other detailed information about the expenditure of marketing and advertising funds should be made available to franchisees yearly.

Good faith (and confidentiality of contact details for ex-franchisees)

9. The Code be amended to include an express obligation to act in good faith. Such an obligation should:
 - a. extend to the negotiation of a franchise agreement, the performance of a franchise agreement, the performance of obligations under the Code, and the resolution of any disputes between the parties whether or not there is a valid franchise agreement at the time of the dispute;
 - b. not be defined, instead the unwritten law relating to good faith should be incorporated in a manner similar to the unconscionable conduct prohibition set out in section 20 of the Australian Consumer Law;
 - c. apply to both the franchisor and the franchisee or prospective franchisee and the agents of these parties;
 - d. not be able to be limited or excluded by any provision of the contract between the

- parties (such provisions should be declared void);
- e. be clearly stated as not preventing a party from acting in its legitimate commercial interests; and
- f. expressly exclude an argument that a franchisor has not acted in good faith because there is no term in a franchise agreement specifying a right of renewal.

10. The Code be amended to ensure that a written request from a franchisee that its details not be disclosed to prospective franchisees has in fact been initiated by the franchisee, for example by prohibiting a franchisor from initiating, procuring or encouraging such a request from a franchisee.

The transfer, renewal or end of a franchise agreement

11. That subclause 20(4) of the Code be amended to read:
- a. The franchisor is taken to have given consent to the transfer or novation if the franchisor does not, within 42 days after the request was made, or all information reasonably required by the franchisor under the franchise agreement has been provided, whichever is the latter, give to the franchisee written notice:
 - (i) that consent is withheld; and
 - (ii) setting out why consent is withheld.
 - b. The franchisee should take all reasonable steps to provide all information required under the franchise agreement to enable the franchisor to be able to properly evaluate the request. [Amendments underlined]
12. The Code be amended to state that, if all of the following conditions are satisfied:
- a. the franchisee wishes to have the franchise agreement renewed on substantially the same terms;
 - b. the franchisee is not in breach of the agreement;
 - c. the agreement does not contain provisions allowing a franchisee to make a claim for compensation in the event that the franchise is not renewed;
 - d. the franchisee abides by all confidentiality clauses in the agreement and does not infringe the intellectual property of the franchisor; and
 - e. the franchisor does not renew the franchise agreement;

any restraint of trade clauses in the franchise agreement which prevent the franchisee from carrying on a similar business in competition with the franchisor, are not enforceable by the franchisor against the franchisee.

Dispute resolution

13. The Code should be amended to provide that clause 29(8) applies to participation in any alternative dispute resolution process whether under OFMA, state small business commissioners, privately retained; court appointed or otherwise.
14. Amend the Code to ensure that franchisors cannot:
- a. attribute the legal costs of dispute resolution to a franchisee unless ordered by a court;
 - b. require a franchisee to litigate outside the jurisdiction in which the franchisee's business primarily operates.

Enforcement

15. The Competition and Consumer Act 2010 (the CCA) be amended to:
 - a. allow civil pecuniary penalties to a maximum of \$50 000 to be available as a remedy for a breach of the Code;
 - b. allow the ACCC to issue an infringement notice for a breach of the Code;
 - c. allow the ACCC to use its powers under section 51ADD of the CCA (its random audit powers) to assess a franchisor's compliance with all aspects of the Code, not just to require the production of documents created under the Code;
 - d. include a breach of the Code in the contraventions for which the court may make an order under section 86E (Order disqualifying a person from managing corporations); and
 - e. specify that the court can make franchising specific orders under section 87, including orders requiring a franchisor to:
 - i. give a royalty free period to a franchisee affected by a breach of the Code; and
 - ii. pay a sum of money specified by the court into any marketing or cooperative fund applicable to that franchise system.

Other matters

16. An analysis of the impact of a minimum term and standard contractual terms for motor vehicle agreements should be undertaken prior to a future review of the Code.
17. There should not be another review of the Code for a minimum of five years after any amendments to the Code take effect in response to this report.
18. The Code be amended to make the policy intent of the provisions clearer, remove ambiguities, and improve consistency and certainty of industry practice. A suggested list of provisions and possible changes is set out in Appendix D: Technical or minor changes to the drafting of provisions of the Franchising Code.

Part One – Setting the scene

Introduction

The franchising industry

The figures illustrating the importance of the franchising industry to the Australian economy are well-known. According to Griffith University's *Franchising Australia 2012* report, there are approximately 73 000 franchise units in Australia, with an annual turnover in the order of \$131 billion, employing around 413 500 people.¹

To put that in some perspective, the Australian Bureau of Statistics has indicated that there are around 2 045 375 small businesses in Australia.²

Australian franchising is regulated by a single, national system, through a combination of:

- the Franchising Code of Conduct (the Code);
- laws relating to fair trading and business operations, primarily the *Competition and Consumer Act 2010* (the CCA), the Australian Consumer Law (ACL), the *Australian Securities and Investments Commission Act 2001* and the *Corporations Act 2001*; and
- the unwritten law (also known as the common law).

Previous reviews of franchising

Franchising has been reported on by government and parliamentary committees, at both federal and state levels, many times since the concept of franchising regulation was first put forward in 1976. Tables showing the main recommendations of the most recent reviews are at Appendix A: Previous reviews of franchising policy.

Consideration of the specific regulation of the franchising industry started with the Trade Practices Act Review Committee (the Swanson Committee), which released its report in August 1976.³ One of the issues it considered was compensation to franchisees for the loss of goodwill upon the termination or non-renewal of their franchise agreement by the franchisor. It recommended that franchisees be given the right to just and equitable compensation. That recommendation was not enacted.

This was followed by the Trade Practices Consultative Committee (the Blunt Review), which released its report, *Small business and the Trade Practices Act*, in December 1979.⁴ It recommended changes to the (then) *Trade Practices Act 1974* to include franchise specific provisions, including:

¹ Griffith University, Asia-Pacific Centre for Franchising Excellence, *Franchising Australia 2012*, pp 10-12.

² Note, a small business is defined as a business employing less than 20 people. Australian Bureau of Statistics, Cat No. 8165.0, *Counts of Australian Business, including Entries and Exits*, June 2007 to June 2011, January 2012, p 21.

³ See Trade Practices Act Review Committee, *Report to The Minister for Business and Consumer Affairs*, August 1976.

⁴ See Trade Practices Consultative Committee, *Small business and the Trade Practices Act*, December 1979.

- requiring disclosure of information by franchisors;
- stipulating the circumstances in which agreements could be terminated;
- providing franchisees with rights in relation to transferring a franchise to another person;
- the apportionment of goodwill on the termination or non-renewal of an agreement by the franchisor; and
- the imposition of pecuniary penalties for a breach of the pre-franchise disclosure provisions of the proposed amendments to the *Trade Practices Act 1974*.

In 1986, the Ministerial Council for Companies and Securities released two drafts of the Franchise Agreements Bill for public comment. The first exposure draft:

...proceeded on the basis that various measures of 'unfairness' should be eradicated from franchise agreements, irrespective of the views of the parties to such agreements.⁵

The second exposure draft, on the other hand, was focussed primarily on:

...providing information to potential franchisees prior to their entering into a franchise agreement. (It neither seeks to ensure that franchise agreements are fair nor does it seek to ensure that potential franchisees are aware at the outset of all the potential pitfalls.⁶ [emphasis added])

The second exposure draft also created a criminal offence of offering or accepting payments in relation to a franchise system where the person involved 'has no reasonable grounds for believing that he will be able to perform his obligations under the agreement'.⁷ The proposed penalty for a breach was a fine of up to \$20 000 or imprisonment for five years, or both.

Neither Bill became an Act. At this time franchising was largely regulated under the now repealed *Close Corporations Act 1989*, which aimed to 'simplify the corporate rules for small business by reducing financial and other reporting requirements'.⁸

In 1990, the House of Representatives Standing Committee on Industry, Science and Technology, chaired by the Hon David Beddall MP, looked at small business regulation.⁹ Recommendation 54 of the Committee report, *Small business in Australia: Challenges, problems and opportunities*, addressed the franchising industry:

The Committee recommends that the Commonwealth Attorney-General and Ministerial Council re-examine the case for specific franchise agreement legislation which would contain:

- prior disclosure documentation;
- a cooling-off period;

⁵ See [Franchise Agreements Bill 1986, Explanatory Memorandum](#), pp 2-3.

⁶ See [Franchise Agreements Bill 1986, Explanatory Memorandum](#), pp 2-3.

⁷ See [Franchise Agreements Bill 1986, Explanatory Memorandum](#), p 27.

⁸ See [Close Corporations Bill 1988, Explanatory Memorandum](#) p 1.

⁹ See the report of the House Standing Committee on Industry, Science and Technology, [Small business in Australia: Challenges, problems and opportunities](#), May 1990.

- conditions for alteration to the agreement; and
- conditions for termination/renewal or transfer of franchises.¹⁰

In 1993, following the recommendations of the 1990 Standing Committee, a voluntary Franchising Code of Practice was introduced. It included provisions on disclosure to franchisees, a cooling off period, standards of conduct based on unconscionability and dispute resolution procedures.

The voluntary Code of Practice was reviewed by an experienced franchising solicitor, Robert Gardini, in 1994. Mr Gardini found that only 40 to 50 per cent of franchisors had registered under the Code and that standards under the Code were ineffective. He concluded that:

In view of the lack of coverage of the Code across the franchise sector, and the failure of the present standards of conduct provisions to address serious franchise problems [it is recommended] a system of mandatory self-regulation or co-regulation be introduced to provide universal coverage for franchise systems.¹¹

The House of Representatives Standing Committee on Industry, Science and Technology, this time under Mr Bruce Reid MP, revisited small business and fair trading issues in 1997. In May of that year it released its report, *Finding a balance: Towards fair trading in Australia*¹², which stated that the Committee:

...is convinced that self-regulation has not worked in part because it does not provide a viable regulatory strategy when there is such a disparity in the powers of the parties.¹³

Recommendation 3.3 addressed the franchising industry:

The Committee recommends that the Commonwealth enact specific franchising legislation providing for compulsory registration of franchisors and compliance with codes of practice.

...The legislation should provide for adequate disclosure requirements, the establishment of appropriate independent code administration bodies, and dispute resolution procedures funded through compulsory registration fees.¹⁴

The following year, the Code was introduced as a mandatory industry code under the then *Trade Practices Act 1974*, coming into full effect on 1 July 1998. This was the first industry code, leading to the establishment of the industry code framework. The purpose of the Code, as set out in Clause 2, 'is to regulate the conduct of participants in franchising towards other participants in franchising'.¹⁵

¹⁰ See the report of the House Standing Committee on Industry, Science and Technology, [Small business in Australia: Challenges, problems and opportunities](#), May 1990 p ivi.

¹¹ Robert Gardini, *Review of the Franchising Code of Practice, Report to Senator, the Hon Chris Schacht, Minister for Small Business, Customs and Construction*, October 1994, p v.

¹² See the report of the House Standing Committee on Industry, Science and Resources, [Finding a balance: Towards fair trading in Australia](#), May 1997.

¹³ See the report of the House Standing Committee on Industry, Science and Resources, [Finding a balance: Towards fair trading in Australia](#), May 1997 p 118.

¹⁴ See the report of the House Standing Committee on Industry, Science and Resources, [Finding a balance: Towards fair trading in Australia](#), May 1997, p xxii.

¹⁵ *Trade Practices (Industry Codes – Franchising) Amendment Regulation 1999 (No. 1)*.

As part of its introduction of the Code, the Government established an advisory board, the Franchising Policy Council, comprising three franchisors, three franchisees, two advisers and an independent Chair, the Hon Michael MacKellar.

In May 2000, the Council produced the first major review of the Code, *Review of the Franchising Code of Conduct, Report of the Franchising Policy Council*.¹⁶ It made a number of 'key conclusions' in relation to the Code, including:

- there is 'strong support from most participants in the franchising industry' for the Code;
- 'on balance, the benefits that the mandatory Code provides to the franchising industry outweigh the compliance requirements';
- a short-form disclosure document for franchises with a turnover of less than \$50 000 per annum could be considered;
- 'sector specific codes have an apparent attractiveness [however] the retention of the single generic franchising Code' is recommended;
- 'the overall statutory protections associated with the Code are appropriate and they are producing beneficial practical outcomes'; and
- pecuniary penalties should not be introduced for a breach of the Code, however, 'the issue of termination at will of a franchise by the franchisor needs to be monitored' and 'procedural steps should be inserted in the Code to cover termination by the franchisee'.¹⁷

The amendments arising from the Council review were enacted in the Trade Practices (Industry Codes – Franchising) Regulation 2001 (No. 1).

The 2013 review

Background

A second examination of the Code was undertaken by a committee led by Graeme Matthews.¹⁸ It was tasked with reviewing the operation of the disclosure provisions of the Code. Its report, *Review of the disclosure provisions in the Franchising Code of Conduct*, was presented to the Government on 31 October 2006 and led to the *Trade Practices (Industry Codes – Franchising) Amendment Regulation 2007 (No 1)*, which contained the 2008 amendments to the Code that are part of this review. See Appendix A: Previous reviews of franchising policy for details of the 2008 amendments.

In 2008, the Parliamentary Joint Committee on Corporations and Financial Services (the Joint Committee) established an inquiry into:

...the operation of the Code, and to identify, where justified, improvements to the Code, with particular reference to:

¹⁶ See the Hon Michael MacKellar (Chair), Report of the Franchising Policy Council, *Review of the Franchising Code of Conduct*, May 2000.

¹⁷ See the Hon Michael MacKellar (Chair), Report of the Franchising Policy Council, *Review of the Franchising Code of Conduct*, May 2000, pp 9 – 11.

¹⁸ See Graeme Matthews (Chair), Report to the Hon Fran Baily MP Minister for Small Business and Tourism, *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006.

- (a) the nature of the franchising industry, including the rights of both franchisors and franchisees;
- (b) whether an obligation for franchisors, franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code (having regard to its presence as an element in paragraph 51AC(4)(k) of the *Trade Practices Act 1974*);
- (c) interaction between the Code and Part IVA and Part V Division 1 of the *Trade Practices Act 1974*, particularly with regard to the obligations in section 51AC of the Act;
- (d) the operation of the dispute resolution provisions under Part 4 of the Code; and
- (e) any other related matters.

The Joint Committee released its report, *Opportunity not opportunism: improving conduct in Australian franchising*¹⁹ (the Joint Committee Report), in December 2008.

As part of its response to the Joint Committee Report, the Government established an Expert Panel in 2009. In addition to looking at unconscionable conduct under the then *Trade Practices Act 1974*, the Expert Panel was asked to consider proposals relating to:

...the need to introduce into the Franchising Code of Conduct a list of examples of specific behaviours that may be inappropriate in a franchising arrangement, with particular reference to five behaviours:

- unilateral contract variation;
- unforeseen capital expenditure;
- franchisor-initiated changes to franchise agreements when a franchisee is trying to sell the business;
- attribution of legal costs; and
- confidentiality agreements.

The Expert Panel presented its report, *Strengthening Statutory Unconscionable Conduct and the Franchising Code of Conduct*, to the Government in 2010.²⁰

The Government published its response to both the Joint Committee report in November 2009.²¹ Along with the Expert Panel report, it resulted in the 2010 amendments made to the Code and to the CCA that are the subject of this review. It also committed to:

...review the efficacy of the 1 March 2008 amendments, and any amendments to the Franchising Code proposed as part of this response to the Joint Committee report, in 2013.²²

¹⁹ See Parliamentary Joint Committee on Corporations and Financial Services report, *Opportunity not opportunism: improving conduct in Australian franchising*, 1 December 2008 (Joint Committee Report).

²⁰ See Report to the Hon Dr Craig Emerson MP, Minister for Small Business, Independent Contractors and the Service Economy, Minister for Competition Policy and Consumer Affairs, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, February 2010 (Expert Panel Report).

²¹ See [Government Response to the Joint Committee Report](#), November 2009.

Consultation

The review was also required to ‘undertake appropriate consultation, including with industry and interested State and Territory stakeholders’. Details of the consultation undertaken by me and the review secretariat are set out in Appendix E: Consultation.

Briefly, the following steps were taken to encourage submissions and gather evidence:

- 61 letters were sent to identified key stakeholders, inviting them to make submissions to the review;
- 73 submissions, not counting material provided to supplement existing submissions, were received from stakeholders, as well as various correspondence and emails that were not classified or intended to be formal submissions to the review;
- face-to-face meetings with 24 stakeholders were held in Sydney, Brisbane, Melbourne, Canberra and Perth and teleconferences and video-links were used to allow me to meet with various stakeholders and to attend a special meeting of the ACCC’s Franchising Consultative Committee;
- an op-ed was provided to various media outlets;
- interviews discussing the review were given in various media outlets;
- having regard to the increasing number of franchisees coming from non-English speaking backgrounds, particularly from the Asian and other sub-continental communities, notices were sent to chambers of commerce and media outlets for ethnic communities, with a request that it be circulated to their members (see Appendix F: Summary of publicity relating to the review);
- at the request of the review secretariat, the Department of Immigration and Citizenship circulated the notice to a range of ethnic community groups; and
- the same notice was sent to the Franchising Council of Australia, with a request that it be sent to its members and that franchisor members, in turn, be asked to send the notice to franchisees.

Key requirements of Australia’s competition and fair trading laws

An understanding of the key requirements of Australia’s competition and fair trading laws – the Franchising Code of Conduct, the *Competition and Consumer Act 2010 (Cth)* (CCA) and the Australian Consumer Law (ACL), as they relate to franchising – is valuable background when reading this report.

Franchising Code of Conduct (the Code)

The Code is a prescribed, mandatory industry code under Part IVB of the CCA. It was introduced in 1998 ‘to regulate the conduct of participants in franchising towards other participants in franchising’.²³ There are consequences for non-compliance; a breach of the Code is a breach of section 51AD of the CCA, however, a court cannot impose a civil pecuniary penalty for a breach of section 51AD.

²² See [Government Response to the Joint Committee Report](#), November 2009, p 23.

²³ Refer to *Trade Practices (Industry Codes – Franchising) Regulations 1998*, Schedule (Franchising Code of Conduct), clause 2.

Broadly, the Code requires franchisors to disclose specific facts to franchisees and to follow set procedures in their dealings with franchisees. The Code also provides a cost effective dispute resolution scheme for franchisors and franchisees.

The ACCC has responsibility to ensure compliance with the Commonwealth's competition, fair trading and consumer protection laws, including industry codes. This includes engaging in education and compliance activities in relation to industry codes, such as the Franchising Code of Conduct. The ACCC has a range of publications relating to franchising, as well as competition and consumer law generally, that are available from its website, www.accc.gov.au.²⁴

Disclosure

The Code requires franchisors and master franchisees to provide a franchisee or a prospective franchisee with a copy of the Code; a disclosure document in the required form; and a copy of the franchise agreement in the form in which it is to be executed. These disclosure requirements are to help a franchisee or a potential franchisee 'make a reasonably informed decision about the franchise' before entering into, renewing or extending the scope of a franchise agreement by giving the franchisee 'current information from the franchisor that is material to the running of the franchised business.'²⁵ The Code describes a specific format for disclosure documents and also requires long- and short-form disclosure documents be given to franchisees in certain circumstances.

Disclosure is also required during a franchise agreement. This includes where a disclosure document does not contain a materially relevant fact (such as a change in the franchisor's majority ownership or control) – the franchisor must tell the franchisee or prospective franchisee about it 'within a reasonable time (but not more than 14 days) after the franchisor became aware of it'.²⁶

Disclosure requirements are discussed in more detail in Part Two - Disclosure.

Rights and obligations

Rights and obligations under the Code extend beyond those obligations imposed on a franchisor for disclosure. For example:

- a franchisor must not enter into, renew, extend or extend the scope of a franchise agreement unless the franchisor has received a signed statement from the franchisee or prospective franchisee that it has received, read and had a reasonable opportunity to understand the disclosure document (subclause 11(1));
- before a franchise agreement is entered into, the franchisor must have obtained from the prospective franchisee signed a statement that it has received advice about the proposed franchise agreement or franchised business, or a signed statement confirming that it has been told that the advice should be sought but have decided not to seek it (subclause 11(2));
- there is a cooling off period that allows a franchisee to terminate an agreement within seven days after entering into the agreement or making any payment under the agreement, whichever is earlier (subclause 13);

²⁴ See generally, [ACCC Publications](#) (accessed 11 April 2013).

²⁵ Refer to *Trade Practices (Industry Codes – Franchising) Regulations 1998*, Schedule (Franchising Code of Conduct), clause 6A.

²⁶ Refer to *Trade Practices (Industry Codes – Franchising) Regulations 1998*, Schedule (Franchising Code of Conduct), clause 18.

- a franchisor must not discourage a franchisee or prospective franchisee from forming an association or associating with other franchisees or prospective franchisees for a lawful purpose (subclause 15); and
- franchise agreements entered into on or after 1 July 1998 must not contain, or require a franchisee to sign, a general release of the franchisor from liability towards the franchisor (subclause 16).

Certain aspects of these requirements were affected by the 2008 and 2010 amendments and were considered by this review.

Dispute resolution

The Code establishes a dispute resolution scheme for parties to a franchise agreement. It requires that franchise agreements contain a complaints handling procedure²⁷ and provides that parties should first try to resolve the dispute with each other. If a satisfactory outcome is not reached, the Code provides for mediation.

The Office of the Franchising Mediation Adviser (OFMA) provides a mediation service for those operating under the Code. OFMA can provide early intervention services or assess a complaint and appoint a mediator to help parties negotiate and resolve their dispute.

The parties to a dispute are equally liable for the costs of mediation unless they agree otherwise. Costs of mediation include the cost of the mediator, the cost of room hire and the cost of any additional input agreed by both parties to be necessary, including expert reports.

Dispute resolution is discussed in more detail in Part Seven – Dispute Resolution.

Competition and Consumer Act 2010 (Cth)

The CCA replaced the *Trade Practices Act 1974* as part of the introduction of the ACL in 2010. The object of the CCA 'is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.'²⁸

Industry codes

Part IVB of the CCA relates to industry codes. Section 51AE of the CCA allows for industry codes to be prescribed in regulations. Under section 51AD a corporation must not, in trade or commerce, contravene an applicable industry code. As a prescribed industry code, participants in the franchising industry must, therefore, comply with the Code.

There are three other mandatory codes established under the section 51AE: the Horticulture Code of Conduct, the Oilcode and the Unit Pricing Code. In 2011, the Treasury published *Policy guidelines for prescribing industry codes under Part IVB of the Competition and Consumer Act 2010*, which set out the types of considerations that may be taken into account by the Government when deciding whether to prescribe an industry code of conduct under the CCA to apply to a particular industry.²⁹

²⁷ Refer to *Trade Practices (Industry Codes – Franchising) Regulations 1998*, Schedule (Franchising Code of Conduct), Part 4.

²⁸ Refer to *Competition and Consumer Act 2010 (Cth)*, section 2.

²⁹ See Commonwealth Treasury, *Policy Guidelines on Prescribing Industry codes under Part IVB of the Competition and Consumer Act 2010*, May 2011.

Part IV of the CCA prohibits a range of restrictive trade practices. Broadly speaking, these are practices that prevent or limit competition. Part IV applies to franchisors and franchisees alike. Prohibited conduct under Part IV includes:

- **Anti-competitive agreements:** Under section 45 of the CCA a contract cannot contain an exclusionary provision or a provision that ‘has the purpose, or has or is likely to have the effect, of substantially lessening competition’. An exclusionary provision is an agreement or understanding between competitors that has the purpose of restricting the supply of goods or services.
- **Misuse of market power:** Section 46 of the CCA prevents a trader with a substantial degree of power in a market from using its power to prevent competition in that or another market. This may include ‘eliminating or substantially damaging a competitor’ or preventing a person from entering into a market.
- **Exclusive dealing:** Subject to section 47 of the CCA, ‘a corporation shall not, in trade or commerce, engage in the practice of exclusive dealing.’ Exclusive dealing is, broadly, where one person trading with another person imposes restrictions on the other’s freedom to choose with whom, in what or where they do business. Most types of exclusive dealing are prohibited only when they substantially lessen competition. The ACCC may, where there is not a substantial lessening of competition, grant a business an exemption for certain types of exclusive dealing, which may be particularly relevant to franchising relationships.
- **Third line forcing:** This is a form of exclusive dealing where goods or services are supplied by a business on the condition that the purchaser buys other goods or services from a third party unrelated to the supplier. It is prohibited regardless of its effect on competition but can be notified to the ACCC and gain legal protection, subject to the provisions of the CCA.³⁰

The below table sets out other provisions of the CCA of particular relevance to the enforcement of the Code:

Part VI	Enforcement and remedies
75B	Interpretation provision relating to Part VI of the CCA.
76	Gives a court the power to order a person to pay a pecuniary penalty for a contravention of certain provisions of the CCA, but not including section 51AD.
80	Gives a court the power to order injunctions for a contravention of certain provisions of the CCA, including section 51AD.
82	Allows ‘a person who suffers loss or damage by conduct of another person that was done in contravention of a provisions of Part IV or IVB [to] recover the amount of the loss or damage by action against that other person or against any person involved in the contravention.’
83	Provides that a finding of fact by a court that a person ‘has been found to have contravened, or to have been involved in a contravention’ of Part IVB of the CCA is <i>prima facie</i> evidence of that fact.

³⁰ See Australian Competition and Consumer Commissioner, [Guide to Exclusive Dealing Notifications](#), 2011.

Part VI	Enforcement and remedies
84	Provides for establishing the state of mind of a body corporate where that is necessary to establish the conduct of a body corporate.
86	Establishes the respective jurisdictions of the Federal Court and the Federal Magistrates Court, relating to contraventions of Part IVB of the CCA.
86AA	Limits the amount of damages that can be ordered by the Federal Magistrates Court in proceedings under section 86.
86A	Provides for the transfer of proceedings, including proceedings under Part IVB, from the Federal Court to a state or territory court, if the proceedings are related.
86C	Gives a court the power to make non-punitive orders, including for a contravention of Part IVB of the CCA, including community service, probation, disclosure and advertising orders.
87	Gives a court the power to 'make such order or orders as it thinks appropriate against the person who engaged in the conduct or a person who was involved in the contravention...if the Court considers that the order or orders concerned will compensate the first-mentioned person in whole or in part for the loss or damage or will prevent or reduce the loss or damage', including for a contravention of section 51AD.
87B	Gives the ACCC power to accept written undertakings from a person and that a breach of a term of an undertaking may be enforceable by a court, including for a contravention of section 51AD.
87CA	Gives the ACCC the power to intervene in proceedings instituted under the CCA, with the leave of the court and subject to any conditions the court imposes.
87CB – 87CI	Provides for apportionable claims in action for damages under section 246 of the ACL for a contravention of section 18 of the ACL.
Part XI	Application of the Australian Consumer Law as a law of the Commonwealth
131-131C	Provides for the application of the ACL as a law of the Commonwealth.
134A	Provides the ACCC with the power to issue an infringement notice for a breach of certain provisions of the ACL, where it 'has reasonable grounds to believe that a person has contravened an infringement notice provision' of the ACL. [Note: Contravention of an industry code is not a contravention of the ACL]
Part XID	Search and seizure
154-154ZC	Provides powers to ACCC officers to enter premises to obtain evidence or to execute search warrants where there has been a contravention of the CCA, including for a contravention of section 51AD.

Part XII	Miscellaneous
155	Provides that the ACCC can issue a notice requiring a person to provide it with information or documents or to appear to give evidence, where it 'has reason to believe that a person is capable of furnishing information, producing documents or giving evidence relating to a matter that constitutes, or may constitute, a contravention' of the CCA, including for a contravention of section 51AD.
155AAA	Provides that an officer of the ACCC must not disclose any protected information, as defined by the section, except in the performance of their duties or as required by law.
156	Provides for the inspection of documents produced in accordance with a notice issued under section 155 of the CCA.
157	Provides for a person to make an application for the provision of documents by the ACCC to the person, including where the ACCC has commenced proceedings against the person for a contravention of section 51AD.
159	Provides that a person 'is not excused from answering a question, or producing a document, on the ground that the answer to the question, or the document, may tend to incriminate the person or expose the person to a penalty'.
162A	Makes it a criminal offence to threaten, intimidate or coerce a person because that person has furnished, or proposes to furnish, information or a document to the ACCC. A breach of section 162A is punishable by a fine of up to 20 penalty units (\$3400) or 12 months imprisonment.

Australian Consumer Law

The ACL is a national law regulating for consumer protection and fair trading. It commenced as law of the Commonwealth on 1 January 2011 and applies to all Australian businesses, creating a uniform framework for protecting consumers and imposing the same obligations and responsibilities on businesses regardless of where they operate in Australia. The ACL is in Schedule 2 of the CCA and is enforced, at a Commonwealth level, by the ACCC.

The ACL includes:

- definitions and interpretative provisions about consumer law concepts;
- consumer protection, including general bans on:
 - misleading or deceptive conduct in trade or commerce;
 - unconscionable conduct in trade or commerce;
 - specific bans in relation to certain forms of misleading conduct; and
 - unfair contract terms in consumer contracts;³¹

³¹ It should be noted that the unfair contract term provisions of the ACL apply only to consumer contracts and not to contracts between businesses.

- specific protections, including:
 - banning unfair practices in trade or commerce;
 - provisions relating to consumer transactions;
 - the creation and enforcement of information standards; and
 - manufacturer liability for goods with safety defects.

Where applicable, these laws may regulate franchisees and franchisors, in addition to the requirements in the Code.

Misleading or deceptive conduct

Section 18 of the ACL prohibits misleading or deceptive conduct in trade or commerce.

Contravention of the misleading or deceptive conduct provision is subject to remedies including injunctions, damages and compensatory orders. Civil penalties and criminal sanctions do not apply to section 18.

False or misleading representations

Section 29 of the ACL prohibits false or misleading representations about goods or services, including a person must not make a false or misleading representation. This is a more specific prohibition than the general one contained in section 18. Prohibited conduct includes making a false or misleading representations that:

- goods are of a particular standard, quality, value, grade, composition, style or model or have had a particular history or particular previous use;
- services are of a particular standard, quality, value or grade;
- goods are new;
- a particular person has agreed to acquire goods or services;
- purports to be a testimonial by any person relating to goods or services;
- goods or services have sponsorship, approval, performance characteristics, accessories, uses or benefits; or
- that there is a need for any goods or services.

The ACL also specifically prohibits certain conduct that has particular relevance to the Code, such as making misleading representations:

- in connection with the sale or grant of an interest in land (section 30); and
- concerning the profitability, risk or other key aspect of certain business activities (section 37).

The effect is that it is possible that conduct that breaches the Code may also breach one of those provisions of the ACL.

Unconscionable conduct

Section 20 of the ACL prohibits unconscionable conduct in trade or commerce within the meaning of the unwritten law from time to time and, under sections 21 and 22, more specific forms of unconscionable conduct in consumer and certain business transactions, respectively. The ACL retains the general prohibition on unconscionable conduct that existed in Part IVA of the former *Trade Practices Act 1974*.

Remedies available for a breach of the unconscionable conduct provisions of the ACL include injunctions, damages compensatory orders, non-punitive orders, adverse publicity orders, civil pecuniary penalties and disqualification orders.

The table below sets out provisions of the ACL that have particular relevance to enforcement of the Code:

Part 5-1	Enforcement
218	Gives the ACCC power to accept written undertakings from a person and that a breach of a term of an undertaking may be enforceable by a court.
219	Gives the ACCC the power to issue a substantiation notice, requiring a person to provide information or documents 'that could be capable of substantiating or supporting' a claim made by the person in trade or commerce.
223	Gives the ACCC the power to issue a public warning notice, where is 'has reasonable grounds to suspect that the conduct may constitute a contravention of a provision of Chapter 2, 3 or 4' of the ACL; 'is satisfied that one or more other persons has suffered, or is likely to suffer, detriment as a result of the conduct [and] it is in the public interest to issue the notice'.
Part 5-2	Remedies
224	Gives a court the power to order civil pecuniary penalties for contraventions of Part 3-1 of the ACL, of up to \$1.1 million for bodies corporate and \$220 000 for persons.
226	Allows a court to relieve a person from whole or part of the liability for a civil pecuniary penalty imposed under section 224, if it is satisfied that 'the person acted honestly and reasonably and, having regard to all the circumstances of the case ought fairly to be excused'.
227	Where a court orders a person to pay a civil pecuniary penalty under section 224 and compensation also relating to the conduct, and the person 'does not have sufficient financial resources to pay both the pecuniary penalty and the compensation', priority should be given to making an order for compensation.
228	Requires the ACCC to recover civil pecuniary penalties as a civil action.
232	Gives a court the power to grant an injunction if it is satisfied that the person has engaged in or is proposing to engage in conduct that would contravene certain provisions of the ACL.

Part 5-2	Remedies
234	If an application is made for injunctions under section 232, the court may grant an interim injunction 'if it considers it is desirable to do so...pending the determination of the application.'
236	Gives a person the right to seek damages for 'loss or damage' arising from a contravention of Chapter 2 or 3 of the ACL.
237	Allows the ACCC or a person to apply to a court for a compensation order, to compensate them for 'loss or damage' suffered or likely to be suffered, as a result of a contravention of Chapter 2, 3 or 4 of the ACL.
238	Gives a court the power to make a compensation order if it finds during other proceedings that a person has suffered loss or damage because of a contravention of Chapter 2, 3 or 4 of the ACL.
239	Gives the ACCC the power to apply to a court for orders to give redress to persons not named in the proceedings ('non-party consumers'), where there has been a contravention of Chapter 2, Part 3-1, Division 2, 3 or 4 of Part 3-2 or Chapter 4 of the ACL.
243	Gives a court the power to make various orders under sections 237, 238 and 239 of the ACL, including orders declaring the whole or part of a contract void or to vary a contract; preventing the enforcement of a provision of a contract; ordering the refund of money and directing the payment of compensation for loss or damage.
246	Gives a court the power to make non-punitive orders, including community service orders; for the establishment of a compliance or education and training program; the disclosure of specified information and corrective advertising, in relation to a contravention of Chapter 2, 3 or 4 of the ACL.
247	Gives a court the power to make an 'adverse publicity order', as defined by the section, in relation to Part 2-2 or Chapter 3 or Chapter 4 of the ACL.
248	Gives a court the power to disqualify a person from managing a corporation in connection with contraventions or Part 2-2, Part 3-1 and Chapter 4 of the ACL.

State franchising regulation

Introduction

Since 2010, Western Australia has twice had legislation before parliament specifically designed to regulate franchising in that state. In 2012, South Australia has passed an Act which allows for the introduction of a franchising code and has indicated they may move down this path. New South Wales currently has a private member's Bill before parliament, which has not been debated, which would also allow for the regulation of franchising in that state.

Section 51AEA of the CCA provides that it is 'the Parliament's intention that a law of a State or Territory should be able to operate concurrently' with the industry codes provisions of the CCA,

‘unless the law is directly inconsistent’ with those provisions. This provision was introduced in 2001, and has not been considered by the courts.

Western Australia

In April 2008, the Western Australian Government undertook an inquiry, chaired by Chris Bothams, into the fairness of franchise agreements. The recommendations made by the inquiry are set out in Appendix A to this report. It is noted that the inquiry did not recommend the government regulate franchising in the state:

The Inquiry believes that amendments to the current franchising regulatory framework in Australia are required. Given the importance of the franchising business model to the national economy, and the fact that franchise systems operate across state borders, the Inquiry does not recommend that changes be made to franchising regulation on an individual state basis.³²

Nonetheless, following a number of high profile franchise disputes in Western Australia, a private member’s Bill entitled the Franchising Bill 2010 (WA) was introduced into the Parliament of Western Australia in 2010 by Mr Peter Abetz MLA. The Bill was referred to the Parliament’s Economics and Industry Standing Committee for consideration. The Committee tabled its report on 23 June 2011, containing 21 findings and nine recommendations (see Appendix A: Previous reviews of franchising policy).³³

The Committee concluded that ‘[f]ranchising is most appropriately and usefully regulated at the Commonwealth level, as most franchise systems operate across multiple state jurisdictions.’³⁴ The Committee recommended that the WA Franchising Bill be opposed.

It also recommended that the Federal Minister for Small Business ensure that the effectiveness of the recent amendments to the Code are reviewed in 2013, with particular emphasis on considering the need to introduce civil monetary penalties for Code breaches and a general statutory duty to act in good faith. The Bill was subsequently defeated by 25 votes to 24.

On 24 November 2011, the Franchise Agreements Bill 2011 (WA) was introduced as a private member’s Bill in the Legislative Council by the then Shadow Minister for Commerce and Small Business; Training, and Mental Health, the Hon Ljiljanna Ravlich MLC (Labor).³⁵ That Bill was never voted upon and lapsed with the prorogation of the Western Australia Parliament on 14 December 2012. The Western Australia elections were held on 9 March 2013 with the Liberal Government returned to power. To be considered further, the Bill will have to be re-introduced to Parliament.

South Australia

In May 2008, the South Australian Parliamentary Economics and Finance Committee report on the efficacy of the laws regulating the franchisee-franchisor relationship. It recommended:

³² See report to the Western Australian Minister for Small Business, *Inquiry into the Operation of Franchise Businesses in Western Australia*, April 2008, p 45.

³³ See Western Australia Legislative Assembly, Economics and Industry Standing Committee report, *Inquiry into the Franchising Bill 2010*, June 2011.

³⁴ See Western Australia Legislative Assembly, Economics and Industry Standing Committee report, *Inquiry into the Franchising Bill 2010*, June 2011, p 11.

³⁵ See [Franchise Agreements Bill 2011 \(WA\)](#).

- the establishment of a federal registration scheme for disclosure documents;
- a risk statement be included in disclosure material;
- specific penalties for breaches of the disclosure provisions in the Code;
- amending section 51AC of the then *Trade Practices Act 1974* to include a statutory definition of unconscionable conduct;
- mandating more effective mediation and alternative dispute resolution avenues;
- amending the Code to include a requirement to act in good faith; and
- a requirement in the Code for franchise agreements to 'include the basis on which termination payments or goodwill or other such exit payments will be paid at the end of the agreement'.³⁶

The Franchising (SA) Bill 2009 was subsequently introduced into the South Australian Parliament. The Bill lapsed due to a state election before it was able to be fully considered by the South Australian Parliament. However, changes were made to the South Australian *Small Business Commissioner Bill 2011* to facilitate the introduction of industry codes. This Bill was passed in its amended form by the South Australian Parliament and commenced operation on 22 March 2012. The *Small Business Commissioner Act 2011* created the Office of the South Australian Small Business Commissioner (SASBC) and Deputy Commissioner. The SASBC officially opened on 29 March 2012. The Act also amended the *Fair Trading Act 1987* (SA) to provide new powers to the South Australian Government to prescribe industry codes by regulation.

The South Australian Government has indicated that it will develop farming and franchising industry codes under these new laws, with farming being the first priority followed by franchising.

New South Wales

On 23 May 2012, the New South Wales Shadow Minister for Small Business, Mental Health and Housing, the Hon Adam Searle MLC (Labor), gave notice of his intention to introduce the Small Business Commissioner and Small Business Protection Bill 2012 (NSW). The Bill was second read in the NSW Parliament on 23 August 2012.

The Bill allows for the prescribing of codes of practice 'with respect to the fair treatment of small businesses in their commercial dealings with other businesses'. The Bill allows for industry codes to include good faith provisions. The NSW Government has indicated that it believes there is no role for state governments in franchising regulation 'at this point in time'.

Mr Searle explained the rationale for the Bill in his second reading speech:

This Bill seeks to achieve three aims: to provide a proper, effective legal foundation for the Small Business Commissioner—something this Government has failed to do—so that the holder of that office can act independently and with confidence to assist small business meaningfully in this State; to create a flexible legal architecture to ensure small businesses are treated fairly by other businesses

³⁶ See Parliament of South Australia, Economic and Finance Committee report, *Franchises*, May 2008, p 75.

and by State and local government bodies; and, most importantly, to confer on small businesses additional legal rights.³⁷

Evidence considered during the review

At a consultation meeting and in its written submission, the SASBC, Mike Sinkunas, and the Deputy Small Business Commissioner, Associate Professor Frank Zumbo, emphasised the need for greater transparency in franchising relationships, more efficient dispute resolution processes and the promotion of compliance with the Code through direct civil pecuniary penalties.³⁸

In its written submission, and during a consultation meeting on 1 February 2013, the Western Australian Small Business Commissioner, David Eaton, commented on:

- the efficacy of the recent Code amendments and the case for further disclosure;
- good faith in franchising and state-based regulation; and
- dispute resolution and Code enforcement.³⁹

A number of submissions commented on moves to introduce state franchising legislation and gave strong support to a national approach to regulatory frameworks:

...any additional regulation imposed, in particular States or Territories, will likely result in an increased administrative burden and increased costs for franchisors who operate nationally. Further, such State based differences in regulation, if introduced, would not be consistent with the current trend to streamline business regulation and adopt national regulatory frameworks. [It is submitted] that the Federal Government consider taking steps to prevent the introduction of State based regulation of franchising and to ensure that franchising remains an industry sector that is regulated uniformly at the national level.⁴⁰

[Avis Budget Group] understands that active steps are being taken in some jurisdictions to enact legislation which would lead to the regulation of franchising on terms which differ to those of the Code. This is an alarming prospect for a national franchisor such as [Avis Budget Group]. One of the driving forces behind the replacement of the Trade Practices Act by the Competition and Consumer Act, and the adoption by all States and Territories of the Australian Consumer Law, was the importance of uniformity of regulation.⁴¹

Initially I discussed this issue with state colleagues but as WA had largely ceded its corporations powers to Canberra it was considered more appropriate for this matter to be dealt with by the federal government. However having met so many small business people who had suffered the dire consequences of a combination of unconscionable behaviour and legislative shortcomings, I eventually decided to pursue a Private Member's Bill.⁴²

³⁷ See [Small Business Commissioner and Small Business Protection Bill 2012 \(NSW\), Second Reading Speech](#), p 14303, 23 August 2012.

³⁸ South Australian Small Business Commissioner, submission to the review, p 1.

³⁹ Meeting with the Western Australian Small Business Development Corporation, Perth, 1 February 2013.

⁴⁰ Confidential submission to the review.

⁴¹ AVIS Budget Group, submission to the review, pp 7-8

⁴² Peter Abetz, submission to the review, p 3.

Importantly, from an overall business perspective for both franchisees and franchisors, the Federal Chamber of Automotive Industries believes the inquiry should take the opportunity to firmly entrench the value of a national system of enforcement and guidance:

Clearly the National Franchise Code provides this consistent national base for all those engaged in the industry. However, we note that the apparent intentions of some state governments are aimed at state based regulation that will not improve the overall system nor will they develop the most efficient national business model.⁴³

Observations

The concerns that led the government of South Australia to pass legislation that would allow it to regulate franchising in that state, and the introduction of Bills to allow this in Western Australia and New South Wales, are noted. There is no doubt there is some disquiet in those states about the regulation of franchising nationally, particularly in relation to end of term arrangements, including goodwill; the introduction of pecuniary penalties for a breach of the Code; and good faith.

However, submissions to the review that address this subject are overwhelming in their support for the retention of a single, national scheme. The Joint Committee considered this issue. It stated:

Taking into consideration the fact that many franchise systems operate across multiple state jurisdictions, the committee believes that franchising is most appropriately and usefully regulated at the Commonwealth level.⁴⁴

The 2008 Western Australian inquiry reached the same conclusion. It was argued that state regulation would act as a deterrent to the expansion of both overseas franchise systems into Australia and of local franchising systems within the country.

It is noted that a large number of American states have their own regulatory systems, often with considerably different requirements.

The evidence clearly indicates that a national system reduces duplication, red tape, uncertainty, compliance costs and ensures franchisors are in the best position to develop and maintain an effective national business model. Notwithstanding the passage of the *Small Business Commissioner Act 2011 (SA)*, it appears there are no concrete plans for the introduction of state franchising legislation at this time. It is noted that this issue is not within the terms of reference of the review. It would, therefore, be premature and possibly inappropriate to make a recommendation on this matter in the current situation. However, the Commonwealth Government should do whatever it can to ensure that franchising remains regulated at a national level should it become clear that a state will proceed with its own regulation.

⁴³ Federal Chamber of Automotive Industries, covering letter, submission to the review, p 18.

⁴⁴ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 24.

Part Two – Disclosure

Introduction

A key function of the Code is to ensure that franchisees are provided with important information about the franchise and the franchisor. This is achieved by requiring the franchisor to prepare a disclosure document according to a prescribed format and provide it to the franchisee or prospective franchisees in certain circumstances, including *before* they agree to enter into a franchise agreement with a franchisor.

The purposes of the disclosure document are set out in clause 6B of the Code:

- to give to a prospective franchisee, or a franchisee proposing to enter into, renew, extend or extend the scope of a franchise agreement, information from the franchisor to help the franchisee to make a reasonably informed decision about the franchise; and
- to give a franchisee current information from the franchisor that is material to the running of the franchised business.

In March 2008 and July 2010 a number of amendments were made to the information required to be disclosed to franchisees to implement the government's response to the recommendations from the Joint Committee and the Expert Panel. Some of those amendments are discussed elsewhere in this report (for example, disclosures that were mandated with respect to the potential for franchisor failure are discussed in Part Three – Franchisor Failure).

This chapter considers:

- procedures relating to disclosure;
- disclosure rules for foreign and master franchisors;
- issues for franchisees from a non-English speaking background (NESB);
- the role of professional advice and education for prospective franchisees;
- gaps in the current disclosure requirements; and
- the efficacy of disclosure and the 2008 and 2010 amendments as a whole.

Procedures relating to disclosure

Introduction

The main clauses of the Code setting out procedures for disclosure are clauses 6, 6B, 10, 18 and 19.

In summary, a franchisor is required to prepare a disclosure document in accordance with the Code before entering into a franchise agreement and within four months after the end of each financial year after entering into a franchise agreement. A franchisor must give a current disclosure document to a current or prospective franchisee if the franchisor or the franchisee proposes to renew, extend, or extend the scope of the franchise agreement.

In addition to a copy of the disclosure document, the franchisor must give a prospective franchisee a copy of the Code, and a copy of the franchise agreement, at least 14 days before the prospective franchisee enters into a franchise agreement or makes a non-refundable payment to the franchisor. If the franchisor or franchisee proposes to renew, extend or extend the scope of the franchise agreement this information must be provided to a franchisee at least 14 days before renewal, extension, or extension of the scope of the franchise agreement.

A franchisor must also give to a franchisee a current disclosure document within fourteen days after a written request by the franchisee. However, such a request can be made only once by the franchisee in a twelve month period (see clause 19 of the Code).

In addition to the disclosure document, franchisors must provide ongoing disclosure of materially relevant facts. Materially relevant facts are set out in the Code (see subclause 18(2)) and include matters such as a change in majority ownership of control of the franchisor, and certain proceedings or judgments against the franchisor. In 2010 an amendment was made to the Code which reduced the timeframe for disclosure of materially relevant facts to franchisees. Following those amendments, materially relevant facts must be disclosed to a franchisee or prospective franchisee, in writing, within a reasonable time (but not more than fourteen days) after the franchisor becomes aware of them. Previously the time period for disclosure of materially relevant facts was sixty days.

The rights and obligations to provide disclosure apply to parties in multi-level relationships. Both master franchisors (including foreign master franchisors) and master franchisees (also known as sub-franchisors) are required to provide disclosure to subfranchisees.

The consequences for failing to follow these procedures are the same as the consequences for all breaches of the Code (see Part Eight – Enforcement).

Evidence considered during the review

Requirement to provide a copy of the franchise agreement 'in the form it is to be executed'

Many submissions raised concerns about the requirement for a franchisor to provide a copy of the franchise agreement 'in the form it is to be executed' fourteen days before a relevant event as set out in clause 10 of the Code.⁴⁵ This change responded to a recommendation made to the government in 2006 that:

Clause 10 and item 17 of Annexure 1 of the Code be amended to require the franchisor to provide the franchise agreement in the form it is intended to be executed with the disclosure document (emphasis added).⁴⁶

The government agreed with this recommendation without qualification, however when the changes were introduced to the Code the word 'intended' was not in the wording of the provision, without apparent explanation. Indeed, it appears this may have simply been an oversight because

⁴⁵ See, for example: Phil Blain, submission to the review, p 1; Philip Colman, submission to the review, pp 2 – 3; The Franchise Lawyer, submission to the review, p 3; Tim Hantke (Franchising Solutions), submission to the review, p 8; Australian National Retailers Association, submission to the review, p 7; Derek Sutherland, supplementary submission to the review, p 1.

⁴⁶ See recommendation 1, [Review of the Disclosure Provisions of the Code of Conduct, Report to the Hon Fran Bailey MP, Minister for Small Business and Tourism, October 2006](#), p 9.

even the government's explanatory statement to accompany this change noted that '[t]he Regulations amend the Code to require the franchisor to provide the franchise agreement in the form it is intended to be executed with the disclosure document'.⁴⁷

Many submissions complained that the provision presents practical difficulties and delays at the time franchise agreements are being negotiated and disclosure is being provided by franchisors, since it may require a franchisor to provide multiple instances of disclosure (including restarting the fourteen day period) if any changes are made or negotiated to the franchise agreement. This may be the case even if the relevant changes were requested or initiated by the franchisee, or are only minor, such as the insertion of the franchisees details into the agreement.

It was also noted that the provision may increase the cost to franchisees of seeking legal advice and thereby operate as a disincentive to do so, since franchisees may have two sets of disclosure documents and agreements they have to get lawyers to review because of this issue.⁴⁸ This may equally apply to other types of professional advice and would also be a concern for franchisors.

This matter is one of a number of issues raised in submissions which suggest amendments to clarifying provisions of the Code without changing the policy intent of the provisions. These matters are dealt with collectively in Part Eleven – Technical or minor changes to the drafting of the provisions of the Code.

Ongoing disclosure

There is no express language used in the Code that specifies in which circumstances a franchisor is, or may be, required to provide a new disclosure document or other disclosure to a franchisee or prospective franchisee. However, there is a continuing obligation for a franchisor to give disclosure of certain materially relevant facts to a franchisee or prospective franchisee (see clause 18), and the franchisee can request a new disclosure document once in a twelve month period (see clause 19).

Some submissions argued that the Code should be amended to require a franchisor to give supplementary disclosure to either a prospective franchisee or franchisee

...if a relevant item of the disclosure document becomes incorrect, misleading or deceptive after the disclosure document is given to the franchisee or prospective transferee, but at any time during the period immediately before the franchise agreement (or the agreement to extend the scope of the franchise agreement) is signed.⁴⁹

At present, the Code limits the disclosure that is required to be updated to those items specified in clause 18 (see item 21 of Annexure A to the Code).

Disclosure in the context of exercising an option to renew a franchise agreement

Commercial practice may require franchisees to exercise their rights to an option to renew in advance of the provision by the franchisor of disclosure relating to renewal (that is, more than fourteen days before the renewed agreement is entered into).

⁴⁷ Explanatory Statement, *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2007* (No. 1), p 4.

⁴⁸ Phil Blain, submission to the review, pp 1 - 2.

⁴⁹ Derek Sutherland, supplementary submission to the review, p 5.

The franchisor is not explicitly obliged to give the disclosure document with a notice to renew under clause 20A to a franchisee and, accordingly, disclosure may not happen until the execution copy of a new franchise agreement is sent to a franchisee.

Some submissions argued that, at that stage, disclosure is too late to be effective and, from the time they exercise the option to the time they finally sign, franchisees may not know what the renewal terms will be.⁵⁰ It was suggested that it may be useful for a notice required to be given by a franchisor under clause 20A to be accompanied by the disclosure document to affect the renewal.

Observations

The laws relating to misleading or deceptive conduct are relevant in the context of disclosure to franchisees, including supplementary disclosure. The laws relating to misleading or deceptive conduct can apply where a party is 'silent' as to a matter when there was a reasonable expectation of disclosure.⁵¹ Given that concerns about the need for supplementary disclosure were not raised frequently in submissions, there does not appear to be an evidence base to recommend a new requirement to give supplementary disclosure if the disclosure document becomes incorrect, misleading or deceptive.

The issue of franchisees exercising options to renew before disclosure is an interesting one. Issues relating to renewal are discussed below in Part Six – Transfer, renewal and end of term arrangements, however it is appropriate to deal with this aspect of 20A in this part since it specifically relates to disclosure. A franchisee might argue that it is entitled not to agree to enter into a renewal of a franchise agreement (even if it had already exercised an option to renew) by virtue of clause 10 which states that the franchisee must be given disclosure fourteen days before entering into an agreement. If the franchisee exercised a binding option to renew, this may be construed as an agreement to enter into a franchise agreement, meaning that the franchisor should have provided the franchisee with disclosure fourteen days before the franchisee exercised the option.

In the *Ketchell* case, an agreement was not found to be invalid because of the failure to provide disclosure.⁵² Accordingly, even though a franchisor may technically be obliged to provide disclosure before a franchisee exercises an option to renew, to make it clear to parties what is expected of them it seems sensible that the Code should be amended to address the possibility that franchisors are not providing disclosure at the time of asking franchisees to exercise an option to renew. This would appear to be consistent with the existing policy intent of the Code. A simple way to effect this might be to require that a notice under clause 20A should be accompanied by a disclosure document, since most options to renew would not need to be exercised until after the provision of a 20A notice.

⁵⁰ Derek Sutherland, submission to the review, p 18.

⁵¹ See, for example, *ACCC v Keshow* [2005] FCA 558 (5 May 2005). The recent case of *SPAR Licensing Pty Ltd v MIS QLD Pty Ltd (No 2)* [2012] FCA 1116 is also relevant in this regard.

⁵² See *Master Education Services Pty Limited v Ketchell* [2008] HCA 38 (27 August 2008)

Recommendation

1. The Code be amended so that the provision of a notice under clause 20A of the Code, if it states the franchisor's intention to renew a franchise agreement, triggers a requirement to provide disclosure. A franchisee should not be bound by its exercise of an option to renew prior to the provision of disclosure by the franchisor.

Disclosure by foreign and master franchisors

Introduction

A 2008 amendment to the Franchising Code removed an exemption from the Code's requirements for foreign franchisors. As a result the Franchising Code applies to a franchise agreement even if the franchisor is "resident, domiciled or incorporated outside Australia", and grants only one franchise or master franchise to be operated in Australia.

In the review of the disclosure provisions of the Franchising Code during 2006 which led to the 2008 amendments, it was argued that the exemption should be removed on the basis that foreign franchisors were targeting potential Australian franchisees with a view to recruiting single unit franchisees for business concepts that were untested in the Australian market. It was considered that the franchisees being recruited were not experienced business operators, and given the substantial skill and capital that may be required from a Master Franchisee to establish a franchise system in Australia from scratch, it might be problematic for inexperienced operators not to have the benefits of disclosure.

Accordingly, the 2006 review recommended the removal of the exemption and the government agreed with this and removed it in 2008.



Examples of possible franchise structures

Evidence considered during the review

Several submissions raised concerns about the removal of the disclosure exemption for foreign franchisors with the 2008 amendments to the Code. The effect of removal of the exemption is that

foreign franchisors are required to comply with the Code, most importantly, to provide a disclosure document to prospective franchisees and franchisees seeking to renew the agreement.

This requirement has been labelled overly burdensome on foreign franchisors in the Australian market.⁵³ The foreign franchisor disclosure document has also been labelled a redundant document for franchisees.⁵⁴ In addition, some submissions argued that disclosure by master franchisors to subfranchisees was irrelevant, impractical and/or confusing,⁵⁵ similar to the criticisms levelled at the disclosure requirements for a foreign franchisor.

In a joint submission, Dr Elizabeth Spencer and Simon Young noted the impact of the removal of the exemption:

Anecdotally a number of overseas franchisors have decided that Australian regulation was 'too hard' to meet for just one distributor and chose not to bring their business on shore.⁵⁶

A number of stakeholders commented that often a master franchisee is a sophisticated investor who then provides its own full disclosure document to its subfranchisees.⁵⁷ A confidential submitter stated:

...the Code should not apply to master franchisees or to franchisees who meet certain criteria that qualify them as 'sophisticated investors' or 'knowledgeable franchisees' for the purposes of the Code.⁵⁸

Law firm DLA Piper argued that franchisees would still have adequate protection under Australian law if the exemption was reinstated as they receive the disclosure document from the master franchise in Australia stating:

We would like to highlight that the reinstatement of the exemption would not affect the obligations of master franchisees in Australia, who have been appointed by foreign franchisors, to comply with the code in respect of their agreements with their Australian subfranchisees.⁵⁹

However the Franchise Advisory Centre and the Asia-Pacific Centre for Franchising Excellence (APCFE), in a joint submission, stated that the exemption 'is likely to have resulted in better preparation by international franchisors prior to entering the Australian market, where anecdotally, the failure rate upon entry has previously been quite high.'⁶⁰ Other submissions argue that the removal of the foreign franchisor exemption has proven successful but accept the disclosure requirements could be simplified.⁶¹

⁵³ International Franchising Association, submission to the review, p 2.

⁵⁴ 7-Eleven Incorporated, submission to the review, p 3.

⁵⁵ For example: The Franchise Lawyer (Mr Sanfilippo), submission to the review, p 14; Queensland Law Society Franchising Law Committee, submission to the review, p 13.

⁵⁶ Dr Elizabeth Spencer & Mr Simon Young, submission to the review, p 14.

⁵⁷ DLA Piper, submission to the review, p 2.

⁵⁸ Confidential submission to the review.

⁵⁹ DLA Piper, submission to the review, p 2.

⁶⁰ Franchise Advisory Centre and the Asia Pacific Centre for Franchising Excellent, submission to the review, p 10.

⁶¹ Jani-King, submission to the review, p 4; Philip Colman, submission to the review, pp 3 – 4.

Submissions acknowledged some level of disclosure from the foreign franchisor would be useful for franchisees operating in the Australian market. Derek Sutherland proposed that instead of the foreign franchisor producing a full disclosure document, it could produce a document with only essential information for the franchisee. This would include the foreign franchisor's obligations which are delegated under the master franchise agreement, and what the impact would be if the master franchise is terminated or not renewed.⁶²

Law firm Minter Ellison agreed that the foreign franchisor should only be required to provide limited information which is relevant to the franchisee. It suggested:

...it is reasonable to require a foreign franchisor to provide disclosure regarding intellectual property including the ownership or licensing arrangements regarding intellectual property that the franchisee will have rights to.⁶³

The Queensland Law Society suggested an alternative, that the disclosure of relevant information should come from the master franchisee:

...allow for the master franchisee to provide a modified disclosure document, disclosing relevant information regarding the master franchise agreement but without requiring the foreign franchisor to be a party to it.⁶⁴

Disclosure by master franchisors to subfranchisees

Some submissions argued that disclosure to subfranchisees should be limited to what is provided by the master franchisee, or alternatively a simplified form of disclosure should be provided to the subfranchisee by the master franchisor since not all the information required to be provided currently would be relevant.

To the extent that information is not relevant or useful, it is said only to add confusion and complexity to the disclosure process, with negative consequences for both franchisors and franchisees. Such consequences may include increasing the cost of accessing legal advice to the franchisee.

The Queensland Law Society suggested that 'this is an issue in relation to the operation of clause 6B generally and does not specifically arise because of the removal of the foreign franchisor exemption.'⁶⁵

Observations

The removal of the foreign franchisor exemption from the Code has not provided the intended benefits for franchisees. Much of the information provided by the foreign franchisor appears to be irrelevant to franchisees who predominantly receive information pertinent to them from a master franchisee. A balance can be struck between an overly burdensome disclosure requirement and the need for franchisees to have access to relevant information about their foreign franchisor. Similarly, the disclosure requirement for master franchisors to subfranchisees also needs to be modified to avoid duplication of information or the provision of irrelevant and confusing information. Only those

⁶² Derek Sutherland, submission to the review, p 25.

⁶³ Minter Ellison, submission to the review, p 10.

⁶⁴ Queensland Law Society, submission to the review, p 13.

⁶⁵ Ibid.

franchisees that do not also act as franchisors should be provided the full disclosure document in accordance with Annexure 1.

Changing the approach to disclosure for foreign and master franchisors to limit disclosure will reduce the 'red tape' associated with entering into a franchise agreement by removing duplication and unnecessary costs. All other things being equal, it may also improve the attractiveness of Australia as an investment destination for foreign franchisors as compared to other jurisdictions such as the United Kingdom or New Zealand which do not have any franchising specific regulation. Short form disclosure from a foreign or master franchisor will also ensure that franchisors who are required to produce a disclosure document in accordance with Annexure 1 have all necessary information.

Recommendation

2. The Code be amended to:

- a. prescribe a short-form of disclosure that a foreign or master franchisor must provide to a master franchisee instead of requiring the foreign or master franchisor to provide disclosure in accordance with Annexure 1 of the Code;
- b. ensure that only franchisees who do not also act as franchisors are provided with the full Annexure 1 disclosure document by their immediate franchisor; and
- c. require that a copy of all short-form disclosure documents provided in accordance with (a) are provided to franchisees as an item of disclosure under Annexure 1.

The reduced disclosure document mentioned in (a) should include information such as:

- if applicable, any short-form disclosure document that has been provided to the disclosing party for the franchise;
- the basic contact details and background of the foreign franchisor or master franchisor;
- the essential obligations that have been delegated under the master franchise agreement;
- information regarding intellectual property including the ownership or licensing arrangements that the franchisee will have rights to; and
- what the impact will be on the subfranchisee if the master franchisee is terminated or not renewed.

Increasing numbers of franchisees from a non-English speaking background

Introduction

Difficulties facing franchisees from non-English speaking backgrounds was not a significant issue presented as a concern during consultations. However, anecdotally it is an issue which may benefit from further attention through future surveys and investigation.

The Victorian Small Business Commissioner (VSBC) outlined a case where people of non-English speaking background were targeted by a franchisor 'to build its franchise base'.⁶⁶ There were several disputes between the parties as a result of a lack of understanding of the disclosure documents

⁶⁶ Victorian Small Business Commissioner, submission to the review, p 5.

provided. The VSBC noted that many of these disputes were resolved before or during mediation.⁶⁷ It also commented generally on the issue stating:

...anecdotal evidence suggests such franchisees may require additional assistance and/or representation – including legal representation – during mediation processes. It also supports increasing information and education activities directed specifically towards such franchisees, and prospective franchisees.⁶⁸

A recent article on the 'Smart Company' website highlighted the increasing number of franchisees with English as a second language. It quoted the Retail Food Group (a franchisor of several well known brands) as indicating over 50 per cent of its franchisees are from a non-English speaking background.⁶⁹ The article also quoted Jason Gehrke, an academic and prominent franchising commentator:

There is the issue of ensuring there is a correct understanding of the franchise relationship and that's not always perfectly established, even for native English speakers. The next thing is to customise a training and induction program that allows not just for the language challenges that might exist... but also the cultural and social differences that may exist.⁷⁰

Observations

There is insufficient data on non-English speaking franchisees and the difficulties that arise for this group, a group which is, anecdotally, growing in size. The ACCC has recognised the need to provide increased support to this group and has services available such as a translator and interpreter service and publications in languages other than English.⁷¹ This industry would benefit from further attention from research institutions such as Griffith University. An improved understanding of the issues facing non-English speaking background franchisees would allow franchisors to better account for this in their documentation and training. The Franchising Council of Australia could also use the information gathered to provide more comprehensive guidance to its members. It would also highlight areas which the ACCC, Small Business Commissioners and the Office of the Franchising Mediation Adviser could focus on through education and their mediation support services.

For completeness, where there is questionable conduct by a franchisor in the context of a franchisee or potential franchisee from a non-English speaking background, the law relating to unconscionable conduct may be particularly relevant. One of the factors the court may have regard to for the purpose of determining whether a party has engaged in unconscionable conduct is whether the other party was able to understand any relevant documents.⁷² Guidance on the ACCC website advising businesses on how to avoid engaging in unconscionable conduct recommends that a

⁶⁷ Victorian Small Business Commissioner, submission to the review, p 6.

⁶⁸ Victorian Small Business Commissioner, submission to the review, p 7.

⁶⁹ SmartCompany, Michelle Hammond, [How Well do you Need to Speak English to run a Business in Australia, SmartCompany website](#), 8 Feb 2013.

⁷⁰ SmartCompany, Michelle Hammond, [How Well do you Need to Speak English to run a Business in Australia, SmartCompany website](#), 8 Feb 2013.

⁷¹ Australian Competition and Consumer Commission, *Non-English speaking background*, webpage on the ACCC website, accessed April 2013.

⁷² The effect is summarised here. For the precise wording, see the *Competition and Consumer Act 2010* (Cth), Schedule 2 (Australian Consumer Law), section 22.

business 'consider the characteristics and vulnerabilities of your customers. For example, use plain English when dealing with customers from a non-English speaking background.'⁷³

The role of professional advice and education for prospective franchisees

Introduction

It is universally accepted that prospective franchisees should undertake due diligence prior to entering into a franchise agreement. Two important facets of due diligence for potential franchisees are obtaining advice from experienced professionals, and educating themselves about franchising and what it involves.

The Code does not mandate that franchisees must obtain advice or undertake education prior to entry into a franchise agreement. With respect to advice, the Code effectively requires a prospective franchisee to confirm in writing either that it has received legal, business or accountancy advice or that the prospective franchisee has been told that that kind of advice should be sought but has decided not to seek it.⁷⁴

There have been a number of initiatives in recent years that are worth mentioning with respect to education of participants in the industry.

The ACCC has an important role in relation to education for the industry, to improve awareness of and compliance with the Code and has funded a 'free online education program for prospective franchisees, which is administered by Griffith University. More than 3 600 people have signed up to do this course since its release in 2010'.⁷⁵

The ACCC has a team of staff with a focus on education and engagement operating across Australia, giving presentations and disseminating important information to franchisees, franchisors and other small business operators about their rights and obligations under the Act [the *Competition and Consumer Act 2010*] and the Code'.⁷⁶

The ACCC has recently released a free online education program for small businesses to help them learn about their rights and obligations under Australian competition and consumer laws.⁷⁷

An Industry body, the Franchise Council of Australia (FCA), has also recently launched a Certified Franchise Executive (CFE) program to its members, in association with the American-based Institute of Certified Franchise Executives (ICFE). According to a statement issued by the FCA on 26 November 2013:

⁷³ Australian Competition and Consumer Commission, *Unconscionable conduct*, [ACCC Website](#) (accessed 16 April 2013). This guidance is likely to reflect judgments regarding unconscionable conduct which emphasised the vulnerability of parties from a non-English speaking background to exploitation by parties acting unconscionably. See, for example, *The Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.

⁷⁴ The actual provisions are only summarised here according to their effect. See clause 11 of the Code for the wording of the provisions.

⁷⁵ Australian Competition and Consumer Commission, submission to the review, p 1.

⁷⁶ *Ibid*, p 2.

⁷⁷ Australian Competition and Consumer Commission, Media Release, [ACCC releases free online education program for small businesses](#), ACCC website, 10 April 2013.

The mission of the ICFE is to enhance professional standards in franchising by certifying the highest standards of quality training and education. The CFE offers existing and aspiring franchising professionals and franchise entrepreneurs the opportunity to grow professionally and reach a recognised standard of excellence within the local and international franchising community.⁷⁸

This is encouraging and underlines the important fact that education is critical not just for prospective franchisees, but for a franchisors too.

Evidence considered during the review

Submissions revealed support among a cross section of participants in the industry for either education and/or advice for prospective franchisees to be made a mandatory requirement of the Code.

One franchisor, Gavin Culmsee, Bedshed Franchising Pty Ltd, submitted that:

In my view it is impossible to eliminate failure in any business enterprise. The current Code provisions are fine. The challenge is to educate prospective Franchisees e.g. the ACCC sponsored training course established by Griffith University (which is online and cheap) is an excellent initiative. Prospective franchisees need to learn what a franchise is and what the basic terms mean. The question of mandating independent professional franchise advice pre sign up is best practice and should be promoted.⁷⁹

Bakers Delight Holdings Ltd suggested that franchisees should be compelled to seek professional legal and accounting advice and 'undertake an approved training program before embarking upon buying a franchise'. It said such a requirement would be beneficial to both the franchisee and the franchisor, including helping franchisees understand that at the end of the term they have no right to compensation or automatic renewal.⁸⁰ Others commented that '[m]any disputes would not occur if prospective franchisees obtained professional franchise advice prior to entering into their franchise agreement.'⁸¹ End of term issues and disputation are covered elsewhere in this report, however the role of education and advice was a common theme in the context of the range of issues raised by the current review.

Griffith University's Asia-Pacific Centre for Franchising Excellence (APCFE) and the Franchise Advisory Centre in a joint submission also supported mandatory education:

The Code already advocates in the strongest possible terms the need for pre-purchase advice in Part II, Item 11(2). This is and should remain an essential element of the Code, but is challenged by a reluctance of potential franchisees to follow through and get advice for the following two reasons;

1. The advice is perceived as unnecessary as the potential franchisee has already made up their mind to proceed with the franchise; and
2. The potential franchisee does not wish to pay for professional advice, which is often seen as unnecessary (particularly if the franchisee has already decided to proceed).

⁷⁸ See Franchise Council of Australia media release, *World leading accreditation process to be introduced in Australia* 26 November 2012 (access on the [FCA website](#) 9 April 2013).

⁷⁹ Bedshed Franchising Pty Ltd, submission to the review, p 3. See also Stephen Hansen, submission to the review, p 3; New South Wales Small Business Commissioner, submission to the review, p 4.

⁸⁰ Bakers Delight Holdings Ltd, submission to the review, p 1.

⁸¹ Tim Hantke (Franchising Solutions), submission to the review, p 13.

With professional advice on a franchise agreement costing up to (or even more than) \$5,000, franchisees who have made up their mind to proceed will be reluctant to spend that kind of money in order to “tick a box”. Of course at this stage prior to committing to the franchise, they don’t know what they don’t know, and this means they can’t be confident that the professional advice will represent any kind of value for money. **The first step in this process should instead be a requirement in the Code for the potential franchisee to undertake an endorsed pre-entry education program in addition to obtaining advice from any of a lawyer, business advisor or accountant.**⁸² (Emphasis added)

The FCA also noted that '[f]ailure to obtain legal and business advice is a major concern' and said that it would support 'enhanced requirements concerning advice, including possibly making it mandatory for a franchisee to seek independent advice unless certain exemptions are met. Exemptions could include being an existing franchisee, a sophisticated investor, a lawyer or an accountant.' Further, the FCA noted:

It may also be worth considering directing franchisees, formally, to the ACCC and its education offerings in disclosure documents. The ACCC reported in its July – December 2012 Small Business, Franchising and Industry Codes report that the free online franchising education program funded by the ACCC and run by Griffith University has more than 3590 registrants. Given the uptake of this education program, and the unending benefits of improved knowledge of the sector to all members of the franchising community, it is worth considering formal notification of its availability. A sentence could simply be added to the mandatory content on page 1 of each disclosure document. For example, a final sentence added: “The Australian Competition and Consumer Commission is publically funded and offers franchising education programs as well as other information and support services to franchisees.”⁸³

It was also observed that:

Being provided with ‘adequate information’ is not as important as being able to understand the nature and effect of the information and this is the critical failure of many of the recent Code amendments.⁸⁴

Again, this underscores the importance of education and easily accessible and understood information.

The Franchising Advisory Centre and the APCFE commented, in their joint submission, on research into the effectiveness of its pre-entry education program for prospective franchisees:

... recent research ... into the effectiveness of the pre-entry education program compared participants in the program against those who went into franchising without undertaking the pre-entry education. Among other things, the research found that people who participated in the pre-entry education program took an average **five weeks** longer than non-participants to undertake their due diligence before committing to a business. Most significantly however, was the finding that pre-entry education participants reported significantly higher levels of satisfaction with their business performance after commencement than non-participants. ... The bottom line is that the pre-entry education program

⁸² Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, p 9.

⁸³ Franchise Council of Australia, submission to the review, pp 22 – 23.

⁸⁴ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 15.

has created a benefit to franchisees, and should be made more accessible to more potential franchisees.⁸⁵

On the other hand, research by Griffith University has also highlighted the limitations of professional advice for franchisees

...just under half of the interviewees indicated that they had ignored or overridden the advice provided by external advisors in their quest to become self-employed.⁸⁶

Some franchisors were also more circumspect, noting potential drawbacks of a compulsory system and/or scepticism about the impact of professional advice on franchisees' decisions to invest:

Whilst McDonald's sees some merit in making it mandatory for franchisees to obtain legal, accounting and business advice, there needs to be a weighing up of how these changes to the Code may increase start up and administrative costs and limit the freedom of franchisees to choose how they do business and conduct their affairs. McDonald's holds the same view in relation to calls for compulsory pre-franchise education for franchisees.⁸⁷

Real world experience is that most franchisees make the emotional decision to invest based on trust and their impression of the brand, and franchisors encourage this "trust me" attitude. It is often only their lawyers, accountants and business advisers who read the disclosure material in detail, after the franchisee has made the emotional commitment to invest, but before entering a franchise agreement.⁸⁸

It is said an aspiring franchisee's desire to 'buy a job' clouds the 'willingness to analyse objectively the commercial terms and risks or to make sure that expectations match the contractual reality'.⁸⁹

This was acknowledged by many franchisees, that argued that even those who may be regarded as fairly sophisticated are not necessarily prone to act in accordance with professional advice. The failure of prospective franchisees to obtain or heed professional advice was a recurrent theme in meetings and submissions.

Observations

There is limited evidence of some franchisors requiring their franchisees to undertake pre-entry education about franchising before they may buy into the franchisor's franchise system.⁹⁰

Although some submissions supported mandatory pre-entry education, this runs the risk of regulatory overreach and it should be left to the industry and regulators to continue efforts to educate both franchisors and prospective franchisees, recognising the benefits that education will bring. These benefits may include a reduction in disputation, the 'vetting' of unsuitable franchisees,

⁸⁵ Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, p 10.

⁸⁶ Research by Griffith University, *Survival of the fittest: The performance of franchised versus independent small business during economic uncertainty and recovery*, cited in Franchise Council of Australia, submission to the review, p 42.

⁸⁷ McDonald's Australia Limited, submission to the review, p 6.

⁸⁸ Competitive Foods Australia Pty Ltd, submission to the review, p 9.

⁸⁹ Victorian Small Business Commissioner, submission to the review, p 12.

⁹⁰ Meeting with Professor Lorelle Frazer, 22 February 2013.

and most importantly a narrowing of the expectations gap between what franchisees expect to receive when buying a franchise, and the actual experience they have once operating the business.⁹¹

Making education compulsory at a time when there is a positive trend in this area led by industry, academia and government working together would not appear to be justified, however encouragement for a continuation of this trend is appropriate.

Notwithstanding that there is a mandatory code to regulate franchising in Australia, there is still a place for self-regulation in the franchising industry. There is significant opportunity for industry associations, representative bodies and other participants in the industry to encourage cultural change and a move towards best practice in the industry, particularly regarding the advice and education provided to franchisees prior to their entry into a particular franchise system. It might be in the interests of the industry to take these steps rather than the government taking such action.

Although it is a possibility for individual franchisors to decide to implement a requirement that their franchisees undertake compulsory pre-entry education, or receive professional advice, if there is only limited take up of this option then it may be perceived as a competitive disadvantage. This is why a push for self-regulation of this nature should be spear-headed by industry associations.

For example, the Franchise Council of Australia maintains Member Standards which 'are designed to provide members of the FCA with an authoritative guide on acceptable standards of conduct'.⁹² Breach of the member standards may have implications for membership of the FCA and, again as noted on the FCA website, 'a member gains significant market benefit in identifying themselves with FCA membership'.

It is open to the FCA to consider changing its Member Standards to ensure that franchisors require that franchisees undertake pre-entry education (for example through the online modules developed by Griffith University in partnership with the ACCC). A similar requirement may be imposed in relation to franchisees having to obtain independent legal, accountancy and/or business advice prior to purchasing a franchise. The FCA could discuss such possibilities with the ACCC to ensure they are effective and do not raise concerns of anti-competitive conduct.

Noting the commentary in many submissions from franchisors and service providers to the industry that a fundamental cause of disputation and dissatisfaction with franchising is the failure by franchisees to undertake education or seek advice prior to entering into franchising, there would appear to be a sound basis for the industry itself moving towards such a regime.

Gaps in the current disclosure requirements

Disclosure of infringement notices

Infringement notices may be issued in relation to various breaches of the Australian Consumer Law, such as making false or misleading representations. A detailed discussion of infringement notices is included in Part Eight - Enforcement.

⁹¹ As noted by Derek Sutherland, submission to the review, p 33: 'The problem of mismatched expectations causes parties to believe that the code is ineffective.'

⁹² FCA website, [FCA Member Standards](#) (accessed 21 March 2013).

Relating to disclosure, the ACCC submitted that:

Franchisors are currently required to disclose certain current court proceedings and past judgments under item 4 of their disclosure documents. Franchisors must also inform their franchisees of the existence and content of any undertaking or order under section 87B of the Act. However, franchisors are not required to disclose infringement notices they have paid. The ACCC considers that it would be appropriate to require disclosure of any infringement notices paid by a franchisor.⁹³

Importantly, payment of an infringement notice is not an admission of guilt. As set out in *Guidelines on the use of infringement notices by the Australian Competition and Consumer Commission* 'if a recipient chooses to pay an infringement notice penalty, the person is not, merely because of the payment, to be regarded as having contravened the Act.' Further, infringement notices are designed to be used for what the ACCC's terms relatively minor contraventions of the Act.⁹⁴ It is possible that a party may not agree that it has breached the law, but chooses to pay an infringement notice to avoid the cost of proceedings by the ACCC.

Disclosure of disputes

Some submissions argued that further details about disputes the franchisor has been involved in should be included in the disclosure document. For example, some submissions argued that franchisors should have to disclose the occurrence of mediations with their franchisees and the 'bare... outcome'.⁹⁵

At present, franchisors do not have to disclose information about disputes progressed through mediation in their disclosure document, consistent with the confidential nature of dispute resolution through mediation. It is arguable that this gives franchisors an additional incentive to ensure the resolution of a matter at mediation.

Lease obligations

The VSBC submitted that the disclosure of lease obligations should be made clearer in the franchisor's disclosure document. For example, the application, or non-application, of relevant retail leasing legislation should be made clear and the franchisee should be directed to advice regarding rights and obligations under retail leasing legislation.⁹⁶

While many submissions did comment on leasing issues, there was not widespread support for further disclosure by way of the disclosure document. Such disclosure would be difficult noting that the laws regarding leasing differ among the states and territories. Applicable legislation would also depend on the type of premises being leased. Leased premises are also not required for every franchised business.

Disclosure relating to sites and territories including online issues

At present, item 8 of Annexure 1 to the Code provides that a franchisor must disclose certain information about a franchisee's right to operate in an exclusive or non-exclusive territory, including,

⁹³ Australian Competition and Consumer Commission, submission to the review, p 9.

⁹⁴ Australian Competition and Consumer Commission, *Infringement notices - Guidelines on the use of infringement notices*, 16 October 2012, p 9.

⁹⁵ Dr Jenny Buchan, submission to the review, p 5.

⁹⁶ Victorian Small Business Commissioner, submission to the review, p 14.

for example, whether the franchisor or other franchisees may operate a business that is substantially the same as the franchised business in the franchisee's territory.

As the internet is not what is conventionally considered a territory, 'it is unclear whether the franchisor is required to disclose its ability to compete with a franchisee online'.⁹⁷

Submissions were received from franchisees who felt that the franchisor's move into online markets was having an unfair outcome for them, and making it difficult for them to compete. This extended in some cases to franchisees alleging they were being asked to promote the franchisor's online sales channels even though it was in competition with their own service:

Franchisees are required to advertise the online channel through instore signage, advertising and merchandising aids, but receive no compensation in return and are excluded from participating in the online channel in any way.⁹⁸

It was recommended in submissions that franchisors should have to disclose

Whether the franchisor offers a product or services that can be purchased online, mail order or in such a way that bypasses the franchisee, and if so, whether and how the franchisees are compensated in the event of a customer living in their area buying by this means. This is especially relevant in respect of items that can be easily purchased via the internet such as books, music, DVDs and the like.⁹⁹

The ACCC noted it has received seventeen complaints from franchisees in the last five years who are concerned that their franchisor is competing against them through its website. The ACCC stated that it expected this issue to become more prevalent over time.¹⁰⁰ This is consistent with Griffith University's *Franchising Australia 2012* report, which found that almost 40 per cent of franchisors engage in online sales. A further 32 per cent indicated that whilst they do not currently sell online, they intend to do so in the future.¹⁰¹

Item 11 of the Code also requires franchisors to provide details regarding the history of a prospective franchisee's site or territory, including the circumstances in which the previous franchisee ceased to operate. The Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Council submitted that:

The site or territory history disclosure provisions of the Code (Item 11) appear to satisfy previous information gaps relating to franchises operated in a specific or general location. However it does not apply to franchises operated in industries, where there may be no previous outlet in the general location to be franchised, but where a duty of disclosure would be reasonably expected to exist. For example, the diverse range of service divisions which form the Jim's Group now includes a Jim's Locksmith's division, based in Adelaide. However, it is understood that Jim's previously operated a Locksmith's division, albeit in a different location. In this example, the prior existence of a division offering the same service in the same market segment (or industry) would be materially relevant both

⁹⁷ Australian Competition and Consumer Commission, submission to the review, p 8.

⁹⁸ Lotteries Agents Association of Victoria, submission to the review, p 2. This was also supported in the Lotteries Agents Association of Tasmania and the Australian Newsagents Federation (South Australia), submission to the review, p 3.

⁹⁹ Colin Dorrian, submission to the review, p 8.

¹⁰⁰ Australian Competition and Consumer Commission, submission to the review, p 8.

¹⁰¹ Griffith University, *Franchising Australia 2012*, p 75.

to the master franchisee and any unit franchisees subsequently granted. If the previous division ended more than three financial years ago (ie. the timeframe to disclose details of former franchisees and the circumstances by which they left under Item 6 of the Disclosure Document), then there is no current obligation under the Code to disclose its existence, or the circumstances of its discontinuance. Irrespective of the physical location of the division's initial operations, the existence of a prior division in the same industry should be disclosed so that the new operator is prepared for market perceptions toward the division (both positive and negative) by centres of influence (eg. media), customer groups, and suppliers.¹⁰²

This perceived gap in item 11 was not raised frequently in submissions. This may indicate that, to the extent there may be a 'gap', it is not generating significant concern in practice.

Observations

Substantial additions to the disclosures required by Annexure 1 of the Code were made in 2008 and 2010. Given the comments in the next section regarding the difficulties caused by lengthy disclosure documents – even if each individual piece of information is pertinent – it is important to recognise that the principle of diminishing returns likely applies to the inclusion of further information in Annexure 1 of the Code.¹⁰³

There is, therefore, some reluctance to suggest significant further disclosures, as suggested in some of the submissions. With the exception of the issue relating to online trading, there was not a consistent message in submissions that further disclosure was needed on particular topics.¹⁰⁴

Accordingly, even though some of the suggestions seemed sensible, sufficient evidence has not been provided to warrant further additions to the disclosure requirements. However, the disclosure of online trading is important to ensure that the provisions of the Code keep pace with changes in technology and purchasing behaviours.

Recommendation

3. The Code be amended to ensure that a franchisor is required to disclose the rights of the franchisor and franchisee to conduct and benefit from online sales, including any ability of the franchisor to conduct online sales.

Efficacy of disclosure amendments as a whole

Introduction

The 2008 and 2010 amendments resulted in a number of new disclosure requirements. One important consideration in reviewing the efficacy of the individual amendments is to consider the cumulative effect of the disclosure requirements in the context of the remainder of the Code.

This section covers two main issues raised in the context of the review:

- the relevance of Annexure 2 of the Code; and

¹⁰² Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, pp 6 – 7.

¹⁰³ Competitive Foods Australia Pty Ltd, submission to the review, p 8.

¹⁰⁴ See also the discussion and recommendation relating to marketing funds, in Part Four, which relates to further disclosure (among other things) relating to marketing funds.

- calls for a short, high-level risk statement to accompany the disclosure document.

Calls for a short, high-level risk statement have also been made in previous reviews. At present, the Code requires that a disclosure document contains the following generic risk statement on the first page:

This disclosure document contains some of the information you need in order to make an informed decision about whether to enter into a franchise agreement.

Entering into a franchise agreement is a serious undertaking. Franchising is a business and, like any business, the franchise (or franchisor) could fail during the franchise term. This could have consequences for the franchisee.

A franchise agreement is legally binding on you if you sign it.

You are entitled to a waiting period of 14 days before you enter into this agreement.

If this is a new franchise agreement (not a renewal, extension, extension of the scope or transfer of an agreement), you will be entitled to a 7 day 'cooling off' period after signing the agreement, during which you may terminate the agreement.

If you decide to terminate the agreement during the cooling off period, the franchisor must, within 14 days, return all payments (whether of money or of other valuable consideration) made by you to the franchisor under the agreement. However, the franchisor may deduct from this amount the franchisor's reasonable expenses, if the expenses or their method of calculation have been set out in the agreement.

Take your time, read all the documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with the requirements of the franchised business.

You should make your own enquiries about the franchise and about the business of the franchise.

You should get independent legal, accounting and business advice before signing the franchise agreement.

It is often prudent to prepare a business plan and projections for profit and cash flow.

You should also consider educational courses, particularly if you have not operated a business before.¹⁰⁵

The 2006 Matthews review recommended that:

The Code be amended to include a requirement for the franchisor to include a Risk Statement with the disclosure document. The ACCC be tasked with developing a prescribed Risk Statement document with disclosure requirements.¹⁰⁶

¹⁰⁵ See the Code, Annexure 1, item 1.

¹⁰⁶ Report to the Hon Fran Bailey MP, Minister for Small Business and Tourism, *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, recommendation 3.

The government did not accept this recommendation, noting:

Decisions relating to the viability and associated risks of any business venture are ultimately the decision of the businesses themselves. The Government will ask the ACCC to continue their efforts in educating the industry as to the importance of risk analysis and for prospective franchisees to be encouraged by their business advisors to conduct risk analysis.¹⁰⁷

On this issue in 2008, the Joint Committee did not consider a general and broad risk statement as part of disclosure/pre-agreement materials was necessary. The Joint Committee considered that it is the franchisee's responsibility to obtain and have regard to competent legal and accounting advice that identifies relevant risks. However, the Joint Committee did note that it felt there were gaps in the warnings being given to franchisees about the possibility of franchisor failure. This eventually led to the requirement that the first page of a franchisor's disclosure document state that 'Franchising is a business and, like any business, the franchise (or franchisor) could fail during the franchise term. This could have consequences for the franchisee.'¹⁰⁸

In its 2010 report, the Expert Panel stated:

While the panel does not recommend broad changes to the disclosure arrangements under the Code ... it does consider there to be scope for a short, simpler, 'plain English' document to be provided to prospective franchisees **earlier in the process of entering a franchise agreement**. ... The panel does not necessarily consider that this document need be mandated by legislation. Instead, it encourages the industry to develop a document in line with the mutual business interests of franchisors and franchisees. However, the Government should consider mandating a short disclosure document of this kind if evidence emerges of systemic problems indicating that franchisees remain unaware of key risks inherent in their role in the franchise business model.¹⁰⁹ (Emphasis added)

It is understood that this suggestion was not taken up by industry following the Expert Panel report.

Evidence considered during the review

Annexure 2 to the Franchising Code – short form disclosure document

Submissions and consultations indicated that Annexure 2 of the Code should be deleted as it is not being used by the industry. The following extract from the submission of the Franchise Advisory Centre and the APCFE, although lengthy, aptly summarised the point:

The authors are not aware of any franchisor at any investment level, or indeed any lawyer acting for any franchisor, who uses or recommends Annexure 2 disclosure. This "short form" disclosure is an anachronism that may have had some relevance as a transitional arrangement for low-investment service systems to ease the original introduction of the Code in July 1998, but in practice today is redundant. The authors are not aware of any franchisor who currently uses Annexure 2 disclosure, or any who have ever used it. Its continued existence in the Code is irrelevant as any franchisee who receives Annexure 2 disclosure is entitled to receive Annexure 1 disclosure on request, thereby leading franchisors to comply with Annexure 1 as the safest method of disclosure. This would also reduce the Franchising Code of Conduct by 15 pages. **It is recommended that**

¹⁰⁷ *Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code Of Conduct*, February 2007, p 2.

¹⁰⁸ Franchising Code of Conduct, Annexure 1, Item 1.

¹⁰⁹ Expert Panel report, *Strengthening Statutory Unconscionable Conduct and the Franchising Code of Conduct*, pp 79 – 80.

Annexure 2 disclosure be removed from the Code to eliminate a redundant element, and to reduce the Code’s overall volume. Aside from the benefit of relieving franchisees and their advisors of the unnecessary and duplicated task of reading Annexure 2 when supplied with a copy of the Code by franchisors, it would also save a significant amount of paper currently being wasted. (It remains common practice for disclosure documentation to be provided in hard copy, or if provided electronically, the sheer number of total pages will still require a reader to print it out rather than attempt to read it on a computer screen. For every 5,000 new franchise grants, renewals or resales, this would amount to at least 40,000 sheets of paper (ie. 8 sheets saved per document, printed both sides) and weighing more than 200kg [calculated by the authors on the basis of a ream of 500 sheets of paper weighing 2.55kg] saved, not including the resources and energy consume in producing, printing, handling and reading the paper. This initiative has no downside to franchisors, franchisees or other participants in the franchise sector.¹¹⁰

The need for a short, high-level risk statement to accompany the disclosure document

Many submissions took the view that the purpose of disclosure being provided to franchisees was being undermined because disclosure documents have become long and complex. Many of these submissions cited the need for a short high-level risk statement to be provided to franchisees in addition to the disclosure document.

The follow extracts indicate the nature of the concerns expressed in submissions regarding disclosure documents:

There is anecdotal evidence (and complaint data) suggesting that many franchisees do not read, or at least do not understand, the disclosure document they receive before they enter into a franchise agreement. This is usually attributed to the length and complexity of most disclosure documents. ... The ACCC considers that it may be appropriate to require franchisors to provide prospective franchisees with a one or two page summary document or risk statement that accompanies (or forms part of) the disclosure document.¹¹¹

McDonald’s believes the sheer volume of disclosure materials now required makes close scrutiny of that information by potential Franchisees less likely and some of the most important information to a franchisee is inevitably lost in a sea of information.¹¹²

It is worth noting that the Matthews Committee recommended not just a warning, but for franchisors to include a Risk Statement with the disclosure document. The Government’s failure to adopt this recommendation undermines the practical and theoretical foundations of disclosure as the principal regulatory tool in this area. ... disclosure is now so complex as to be beyond the grasp of the lay person and stretches the capacity of professional advisors who do not work regularly in the area. ... We feel that the extent of disclosure in Australia has become so detailed as to have become more of a burden than a benefit, not only to franchisors, but also to franchisees.¹¹³

The [2010] amendments ... increased the burden on franchisors requiring additional information to be included in their disclosure documents. The end result is longer, more cumbersome disclosure documents. I highlight that the Bakers Delight Disclosure Document is now some 288 pages in length.¹¹⁴

¹¹⁰ Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, p 19.

¹¹¹ Australian Competition and Consumer Commission, submission to the review, pp 7 – 8.

¹¹² McDonald’s Australia Limited, submission to the review, p 5.

¹¹³ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, pp 2, 3, 13.

¹¹⁴ Bakers Delight Holdings Ltd, submission to the review, p 1.

At the last review it was a recommendation that a risk statement be prepared and there was consultation to occur between the ACCC and industry associations to try and develop a template for use in the sector. Nothing appears to have been done to further that goal. It would be preferential for the ACCC to develop those risk statements in consultation with the Sector.¹¹⁵ [Emphasis added]

Keep it simple and have a summary sheet with key terms.¹¹⁶

There is no information that is irrelevant and could be removed. A summary sheet of key terms might be useful.¹¹⁷

The VSBC has seen many franchise agreements and disclosure statements which are highly complex, legalistic, and difficult to understand quickly the commercial elements of the agreement. Many of the franchise disputes brought to the VSBC involve terms of the agreement not being properly understood, despite disclosure, due to the complexity of the documentation.¹¹⁸

The FCA would happily support the provision of a simple and relatively generic risk statement, or the creation of other educational materials to assist to prepare franchisees for business or conduct due diligence. However the FCA does not support any requirement for a franchisor to produce its own risk statement in relation to the specific franchise, as this would impose unreasonable compliance costs, cut across the recommended practice of not providing forecasts and discourage franchisees from taking proper responsibility for their own due diligence and obtaining appropriate advice.¹¹⁹

The inclusion of a short, high level summary of key information was already a standard practice adopted by some professional advisers.¹²⁰

It was also noted in submissions that, over time, sources of information other than the mandatory disclosure document are growing in prominence:

It is worth noting that since 1998, when the Code was introduced, the disclosure document has been supplemented by a wide variety of websites, blogs and information sources. A simple Google search is now probably the most common search activity undertaken by prospective franchisees. So there is ample information available to a prospective franchisee and the franchisee's advisors.¹²¹

Many submissions considered that the onus of providing additional disclosure was not great insofar as a franchisor was concerned:

It must be remembered that franchising is nothing more than a method by which a business owner may grow their business. It is not a business in itself. There are other ways in which a business may grow, including a public share float, obtaining venture capital or other finance, going into partnership, entering a joint venture, or simply employing more staff and opening more stores, particularly in the sales and business development area. Franchisors may complain about the red tape associated with franchising, the disclosure requirements and the like, but they must remember that the current

¹¹⁵ Derek Sutherland, submission to the review, p 6.

¹¹⁶ Stephen Hansen, submission to the review, p 4.

¹¹⁷ Tim Hantke (Franchising Solutions), submission to the review, p 8.

¹¹⁸ Victorian Small Business Commissioner, submission to the review, pg 11.

¹¹⁹ Franchise Council of Australia, submission to the review, p 13.

¹²⁰ See, for example, Derek Sutherland, supplementary submission to the review, p 13.

¹²¹ Franchise Council of Australia, submission to the review, p 15.

disclosure requirements pale into insignificance compared to the disclosure and other requirements necessary for a public share float. A quick look at the ASX Listing Rules confirms this.¹²²

There was not a consistent level of complaint from franchisors that disclosure was too onerous from their perspective.

Some submissions considered that the usefulness of disclosure and warning, even in a more succinct summary form, may be questionable:

Warnings can be designed to include persuasive elements to correct beliefs and attitudes (such as over-optimism and confirmation bias), and they should motivate people to comply. Because warnings do not always lead to compliance, however, research suggests that the better approach wherever possible is to 'design out the hazard' using other means.¹²³

Observations

Annexure 2 to the Code was introduced as a shortened form of disclosure in the hope that it would be more appropriate for franchised businesses with a lower annual turnover by excluding 'superfluous' information.¹²⁴ It no longer appears to achieve this objective and there is no discernible rationale for its continued existence. In the interests of reducing red tape and complexity, it should be removed. Another option may be for the government to increase the threshold applicable to use of Annexure 2 to increase its relevance, however given the franchisees' ability to request the information from Annexure 1 in any event, this would only be likely to be of minimal, if any, benefit. A summary of the differences in disclosure requirements between Annexure 2 and Annexure 1 is at Appendix C – Differences between the Long Form and Short Form Disclosure Documents.

The arguments in favour of a short summary of key risks and matters a prospective franchisee should be aware of when going into franchising are persuasive, however it is unclear to what extent this would depart from the requirements of the existing item 1 of Annexure 1 to the Code.

In summary, calls for an additional risk statement suggest the following possible changes of approach:

- the risk statement, although only a one to two page overview, should be more detailed;
- the risk statement should not be generic, and should be tailored to the specific franchise;
- the risk statement should be a stand-alone document rather than incorporated into the disclosure document; and/or
- the risk statement should be provided to a franchisee earlier than the disclosure document, before a franchisee is emotionally committed to making an investment in the franchise.

The reasoning of the Expert Panel that this document should be provided to franchisees in advance of formal disclosure to ensure the message is conveyed prior to the franchisee becoming emotionally invested in the particular franchise opportunity is persuasive.

¹²² Colin Dorrian, submission to the review, p 6.

¹²³ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 2 (citing Wogalter & Laughery).

¹²⁴ Annexure 2 was developed following a review of the Code which was conducted by the Federal Government Office of Small Business in 2000.

It general terms, it appears that the need for an additional risk statement is becoming greater over time, with the advent of additional disclosure requirements such as those that were introduced in 2008 and 2010. Although in theory a rational and reasonable franchisee will read carefully through a disclosure document and the associated material, making sure to understand all the information contained therein, it appears clear that in practice this is a problem.

One potential drawback of introducing a short form risk statement is that franchisees may in fact be more inclined to only read the risk statement and not delve into the disclosure document and franchise agreement for additional relevant and important information. However, this risk is probably outweighed by the current risk that franchisees will not read or understand the disclosure document in any event. A generic risk statement may be less likely to induce a franchisee to only rely on that document than a short but tailored risk statement for the particular franchise system.

There is a consistent and sensible argument put forward in submissions for a short, high-level summary of key information and warnings.

Recommendations

4. The Code be amended to remove Annexure 2 (Short form disclosure document for franchisee or prospective franchisee).
5. The Code be amended to require franchisors to provide prospective franchisees with a short summary of the key risks and matters they should be aware of when going into franchising, based on the following principles:
 - a. the summary should be generic (as per the existing warnings in item 1 of Annexure 1 to the Code);
 - b. the summary should provide more detail than the current item 1 of Annexure 1 to the Code, but should not be more than one to two pages in length;
 - c. the summary should be a standalone document rather than incorporated into the disclosure document; and
 - d. the summary should be provided to franchisees at their first point of contact with a franchisor (that is, at the time of enquiring about a franchise opportunity).

Part Three – Franchisor Failure

Introduction

At present, the Code contemplates the failure of the franchisor or franchisee in clause 23B, and item 1 of Annexure A. Clause 23B of the Code exempts a franchisor from certain processes relating to termination in the event of a franchisee's bankruptcy or insolvency and is discussed below.

The relevant section of item 1 in Annexure A has been added as a result of the 2008 Joint Committee deliberations. The potential impact on franchisees in the event of the failure of the franchisor was a concern raised in 2008 in the context of the Joint Committee inquiry. The Joint Committee recommended that the Code be amended to require that disclosure documents include a clear statement by franchisors of the liabilities and consequences applying to franchisees in the event of franchisor failure.

The government's response to this recommendation noted that individual franchisees, rather than franchisors, would be better placed to assess the liabilities and consequences applying to them in the event of their franchisor failing. The government did, however, amend the item 1 of Annexure 1 of the Code to expand the information that must be included on the first page of a disclosure document. It must now state that 'Franchising is a business and, like any business, the franchise (or franchisor) could fail during the franchise term. This could have consequences for the franchisee'.¹²⁵

This statement was included with the intention of alerting prospective franchisees and their advisers to the risk of franchisor failure and to assist them in undertaking their due diligence to adequately assess the business opportunity.

Since the 2008 Joint Committee inquiry, there have been efforts by the Franchise Council of Australia (FCA) to improve franchisee education regarding franchisor failure. The FCA publication *The Franchisee's Guide* was amended to include a chapter on this issue.¹²⁶ In addition, the ACCC has published material on its website regarding franchisor failure.¹²⁷

There are various types of external administration events that may be described as franchisor 'failure', including: insolvency, receiver management, voluntary administration, or personal bankruptcy. Each is slightly different, and the appointed insolvency officials may have different powers and obligations. For example, during a voluntary administration, creditors such as landlords may be prevented from taking action to recover their assets. A detailed analysis of the difference is beyond the scope of this report, but the nature of the external administration will influence how a franchisee may act. The Code may apply to administrators of a company who have assumed the role of the franchisor, however, as noted above, the appointment of an administrator triggers a stay of proceedings against the franchisor.¹²⁸

¹²⁵ Refer to Item 1, 1.1(e) of Annexure 1 to the Code.

¹²⁶ The FCA submission notes that 'This Chapter was included in the Franchisee's Guide ... as a specific industry response to the 2010 Federal inquiry into franchising, and supplements the additional warning including on the front page of the disclosure document in the 2010 amendments to the Code.' See pg 26, Annexure B of their submission.

¹²⁷ Australian Competition and Consumer Commission, *Ending a Franchise Agreement*, [ACCC website](#) (accessed 11 April 2013).

¹²⁸ Section 440D of the *Corporations Act 2001* (Cth).

Evidence considered during the review

In general, submissions to the review felt that the government's 2010 amendment to the Code did little to address the problem of franchisor failure.

We do not believe that this additional warning/disclosure requirement has effectively addressed concerns about franchisees entering into franchise agreements without considering the risk of franchisor failure. ... We are of the view that such an amendment does not adequately address the problem because of the limitations inherent in this type of regulatory intervention. The use of a warning does little to improve franchisees' capacity to protect themselves against the risks.¹²⁹

We have not seen improved due diligence or an increase in the number of franchisees obtaining legal and accounting advice.¹³⁰

...[the current warning] is susceptible to being overlooked because of its general, noncommittal phrasing and placement within a large block of text.¹³¹

It was generally felt that the problem of franchisor failure is a serious and ongoing one. The Law Institute of Victoria (LIV), noted its belief that the warning introduced in 2010 is inadequate, suggested that a more comprehensive warning that gives specific examples of the problems that franchisees may face would better serve prospective franchisees and help to guide their due diligence processes.¹³²

Noting the government's previous reason for not mandating a more comprehensive warning, the LIV submitted that 'the danger of inducing a belief among franchisees that they are only exposed to the risks listed in the warning noted by the government may be addressed by a disclaimer that the risks listed in the warning are not exclusive.'¹³³

Others suggested different solutions to this issue:

...consideration should be given to altering Item 20.1 of the Disclosure Document to require the franchisor's statement of solvency to be current as at the time the disclosure document is issued to a prospective franchisee.¹³⁴

A possible solution to provide a level playing field for a greater proportion of franchisees would be to **amend current accounting practices to recognise the payment of upfront franchise fees by franchisees to franchisors prior to joining a system as a prepayment to be amortised by the franchisor over the term of the franchise**. For any system which charges an upfront fee (and most do), this would create a reducing debt owed to the franchisee over the term of the franchise, thus making a creditor of the franchisee throughout the term.¹³⁵

Furthermore, franchisors can avoid disclosing their own financial statements by simply substituting this with a signed statement by an independent auditor stating that the franchisor is solvent. Given the severe consequences of franchisor failure to the franchisee, the LIV suggests it may be preferable

¹²⁹ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 2.

¹³⁰ M&K Lawyers, submission to the review, p 1.

¹³¹ Law Institute of Victoria, submission to the review, p 3.

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, p 6.

¹³⁵ Ibid, pg 4.

for the latter to be provided with the financial statements in all cases. This information would allow franchisees to form a more nuanced view as to the franchisor's financial health than is facilitated by a bare statement of solvency by an independent auditor.¹³⁶

The [SME Business Law] Committee recommends that there be reform to the effect that:

1. In the case of an insolvent franchisor, a franchise cannot be terminated except upon reasonable notice (for instance 30 to 60 days) unless there is an agreement to terminate with the franchisee or, alternatively, an order of the Court if it is demonstrated that the insolvent franchisor, through its insolvency practitioner, is not in a position to trade the franchise or continue to supply services, materials or intellectual property which is the subject of a franchise agreement. A moratorium of, say, 30 to 60 days would enable the franchisee to negotiate a possible purchase of their business, reconfigure their business or, alternatively, participate in a financial work out of the franchisor such as a Deed of Company Arrangement or Scheme of Arrangement.
2. In the case of a franchisee, a similar moratorium period would enable the insolvent franchisee, through the insolvency practitioner, to negotiate a sale of the franchise and realise potential value for the business.¹³⁷

Whilst a warning statement has assisted to highlight that there is always a risk of head franchisor, franchisor or master franchisee failure, ultimately franchisees need further education and advice about the consequences that will occur in the event of insolvency of a head franchisor, franchisor or master franchisor. This should be made much clearer in the ACCC Franchisees Guide publication issued by the ACCC. Possibly it should be made mandatory for a franchisor to give the guide to franchisees as part of the disclosure document and amend the statement required to be obtained under clause 11(1) of the Code before entering into the franchise agreement.¹³⁸

It was also suggested that further information be included in a short risk statement to accompany the disclosure document, and/or mandated education for franchisees including on this subject.

Examples of problems the failure of a franchise can cause for franchisees were also noted in submissions:

We also note that some of the worst outcomes suffered by franchisees in recent franchisor failures have been at the hands of external administrators who take control of the franchise system. In one example, the administrator forced franchisees to purchase 'dead stock' for the benefit of the creditors but refused to provide the services required of the franchisor. It was argued, probably correctly as a matter of law, that the administrator had obligations to creditors over and above that owed to franchisees.

In another case the franchise agreements of 'unprofitable' stores (as defined by the return to the external administrator) were disclaimed but the leases were retained so a new franchise store could be sold in that location.

¹³⁶ Law Institute of Victoria, submission to the review, p 4.

¹³⁷ Law Council of Australia, Business Law Section, SME Business Law Committee, submission to the review, pp 2 – 3.

¹³⁸ Derek Sutherland, submission to the review, p 5.

Administrators are in a difficult position; reluctant to disclaim franchise agreements to preserve the system as a 'going concern' but usually being unable or unwilling to meet the franchisor's responsibilities.¹³⁹

There were, however, no submissions from franchisees (or former franchisees) who stated they had participated in a franchisor's business which subsequently went into insolvency. It is unclear how many franchisees have been affected by franchisor failure.

Many submissions also perceived an inequity in clause 23 of the Code. To give one example:

If a franchisee commits an act of bankruptcy, the franchisor can immediately terminate their agreement under Clause 23(b) and thereby deprive the franchisee's administrator of the opportunity to satisfy creditors by selling the agreement. ... Conversely, if the franchisor commits an act of bankruptcy the franchisee has to continue to perform its obligations under the agreement while the franchisor's administrator looks for a buyer of the franchisor's business, including the franchise agreements, or recommends winding up.¹⁴⁰

Some submissions called for franchisees to have a right to terminate in the event of a franchisor's failure. However this approach was noted in some submissions to be problematic:

From an economic, or commercial, perspective maintaining the franchise network while the franchisor is in administration is a critical benefit to administrators who are either restructuring the company to make it viable or trying to sell the entire network as a going concern. If some franchisees could walk away it would undermine the ability of a restructure or sale to proceed and greatly increase the risk facing other creditors, such as financial institutions. There is also a risk to franchisees that may prefer to stay as part of the franchise network. The value of their business would significantly diminish if other franchisees were simply allowed to walk away and weaken the franchise network.¹⁴¹

If the preferred outcome on balance is to keep the system intact for a potential resale of the network has merit, then a franchisee with a right to terminate (which is identical to that in clause 23(b)) after appointment of an external administrator would frustrate this.¹⁴²

Observations

The perceived inequity in clause 23 is questionable. On one reading of the provisions of the Code, clause 23 does not provide the franchisor with a right to terminate the franchise agreement in the event of the franchisee's bankruptcy or insolvency. Rather, such a right would have to be provided for in the franchise agreement. Clause 23 of the Code merely exempts a franchisor from a *procedure* which the franchisor must otherwise follow to validly terminate a franchise agreement in accordance with its terms. In all cases of termination, any rights to terminate must be conferred by the franchise agreement. However, noting that submissions and judgments have raised doubt about the effect of clause 23¹⁴³, it may be prudent for the government to clarify the intent or purpose of

¹³⁹ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 3.

¹⁴⁰ Dr Jenny Buchan, submission to the review, p 9.

¹⁴¹ Australian National Retailers Association, submission to the review, p 9.

¹⁴² Derek Sutherland, submission to the review, p 7.

¹⁴³ [Cafe2U Pty Limited v Bishambu Pty Ltd \[2013\] FCA 191 \(8 March 2013\)](#), citing [Farahbakht v Midas Australia Pty Ltd \(No 2\) \[2006\] NSWSC 1323](#).

clause 23 by means of a guidance note in the Code (see Part Eleven – Technical or minor changes to the drafting of provisions of the Code).

One option would be for the Code to confer a specific right on both the franchisee and the franchisor to terminate a franchise agreement in the event of the other party's insolvency. In practice, it might be expected that a franchisor would have the right to terminate in the event of the franchisee's insolvency under the franchise agreement.¹⁴⁴ There is little incentive for the franchisor to confer a reciprocal right on the franchisee in its standard form of agreement. So, although the Code arguably does not contain an inequity in this regard, it is true that in practice, termination provisions are likely to be weighted in favour of the franchisor. This is exacerbated because the failure of a franchisor has much more capacity to negatively impact a franchisee than the failure of a single franchisee would have on a franchisor. However, franchisees may still have legal rights to terminate in certain circumstances, such as where there has been a fundamental breach of the contract by the franchisor.

It is understood that the most usual way in which a franchise system is sold to a new owner-franchisor (including because of a franchisor's insolvency) is by way of novation of the franchise agreements in the system. If a franchise agreement is novated, a franchisee would ordinarily have to agree or not agree to the novation and relationship with the new franchisor in any event. Accordingly, providing franchisees with a statutory right of termination, particularly after a period during which the administrator has an opportunity to negotiate a potential sale of the system, may not be all that revolutionary. It may simply provide franchisees with more certainty regarding the procedure and timing of the options they will be faced with if the franchisor fails.

In theory, it is possible that franchisees can protect their interests by negotiating the inclusion of a clause giving them an immediate right to terminate a franchise agreement if a corporate franchisor goes into insolvency (such as the franchisor would ordinarily do for itself). It would be important not to prevent franchisees from being able to negotiate such clauses if also providing a statutory right of termination at a later point.

It may be important to the creditors of a franchisor that has entered bankruptcy or insolvency that there is an opportunity for sale of the assets of the franchisor – and a significant part of any franchisor's assets are its franchise agreements with franchisees. The ability of franchisors to attract and retain capital and credit could be affected by changes which significantly altered the rights of the parties upon the insolvency of a franchisor, such as an immediate right for the franchisee to terminate. Such clauses are in fact void in bankruptcy (relating to individuals) as opposed to insolvency (relating to companies).¹⁴⁵ However, it is noted that lending institutions did not make submissions to the review, so the impact is difficult to assess. Lenders could, however, be expected to be familiar with termination rights in the event of insolvency, given the parties' rights to negotiate such clauses.

¹⁴⁴ The Law Council of Australia, Business Law Section, SME Business Law Committee notes that '[i]n the case of an insolvent franchisee, an insolvency appointment is likely to trigger an ipso facto clause in a franchise agreement which has the effect of the franchisor without reasonable or any notice, terminating the franchise, "stepping in" to the business of the franchisee and then continuing to operating the franchise and/or re-selling it without having to account to the franchisee for any goodwill or any other value of the franchisee's assets'. submission to the review, p2.

¹⁴⁵ See section 301 of the [Bankruptcy Act 1966](#).

An additional option which may be pursued is effectively 'deeming' franchisees to be creditors of the franchisor in the event of the franchisor's insolvency, by apportioning the initial franchise fee across the term of the franchise agreement. This would give franchisees a pro rata 'debt' in the event of the failure of the franchise during the term of the franchise agreement.

Care must be taken when considering the rights of franchisees in the context of franchisor failure. While the result for franchisors and franchisees in the context of insolvency will almost always be a negative one, that does not necessarily mean there is a problem with the insolvency regime. Rather, it is a consequence of insolvency itself.

When a franchisor fails, the franchisor's creditors and other parties who dealt with the franchisor must also be protected. It is in the interests of franchisees and the industry as a whole to ensure that the framework for administration of insolvent franchisors is a strong one.

It would appear that there are a number of options that could be pursued to address the problems alleged to be faced by franchisees when a franchisor fails. Issues relating to further disclosure and education for franchisees are covered elsewhere in this report. If the observations and recommendations in those chapters are heeded, then that will have the probability of improving the awareness of information available to franchisees in the event of franchisor failure. However, given the persistent concern about this issue, specific action is warranted.

Recommendation

6. The Code be amended to:

- c. Provide franchisees and franchisors with a right to terminate the franchise agreement in the event that any administrator of the other party does not turn the business around, or a new buyer is not found for the franchise system, within a reasonable time (for example 60 days) after the appointment of an administrator. It should be made possible for the courts to make an order extending this timeframe in appropriate cases. It should also be clear that the parties can negotiate a right to terminate at an earlier stage.
- d. Ensure the franchisees can be made unsecured creditors of the franchisor by notionally apportioning the franchise fee across the term of the franchise agreement, so that any amount referable to the unexpired portion of the franchise agreement would become a debt in the event the franchise agreement ended due to the franchisor's failure.

Part Four: Transparency of financial information in a franchise

Introduction

There are a number of items of mandatory disclosure which are designed to ensure that a potential or existing franchisee has sufficient financial information to make a decision regarding their investment in a franchise. Some information relates to expenditure the franchisee will be required to incur, and other information relates to the profitability of the franchisor and the business being franchised.

The degree of disclosure regarding financial matters has led the Franchise Council of Australia to observe that:

It is not possible to rationally argue that there is not extremely transparent disclosure of financial information. Indeed it is hard to imagine more comprehensive and transparent disclosure.¹⁴⁶

In submissions, however, others have taken a different view.

This chapter covers six key areas of financial information which were raised in submissions:

- unforeseen capital expenditure;
- rebates, commissions and volume incentives;
- marketing funds;
- profitability of the franchise and the disclosure of earnings information; and
- disclosure of outgoing payments.

For a number of these items of disclosure there were amendments in 2008 or 2010.

Unforeseen capital expenditure

Introduction

The imposition of unforeseen capital expenditure was one of five behaviours considered by the Expert Panel in 2010. The Expert Panel ultimately recommended further disclosure, noting that:

A general prohibition of the behaviour may constrain franchisors from making valid commercial decisions, and may not be a proportional response to a potentially confined problem.¹⁴⁷

The Expert Panel also did not favour the imposition of a conditional prohibition on unforeseen capital expenditure, or a requirement to obtain a franchisee's agreement. It noted that the unconscionable conduct provisions in the then *Trade Practices Act 1974* (now found in the Australian Consumer Law, Schedule 2 to the *Competition and Consumer Act 2010* (Cth)) may also provide

¹⁴⁶ Franchise Council of Australia, submission to the review, p 14.

¹⁴⁷ Expert Panel report, *Strengthening Statutory Unconscionable Conduct and the Franchising Code of Conduct*, pgs 58 – 59.

recourse in some circumstances where franchisees have been exposed to unilateral contract variations resulting in unforeseen capital expenditure.

Accordingly, in 2010 the government amended the disclosure provisions of item 13A of Annexure 1 of the Code to require franchisors to disclose:

Whether the franchisor will require the franchisee, through the franchise agreement, the operations manual (or equivalent), or any other means, to undertake unforeseen significant capital expenditure that was not disclosed by the franchisor before the franchisee entered into the franchise agreement.

Additional disclosure regarding capital expenditure was also required in the context of end of term arrangements. This essentially requires the franchisor to disclose whether it would take into account any significant capital expenditure undertaken by the franchisee in deciding whether or not to renew the franchise agreement. This was because many of the concerns regarding unforeseen capital expenditure related to the inability of the franchisee to recover their capital investment owing to the insufficient term of the franchise agreement (see Part Six – Transfer, renewal and end of term arrangements) .

As with other amendments to the Code that were made in 2010, the additional disclosure requirements in item 13A only apply to franchise agreements entered into after 1 July 2010.¹⁴⁸

Evidence considered during the review

Concerns about unreasonable and unforeseen capital expenditure were raised in a number of submissions. In particular, concerns were raised about the impracticality of the franchisor disclosing expenses which are by definition ‘unforeseen’.

It was explained in one submission that:

Disclosure under this item may usually contain a general statement that franchisees need to allow for certain unexpected capital expenditure during the term that can occur for things such as premises upgrades and refurbishments on transfers or renewal of the lease, relocation costs or make good costs under the lease, replacement of obsolete equipment and computers, cost of replacing stock or property in the event of fire, flood or other damage or other destruction (irrespective of whether insurance policies cover these areas), replacement of signage, vehicles, telephone systems, furniture, plant and equipment etc.¹⁴⁹

Many submissions raised concerns that the provision was not achieving its objective of ensuring that prospective franchisees, before committing to the franchise, gain access to essential and meaningful information without unduly burdening both franchisees and franchisors. Some franchisors were said to be merely stating 'yes' in their disclosure documents under this item, without giving any further information.¹⁵⁰

Other franchisors were said to be disclosing a long list of expenses which provided little valuable information to a franchisee:

¹⁴⁸ See clause 5(1B) of the Code.

¹⁴⁹ Derek Sutherland, submission to the review, pp 9 – 10.

¹⁵⁰ Queensland Law Society, Franchising Law Committee, submission to the review, p 12.

Many disclosure statements now simply contain a statement to the effect that upgrades to plant and equipment or the premises will be required. They are not specific about when those expenditures will be required and neither are they specific about the amount of the expenditure.¹⁵¹

A better approach to this disclosure requirement is to relabel it as “possible future capital expenditure” which may help to distinguish the probable (ie. Refurbishment at the end of the lease term) from the improbable (ie. Rebuilding a store after being destroyed by a falling meteor), as “unforeseen” would need to otherwise encompass both of these examples, no matter how unlikely the latter.¹⁵²

Providing details of “unforeseen expenses” is in itself a complete nonsense. If the expenses are unforeseen, how can a franchisor fill in this section of the Disclosure with any degree of accuracy? What has occurred practically is that some documents now contain a horrifically long list of possible expenses, the majority of which are highly unlikely to ever occur.¹⁵³

In practice it is generally honoured by franchisors giving an almost meaningless range of expenses.¹⁵⁴

Franchisors have experienced difficulty identifying the full range of potential unforeseen capital expenditure and the outer limits of the required disclosure are not clear. Does the franchisor have to cover matters such as the destruction of premises through natural disaster? Or where the franchisee’s business requires a further injection of capital to continue trading solvently?¹⁵⁵

Notice must be taken of the continuing frequency of disputes involving the payment of further capital amounts, but this 2010 amendment should be removed entirely and should be subsumed (if it was not already covered) under Disclosure item 16.¹⁵⁶

It is said that the result is disclosure that is useless, unhelpful and frightening to a potential franchisee.¹⁵⁷

Various possibilities were put forward for perceived improvements to item 13A of the disclosure document:

- the actual costs for experienced franchisees could be disclosed instead;¹⁵⁸
- franchisors could be prohibited from imposing unreasonable and unforeseen capital expenditure, particularly as a condition of renewal of the franchise agreement;¹⁵⁹
- franchisors could be required to make the business case for outlays,¹⁶⁰ noting that this is something franchisors are said not to do very well.¹⁶¹

¹⁵¹ Queensland Law Society, submission to the review, p 10.

¹⁵² Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, p 6.

¹⁵³ Phil Blain, submission to the review, p 2. The sentiment is reflected in other submissions – see, for eg, The Franchise Lawyer, submission to the review, p 9.

¹⁵⁴ Franchise Council of Australia, submission to the review, p 14.

¹⁵⁵ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 5.

¹⁵⁶ Ibid.

¹⁵⁷ Phil Blain, submission to the review, pg 2.

¹⁵⁸ Ibid.

¹⁵⁹ Peter Abetz, submission to the review, p 8.

¹⁶⁰ Lotteries Agents Association of Tasmania and the Australian Newsagents Federation (South Australia), submission to the review, p 2.

Franchisees claimed that the requirement to undertake unforeseen capital expenditure has made it difficult for them to attract finance due to the uncertainty this creates.¹⁶² The Franchise Relationships Institute's Greg Nathan, a registered psychologist, also commented that:

In our work with franchise systems a consistent source of strain in the relationship is the introduction of new initiatives which involve significant capital expenditure by franchisees. Unfortunately these initiatives are often poorly planned and executed by the franchisor. We believe this lack of thought is partly because it is not the franchisor's money that is being invested.

Unfortunately these initiatives are often poorly planned and executed by the franchisor. **We believe this lack of thought is partly because it is not the franchisor's money that is being invested.** This can lead to bad decisions regarding the management of suppliers and a lack of accountability. Franchisees who then complain are seen as "just being negative" which further puts a wedge in the franchise relationship.

If there was a way of encouraging franchisors to give evidence that they have conducted proper due diligence in their planning and risk management practices, this may help to alleviate a significant source of frustration for all stakeholders.¹⁶³ (Emphasis added)

Observations

Many of the concerns raised in submissions about unforeseen capital expenditure do not go to problems with the policy intention of item 13A of Annexure 1. To the extent that changes may be required to item 13A, these could be dealt with as clarifying amendments to improve consistency of the industry's approach to disclosure of significant capital expenditure (see Part Eleven – Technical or minor changes to drafting of provisions of the Code).

However, there should also be a change to the policy intention that significant capital expenditure should be disclosed to franchisees upfront, rather than regulated in a more 'heavy handed' way.

Decisions made by the franchisor requiring franchisees to incur significant capital expenditure need to be subjected to a test of reasonableness. That is, there should be a 'business case' for the imposition of the expenditure. Most businesses make strategic decisions about capital investment based on a cost benefit analysis (even if this is only an informal process). For franchisors, significant capital expenditure by franchisees has no direct costs, and only has benefits. It stands to reason that they will be motivated to impose such costs on franchisees in the interests of improving the business as a whole. For franchisees, significant capital expenditure has both costs and – it can be presumed in most cases – benefits. The absence of the ordinary constraint imposed by a cost benefit analysis for franchisors when imposing unforeseen capital expenditure on franchisees warrants regulatory intervention.

For completeness, the recommendations in Part Five of this report relating to good faith also may be relevant to franchisors imposing significant capital expenditure on franchisees. The imposition of unreasonable significant capital expenditure on franchisees was one of the key behaviours identified as leading franchisees to call for an obligation to act in good faith to be inserted into the Code at the time of the Joint Committee and Expert Panel reports.

¹⁶¹ Franchise Relationships Institute, submission to the review, p 2.

¹⁶² KFC Franchisees Association, submission to the review, p 2.

¹⁶³ Franchise Relationships Institute, Greg Nathan, submission to the review, p 2.

Recommendation

7. The Code be amended to prohibit franchisors from imposing unreasonable significant unforeseen capital expenditure. 'Unreasonable' and 'significant' should be defined, with a view to a franchisor being able to demonstrate a business case for capital investment in the franchised business.

Rebates paid to the franchisor for supply to franchisees

Introduction

Item 9 of Annexure 1 of the Code requires franchisors to disclose details of whether the franchisor, or an associate of the franchisor, will receive a rebate or other financial benefit from the supply of goods or services to franchisees, including the name of the business providing the rebate or financial benefit. Franchisors must also disclose whether those rebates or financial benefits are shared, directly or indirectly, with franchisees. The requirement for a franchisor to disclose *from whom* they receive rebates and financial benefits was an amendment made in 2008.

Evidence considered during the review

Some submissions raised the issue of rebates being provided to franchisors. Some provided arguments for maintaining the status quo, questioning the benefit for franchisees and raising concerns about the costs for franchisors of increased disclosure:

Additional disclosure concerning rebates is opposed, as that involves confidential information, involves third parties, disadvantages franchise networks relative to other networks and is likely to disadvantage franchisees in negotiations with suppliers. The ACCC will examine rebate arrangements, and has an appropriate "light touch" regulatory role if prices paid by franchisees are higher than they ought to be.¹⁶⁴

The identification of the entities paying rebates to the franchisor has not materially benefited franchisees; there has been no increase in the relative bargaining power of franchisees with this disclosure and the 'tied supply' nature of franchising makes it extremely unlikely that the franchisee will receive a benefit that is not purely at the discretion of the franchisor. The broad disclosure that the franchisor may, or will, receive rebates that will not be shared with the franchisee coupled with education and independent advice about the ramifications of this practice should be sufficient for the purposes of deciding whether or not to invest in a system.¹⁶⁵

McDonald's opposes any move which would require additional disclosure in this area.¹⁶⁶

Others supported increased disclosure from franchisors on the question of monetary rebates.¹⁶⁷ For example, such detail may include stating the actual amount of rebates. Franchisees apparently do sometimes seek this information from franchisors, who usually withhold it for commercially sensitive reasons.¹⁶⁸

¹⁶⁴ Franchise Council of Australia, submission to the review, p 14.

¹⁶⁵ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 6.

¹⁶⁶ McDonald's Australia Limited, submission to the review, p 7.

¹⁶⁷ See, for example, Competitive Foods Australia Pty Ltd, submission to the review, p 8.

¹⁶⁸ Derek Sutherland, submission to the review, p 10.

Here the requirement is to just disclose the mere fact that rebates or other financial benefits are received by the franchisor or an associate of the franchisor, and whether they are to be shared with franchisees. Unfortunately this is not enough as full disclosure of the amounts or methods for calculating such rebates is essential as they may adversely impact on the financial viability of the franchisee's business. ... In interests of greater transparency the current disclosure requirements could be easily amended so as to require franchisors to also disclose the full amount and methods of calculation of any rebates or other financial benefits to be paid to the franchisors or an associate of the franchisor, or which is to be shared with franchisees are disclosed to franchisees.¹⁶⁹

The subject of rebates paid to franchisors was a significant issue for one franchisee whom a confidential meeting was conducted with. This franchisee felt that the Code should ban the receipt of rebates – which he termed 'secret commissions' – owing to the upwards pricing pressure they place on key inputs, which may affect the viability of the franchisee's business.

Observations

Although it was raised by some parties during consultation, there was not a significant or consistent call for more or less disclosure of rebates paid to franchisors by suppliers and other third parties in relation to goods supplied to franchisees. It would appear that the government's amendments from 2008 to this aspect of disclosure have had the intended effect of improving the transparency of payment of rebates to franchisors without unduly requiring franchisors to reveal sensitive commercial information.

However, it may be useful to insert a minor clarifying amendment to confirm that the meaning of 'other financial benefit' requires disclosure of arrangements such as volume incentives and other commissions.

Finally, the relevance of laws relating to exclusive dealing and third line forcing are noted in the context of supply arrangements imposed in a franchise system (see Part One, under the heading Key requirements of Australia's competition and fair trading laws).

Marketing funds

Introduction

In 2008, in response to widespread concern regarding marketing funds, the government amended the rules in the Code to require franchisors to provide franchisees with a statement detailing the receipts and expenses for such funds each financial year. The statement must be provided within three months of the end of each financial year (previously franchisees were only entitled to receive this information if they specifically requested it, in writing, from the franchisor).

Additionally, a franchisor is now required to have the marketing fund statement audited each year and provide franchisees with a copy of the auditor's report. However, this is not required if 75 per cent of franchisees agree that it is not necessary. If franchisees agree it is not necessary, that decision must be remade every three years for the franchisor to rely on it.

Evidence considered during the review

The review received many submissions which commented on the operation of marketing funds. A consistent theme in submissions was that marketing funds are a common source of dispute

¹⁶⁹ SA Small Business Commissioner, submission to the review, p 8.

between franchisees and franchisors, are prone to improper or questionable use by the franchisor and lack transparency.

This area remains a significant source of dispute and the disclosure amendments have not resolved the problems.¹⁷⁰

... more and more issues arise with marketing funds all the time and it is an area where franchisees and franchisors are often in dispute and undoubtedly will continue to be for as long as there is franchising.¹⁷¹

The ACCC has received 49 complaints in the last five years about how franchisors are spending marketing funds.¹⁷²

Even franchisors conceded that the provisions in the Code relating to marketing funds need to be improved in the interests of franchisees, with one franchisor commenting that '[f]unds in a marketing fund are essentially held on trust for franchisees and the requirements in the Code are too loose'.¹⁷³

Already this year Mr Young has been involved in a franchise dispute where the franchisor appears to have been using the marketing fund to subsidise its administration costs, but arguably in such a way as to comply with the franchise agreement. The franchisee cannot afford to take this matter further, and in any event there is no possible advantage or benefit to be obtained by them in pursuing the issue given the franchisor's undisputed discretion in allocating funds.¹⁷⁴

Most franchise agreements also say that the fund will be used at the discretion of the franchisor and the franchisor does not need to spend a certain amount or for that matter any amount of the money contributed in the franchisee's area. That is the first area of contention. Some franchisors spend the money in areas which the franchisees do not believe is strictly marketing. For example: a franchise system which uses the money for the registration and maintenance of existing or new trade marks. The agreement also says they can use the money to defend any action against the trade marks. Others want to spend the money attending franchise expos because they believe that is marketing of the system. Some others want to spend the money on conferences. Those uses of funds are not what would be thought of by any reasonable franchisee as being what was contemplated by the franchisee when they were originally told they were expected to contribute to a fund. It might be in the document, but unless it is pointed out by the solicitor, the franchisee will be very surprised at those uses of the funds.¹⁷⁵

Marketing fund statements have insufficient detail. Funds in a marketing fund are essentially held on trust for franchisees and the requirements in the Code are too loose. Suggest an annual Profit & Loss statement should be required and that there should be a template for such. Should also be required to disclose how much is in the fund bank account (i.e. cash at bank). Best practice may be to ensure

¹⁷⁰ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 6.

¹⁷¹ Alert, Bywaters Timms law firm, *Franchise Marketing and other cooperative funds*. See also Queensland Law Society Franchising Law Committee, submission to the review.

¹⁷² Australian Competition and Consumer Commission, submission to the review, p 3.

¹⁷³ Bedshed Franchising Pty Ltd, submission to the review, p 4.

¹⁷⁴ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 7.

¹⁷⁵ Alert, Bywaters Timms law firm, *Franchise Marketing and other cooperative funds*.

franchisee input in how fund is run however this is not always viable, e.g. small service master franchises.¹⁷⁶

Some submissions also commented that franchisors are avoiding obligations with respect to marketing by structuring the fund and payments to the marketing and advertising fund so that it does not meet the definition of a fund as set out in the Code:¹⁷⁷

A decision by a 75% or greater majority of franchisees not to conduct an audit of a marketing fund currently lasts for three years. Given the rapid growth experienced by systems (eg doubling or trebling their size in that timeframe), the normal turnover of franchisees as existing operators sell and are replaced by new franchisees, and the capacity for marketing requirements to change considerably in a three-year timeframe, it is recommended that the time be reduced from three-yearly to annually to allow greater engagement by all current franchisees, and improved transparency for and responsiveness through improved accountability.¹⁷⁸

It was suggested that marketing funds should be kept in a separate account, such as a trust account. Apart from the clarity and administrative benefits of a separate marketing and advertising fund, one submission indicated that it is possible such an approach may provide franchisees with an explicit proprietary claim to money in the funds in the event of the franchisor's insolvency (see Part Three – Franchisor Failure).¹⁷⁹

One confidential submission relayed the franchisee's experience with inadequate disclosure by the franchisor, stating that the annual statement of receipts and expenses for the franchisor's marketing fund noted expense as 'consultants fees' but did not saying what the consultant was employed to do or how much they were paid to do it. Another generic description referred to in this confidential submission was 'brand development', again without further detail. This was said to be problematic in the context of significant amount of money being held in this fund, and a number of franchisees' belief that the fund was being misused by the franchisor.¹⁸⁰

There is nothing in the code that requires a franchisor to set up a separate account for the marketing fund. Often franchisors mix the fund money with their own money which can be confusing and costly when it comes to the accounts for the fund and the audit. It is best practice to have a separate bank account for the marketing fund and keep the administration of the fund completely apart from the franchisor's own funds.¹⁸¹

Many submitters that commented on this issue considered that franchisees should be given more information about marketing expenditure by the franchisor and that '[f]ranchisees have a fundamental right to see this information'.¹⁸²

¹⁷⁶ Tim Hantke (Franchising Solutions), submission to the review, p 4.

¹⁷⁷ Phil Blain, submission to the review, p 2.

¹⁷⁸ Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, p 6.

¹⁷⁹ Dr Jenny Buchan, submission to the review, p 4.

¹⁸⁰ Confidential submission to the review.

¹⁸¹ Alert, Bywaters Timms law firm – see also Queensland Law Society Franchising Law Committee, submission to the review.

¹⁸² Phil Blain, submission to the review, p 2.

Observations

Marketing funds are an ongoing area of concern for both franchisors and franchisees. Previous amendments to the Code do not appear to have gone far enough to prevent disputation and potential, or perceived, misuse of marketing and advertising funds. Even if anecdotal evidence regarding the misuse of funds was ultimately unfounded, the fact that this is an area of high disputation supports the need for a different approach. The lack of any explicit right to certain disclosures for the franchisees appears to, at best, be breeding distrust between franchisors and franchisees regarding the use of marketing funds.

Keeping marketing funds in a separate account may impose a greater cost on franchisors. However, to the extent that this happens, it may be expected that there would be a corresponding reduction in disputation which reduced the costs franchisors. This is particularly pertinent given that, as noted above, submissions indicated this is an area in which disputes frequently arise. More detailed information about marketing fund uses should also be provided to franchisees. Franchisees may sometimes draw adverse conclusions about how the marketing funds are being spent if there is insufficient detail in the marketing fund financial statement provided to them.

There is also the potential for an incidental benefit for franchisees in the event of the franchisor's failure if marketing and advertising funds collected from franchisees are held on trust for the benefit of franchisees (see Part Three – Franchisor Failure).

The exception to the above statements with respect to marketing funds is that if a franchise agreement requires a franchisee to reimburse the franchisor for their share of one-off or infrequent expenses that the franchisor has incurred and paid on the franchisee's behalf, then this should not be required to be regulated as a 'marketing fund'.

Finally, it is worth noting that issues relating to marketing funds could be expected to be further addressed by the deterrent effect if a recommendation that the government introduce a civil pecuniary penalty regime for breaches of the Code is accepted (see Part Eight - Enforcement).

Recommendation

8. The Code be amended with respect to the administration of marketing funds based on the following principles:
 - a. a franchisor should separately account for marketing and advertising costs;
 - b. contributions to marketing funds from individual franchisees should be held on trust for franchisees generally, with the franchisor to have wide discretion as to how to expend the funds (subject to principle 'e' below);
 - c. company-owned units must be required to contribute to the marketing and advertising fund on the same basis as franchised units;
 - d. the marketing and advertising fund should only be used for expenses which are clearly disclosed to franchisees by way of the disclosure document, and which are legitimate marketing and advertising expenses;
 - e. a once yearly independent audit should be conducted on marketing funds over a certain threshold value, with no capacity for franchisees to vote against such an audit; and
 - f. the results of the audit (where applicable) and other detailed information about the expenditure of marketing and advertising funds should be made available to franchisees yearly.

Profitability of the franchise and the disclosure of earnings information

Introduction

A prospective franchisee conducting thorough due diligence should always assess the costs of buying into the franchise as against the possible income or profit from the franchise over the term of the franchise agreement. This is essential to ascertaining the commercial viability of the business.

The Code does not currently require a franchisor to provide earnings information or details of the possible income or profit from the franchise, however item 19 of the Disclosure Document set out in Annexure 1 does require the franchisor to provide disclose information relevant to this point:

19 Earnings information

19.1 Earnings information for the franchise, if it is given, must be based on reasonable grounds.

19.2 Earnings information may be given in a separate document attached to the disclosure document.

19.3 Earnings information includes information from which historical or future financial details of a franchise can be assessed.

19.4 If earnings information is not given — the following statement:

The franchisor does not give earnings information about a [*insert type of franchise*] franchise. Earnings may vary between franchises.
The franchisor cannot estimate earnings for a particular franchise.

19.5 Earnings information that is a projection or forecast must include the following details:

- (a) the facts and assumptions on which the projection or forecast is based;
- (b) the extent of enquiries and research undertaken by the franchisor and any other compiler of the projection or forecast;
- (c) the period to which the projection or forecast relates;
- (d) an explanation of the choice of the period covered by the projection or forecast;
- (e) whether the projection or forecast includes depreciation, salary for the franchisee and the cost of servicing loans;
- (f) assumptions about interest and tax.

The law relating to misleading or deceptive conduct and false or misleading representations is relevant to this issue (see Part One – Setting the scene).

The Australian Consumer Law provides that if a person makes a representation with respect to any future matter and the person does not have reasonable grounds for making the representation, the representation is taken to be misleading.¹⁸³ This was a key issue in litigation before the Federal Court in 2012 regarding the Billy Baxter's franchise system. The Billy Baxter's decision was widely reported on in the media, and commentary issued by law firms. A number of lessons for both franchisors and franchisees were said to derive from the case, and it was observed that 'any statements made about

¹⁸³ Australian Consumer Law, section 4.

turnover and profitability when franchisees are considering the business are likely to become an issue if the business subsequently fails'.¹⁸⁴

Evidence

The review was presented with a variety of opinions on the adequacy of information provided to franchisees about the profitability of the franchise model, and the particular franchise site.

The Franchisees Association of Australia submitted that franchisors should have to disclose 'how the system operates commercially with respect to revenue and profit generation and with respect to capital expenditure, capital growth and the ability to realise capital on exiting the system'.¹⁸⁵ This Association argued that the Code should 'be amended to require all franchisors to provide a fully disclosed and costed business model'.¹⁸⁶ The lack of an obligation on the franchisor to operate the franchise system in a profitable manner is a source of concern for franchisees, since a franchise is usually viewed as a proven business model. It is said that it would not be going 'too far' to require such disclosure, because such representations are made in commercial negotiations between a franchisor and a franchisee in any event, and the requirement would only be reducing such representations to writing.¹⁸⁷ In the Association's view, this would assist franchisees in establishing misrepresentation.

On the other hand, concerns were raised about providing this information to franchisees:

As a consequence of the risk of litigation most franchisors are reluctant to give turnover or earnings of other franchisees that have been reported because they have not verified that data or they are concerned about making a representation that this prospective franchisee could do as well as or better than the franchisee who provided the information.¹⁸⁸

However it is acknowledged that as a result of this 'there remains a lack of access to franchisees of information to enable them to prepare meaningful plans because of the perception of risk of litigation'.¹⁸⁹ Dr Elizabeth Spencer and Simon Young stated:

Better outcomes would be achieved if the franchisor were able to engage with franchisees to provide relevant information without the prospect of liability for misrepresentation (aside from careless or negligent involvement). The terms of the CCA are not geared towards 'relational' business models such as franchising where the interests of both parties are intertwined (though often not aligned). The adversarial considerations of the current system mean that franchisors are necessarily, but unreasonably, restrained from assisting franchisees in whose success they otherwise have a vested interest.¹⁹⁰

¹⁸⁴ See *Case Law Update: Billy Baxters' Case*, issued by Madgwicks Lawyers firm, 12 December 2012 (accessed on the [Madgwicks' website](#) 10 April 2013).

¹⁸⁵ Franchisees Association of Australia, submission to the review, p 6.

¹⁸⁶ *Ibid*, p 13.

¹⁸⁷ *ibid*, p 6.

¹⁸⁸ Derek Sutherland, submission to the review, p 13.

¹⁸⁹ *Ibid*, p 14.

¹⁹⁰ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 15.

Some franchisees complained about franchisors providing franchisees with financial information, but telling franchisees not to rely on it:

This P&L [profit and loss statement] is a very important document and reveals the health of the business, if I am told not to use it then why was this version provided to me?¹⁹¹

Observations

Franchisors may be highly conservative in the figures they provide in their disclosure document if they were *required* to provide figures. It is also important to note that such disclosure will not always prevent franchisors making more generous verbal representations to potential franchisees, which may or may not contradict the written material. The existing law relating to misleading or deceptive conduct is a critical in regulating representations made to franchisees about the financial aspects of a franchise. There should be no exception to the laws relating to misleading or deceptive conduct in the context of representations made by franchisors to franchisees. It is also noted that unconscionable conduct may be relevant depending on the circumstances of individual cases.

No clear case has been made for a change to item 19 to require franchisors to provide more detailed information to franchises regarding turnover, earnings or profitability. The status quo, where franchisors have the option of providing this information, should be maintained. This strikes an appropriate balance, and should ensure franchisors only provide information where there is a reasonable grounds for doing so.

Disclosure of payments to third parties

Introduction

In 2010, amendments were introduced to item 13.6A of Annexure 1 of the Code requiring franchisors to provide information to franchisees about payments that the franchisee will be required to make to the franchisor or an associate of the franchisor, so that:

...each recurring or isolated payment, that is within the knowledge or control of the franchisor or is reasonably foreseeable by the franchisor, that is payable by the franchisee to a person other than the franchisor or an associate of the franchisor.

The franchisor is required to provide:

- (a) a description of the payment; and
- (b) the amount of the payment or formula used to work out the payment; and
- (c) to whom the payment is made; and
- (d) when the payment is due; and
- (e) whether the payment is refundable and, if so, under what conditions.

If the amount of the payment cannot easily be worked out, the franchisor can disclose the upper and lower limits of the amount.

¹⁹¹ Aleksandar Trajceski, submission to the review, p 6.

Evidence

Many submissions raised concerns about the practical difficulties of disclosure of payments to third parties.

Some submissions considered that franchisors cannot reasonably estimate payments to third parties, and felt that the obligations should be significantly wound back, stating such disclosure is often meaningless to franchisees:

There is a significant burden here with relatively low benefit to franchisees. This information may be reasonably available in well-established franchise systems that collect the relevant data; it is not common in small to medium systems. There is no extra benefit to franchisees from this amendment because the disclosure information is generally presented as a range of estimates and is not specific to their franchise unit.¹⁹²

In our view, the wording of this provision causes confusion for franchisors. Franchisors are not aware of the scope of the payment types which should be disclosed. For example, is a franchisor required to disclose to franchisees that the franchisee will be required to pay wages, Workcover premiums, superannuation contributions and taxes in connection with the operation of the franchised business? Alternatively, the amendment may only be intended to encompass the day to day payments to third parties incurred in the actual operation of the business, such as electricity expenses, stock purchases or even the franchisee's accountancy fees. The provision is unclear as to the extent of the disclosure required and what areas are intended to be covered in the disclosure. A number of disclosure documents have very wide ranges of not only the types of payments, but also the upper and lower estimate of the amount payable, due to the different types of franchised businesses operating within the single franchise system and accordingly the end result is almost meaningless.¹⁹³

On the other hand, one lawyer whose experience consists of assisting emerging franchisors, typically those with less than 20 franchises, considered that this new requirement has not only improved the transparency of financial information for franchisees, but it has had an incidental benefit for franchisors by requiring them to analyse the performance of the franchised business. In one case study provided, this led to reappraisal by a prospective franchisor of the fee structure under its proposed franchise agreement, since in analysing the operating costs it realised the fees it had previously set were not going to be viable for the franchisee.¹⁹⁴

Some submissions were also concerned about the effect of a failure to disclose a payment to a third party, and whether that gives rise to any specific consequence.¹⁹⁵

Observations

The disclosure by franchisors of payments the franchisee will have to make to third parties is important. Particularly for franchisees who are first-time business operators, it will assist them to understand some of the 'hidden costs' that may be involved. However, disclosure under the Code is not intended to replace due diligence and appropriate business planning for a franchisee, and accordingly the disclosure provided by the franchisor of payments to third parties should not be

¹⁹² Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 4. See also Philip Colman, submission to the review, p 4.

¹⁹³ Queensland Law Society Franchising Law Committee, submission to the review, p 10.

¹⁹⁴ The Franchise Lawyer (Mr Peter Sanfilippo), submission to the review, p 2.

¹⁹⁵ Derek Sutherland, submission to the review, p 9, referring to clause 13.6A of the Code.

seen *by the franchisee* to be an exhaustive statement of all the costs they may incur in operating the franchised business.

To the extent there is a concern among franchisors and their lawyers that the bounds of item 13.6A are not sufficiently clear, and that this may be causing an inconsistency of practice among franchising lawyers, this can be addressed by a clarifying amendment, or guidance note, for inclusion in item 13.6A (see Part Eleven – Technical or minor changes to the drafting of provisions of the Code).

A failure to disclose a payment under item 13.6A may or may not mean that the disclosure is defective or misleading. There have been arguments put forward that the failure to disclose may mean that the fee or payment is or is not recoverable, or able to be enforced as a breach of the franchise agreement, by the franchisor. However, there is no express language used in the Code as to the consequence, that is, there is no clear language that says if a franchisor does not disclose the nature or extent of a fee or payment under this item or in its franchise agreement that must be made to it (or an associate of it), then the franchisor cannot enforce payment of that fee or payment under the franchise agreement.

Whether that sort of language is required depends on many things, including whether non-disclosure is so widespread that it is a serious mischief that must be remedied. That would not appear to be the case and, accordingly, the current consequences for breach of this item of disclosure (relying on the general provisions relating to breach, subject to the recommendations elsewhere in this report) are sufficient.

Part Five – Good faith

Introduction

The issue of good faith in franchising is of significant and ongoing concern to the industry. Calls for good faith in franchising have typically accompanied allegations of opportunistic conduct by franchisors taking advantage of any imbalance of bargaining power between franchisors and franchisees.

Previous reviews of franchising at the state and federal level, including the 2008 Joint Committee inquiry, have recommended that a statutory obligation to act in good faith be imposed on franchisors and franchisees (see Previous recommendations and attempts to legislate good faith, below).

The government agreed with the intent of the Joint Committee's recommendation to introduce an obligation to act in good faith in 2008, being to improve the relationship between franchisors and franchisees by addressing behaviour which may be problematic in a franchising relationship and against the spirit of acting in good faith. The government's response to the Joint Committee's recommendation regarding good faith was to do four things:

1. amend the Code to deal specifically with end-of-term arrangements for all new franchising agreements entered into after the commencement of the amendments (see Part Six – Transfer, renewal and end of term arrangements);
2. amend the Code to include a list of necessary and desirable behaviours to encourage parties to approach a dispute resolution process in a reconciliatory manner (see cross reference to Part of the report dealing with dispute resolution);
3. refer specific behavioural issues to an expert panel for advice on whether further specific amendments to the Code are required to address those behaviours; and
4. amend the Code to provide that nothing in the Code limits any common law requirement of good faith in relation to a franchise agreement to which the Code applies (thereby explicitly preserving and drawing attention to the parties' potential ability to take action pursuant to the common law relating to good faith).

The government was concerned that uncertainty would be increased by an express statement of the requirement in the Code, since neither franchisors nor franchisees would be certain of the occurrence of a breach. Further, in any given situation the franchisor's perspective on the scope of the concept may differ from that of the franchisee. For these and other reasons outlined in the government response, the government did not create an explicit statutory obligation requiring franchisors and franchisees to act in good faith.

The result of the above part three of the government response was the development by an Expert Panel of a report to government in early 2010. The Expert Panel report resulted in a number of amendments to the Code to address specific behavioural problems in franchising. A number of these reforms are discussed elsewhere in this report. Addressing specific issues of concern was intended to make it clear to all parties what they needed to do to comply with the Code.

Existing laws relating to fair trading regulate the relationship between business parties. These laws are crucial context in assessing whether additional regulation requiring parties to act in good faith is needed specifically for parties involved in franchising. The general fair trading framework is discussed in Part One – Setting the scene.

This Part attempts to summarise the issues relating to good faith according to the following structure:

- previous recommendations and attempts to legislate good faith (summary)
- evidence considered during the review
 - Is clause 23A of the Code effective?
 - Should there be an explicit obligation to act in good faith?
 - If there is an explicit obligation to act in good faith, who should it apply to?
 - If there is an explicit obligation to act in good faith, in what circumstances should it apply?
 - If there is an explicit obligation to act in good faith, should it be defined?
 - If there is an explicit obligation to act in good faith, what should the consequences be for breaching the obligation?
- observations
- findings and recommendations

Previous recommendations and attempts to legislate good faith (summary)

Set out below is a summary of the outcome of review and legislative processes in the franchising context.

Previous review or legislative process	Recommendation, comment or relevance to good faith
Matthews Review (2006)	Recommended that a statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part 1 of the Code.
Joint Committee inquiry (2008)	Recommended that a new clause be inserted into the Code providing that franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.
Western Australian inquiry (2008)	Did not recommend that an obligation relating to good faith be introduced into the Code.

Previous review or legislative process	Recommendation, comment or relevance to good faith
South Australian inquiry (2008)	Recommended amending the Code by inserting a provision imposing a duty to act in accordance with good faith and fair dealing by each party to the franchise relationship.
South Australian Bill (2009)	Provided that franchisees and franchisors must at all times, act in good faith in relation to participation in a franchise, entering into, renewing, extending, or any other dealing in connection with, a franchise agreement, and the resolution of a dispute relating to participation in a franchise, or a franchise agreement. Acting in good faith defined to mean ‘to act fairly, honestly, reasonably and in a cooperative manner’.
Expert Panel report (2010)	Did not express a view (outside of the terms of reference). Noted that the government had decided not to introduce a general good faith obligation into the Code, and instead decided to deal with the actual concerns raised by the franchising industry by addressing them directly. Noted that the government’s decision set the context for the panel’s deliberations.
Franchising Bill 2010 (WA)	Required a person who proposes to be or is a party to a WA franchise agreement to act in good faith in any dealing or negotiation in connection with entering into or renewing the agreement, or the agreement, or, resolving, or attempting to resolve, a dispute relating to the agreement, and when acting under the agreement. Good faith defined to mean acting fairly, honestly, reasonably and cooperatively.
Western Australian inquiry into the Franchising Bill 2010	Did not recommend passing the Bill. Found that the 2010 amendment to the Code that inserted clause 23A preserved existing case law on the concept of good faith, and recognised developments in that law. Found that if a general statutory obligation to act in good faith is to be imposed into franchising legislation, it should be pursued at the commonwealth level during the next review in 2013.

Previous review or legislative process

Recommendation, comment or relevance to good faith

Franchising Agreements Bill 2011 (WA)	Required a person who proposes to be, or is, a party to a WA franchise agreement to act in good faith in any dealing or negotiation in connection with entering into or renewing the agreement, or the agreement, or, resolving, or attempting to resolve, a dispute relating to the agreement, and when acting under the agreement. Good faith defined to mean acting fairly, honestly, reasonably and cooperatively.
South Australian inquiry (2011, supplementary to 2008 inquiry)	Noted that the Commonwealth Government had only acted in part on its 2009 recommendation to impose a duty to act in accordance with good faith and fair dealing by each party to the franchise relationship (by inserting clause 23A into the Code).

In summary, seven out of nine review processes and legislative attempts appear to support action in relation to good faith, noting that the issue was outside the scope of the terms of reference provided to the Expert Panel .

Evidence considered during the review

Is clause 23A of the Code effective?

Clause 23A of the Code was inserted in 2010 and reads:

Nothing in this code limits any obligation imposed by the common law, applicable in a State or Territory, on the parties to a franchise agreement to act in good faith.

There was a mixed reaction to the introduction of clause 23A to the Code in 2010. Some, such as Competitive Foods Australia Pty Ltd (a franchisor and franchisee), while still advocating for an explicit obligation in the Code, submitted that:

One positive consequence of clause 23A is that the reference to "*the obligation to act in good faith*" has changed the general culture within franchising, to the point where many franchisors and franchisees readily accept that good faith is a fundamental part of the franchising relationship.¹⁹⁶

According to Competitive Foods, there has been a 'major step forward' in the debate since 2008, with both franchisors and franchisees acknowledging a duty to act in good faith.¹⁹⁷

Law firm Minter Ellison submitted that clause 23A is:

...sufficient and effective at addressing concerns regarding conduct that would breach an obligation of good faith. As it is intended, section 23A highlights to franchisors and franchisees that there is an obligation at common law of good faith that could apply. It also operates to alert parties to their

¹⁹⁶ Competitive Foods Australia Pty Ltd, submission to the review, p 11.

¹⁹⁷ Ibid.

ability to seek redress should they consider there has been a breach. However, it does not state (quite correctly) that good faith will apply equally in all cases or encourage parties to act without considering their commercial position, their legal rights or seeking appropriate advice.¹⁹⁸

At the other end of the extreme, it was considered that clause 23A of the Code is '[e]ntirely ineffective and bordering on patronising'.¹⁹⁹

The key concerns with clause 23A are that:

- it does not necessarily prevent arguments that there is no duty to act in good faith;²⁰⁰
- it can be contracted out of by the parties;²⁰¹
- because it is not a duty under the Code, it is not enforceable by the ACCC,²⁰² and
- because it is not defined, and the franchisor will be more able than the franchisee to pay for legal advice about what the unwritten law says in relation to good faith, the undefined nature of any obligation to act in good faith presents a 'lawyers' picnic' because parties have to get legal advice about what it means.²⁰³

Should there be an explicit obligation to act in good faith in the Code?

A large number of the submissions and consultations addressed the question of whether there should be an explicit obligation to act in good faith in franchising. More submissions supported an obligation to act in good faith than did not support such an obligation.

It is important to note that franchise agreements are relational contracts i.e. contracts where the parties are incapable of reducing important terms of their arrangement to well defined obligations such as would be the case in a sale of land contract. Relational contracts have an element of cooperation or partnership in them and can only "work" if both parties deal with each other in good faith.²⁰⁴

Given the relational nature of the franchise relationship, I am firmly of the view and submit that the Code should be amended to require franchisors, franchisees and prospective franchisees to act honestly and in good faith towards each other... honesty is a fundamental community standard and I

¹⁹⁸ Minter Ellison, submission to the review, p 4.

¹⁹⁹ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 17.

²⁰⁰ As noted by Derek Sutherland, submission to the review, p 2, 'It is also not unanimously or overwhelmingly accepted that the courts will in every state and territory determine that there is an implied obligation to act in good faith implied under the common law into commercial agreements generally or into every franchise agreement specifically (whether regulated by the Code or not)'.

²⁰¹ The Franchise Council of Australia's submission contained a statement that: 'It is clear that the parties to a contract can contract out of a duty to act in good faith either by reference to the duty, or by the inclusion of a specific provision that gives a party an express power or discretion. A term will not be implied if it is inconsistent with an express term.' (Franchise Council of Australia, submission to the review, Annexure C, pg 34). See also the example provided by Judi Moylan, submission to the review, p 5. Peter Abetz, submission to the review, also submitted that 'some franchisors have been able to "write out" an implied duty to act in good faith through an express clause in the franchise contract for quite some time now. Franchisors should not be allowed to "contract out" of good faith requirements' (p 3).

²⁰² Competitive Foods Australia Pty Ltd, submission to the review, pp 12, 13, 14.

²⁰³ Ibid, pp 12, 13, 14.

²⁰⁴ Peter Abetz, submission to the review, p 4. The idea of franchise agreements being relational agreements is also discussed in the Competitive Foods Australia Pty Ltd, submission to the review, p 12.

have seen too many instances where franchisees and franchisors have not been honest towards each other and I believe the Code should promote such high standards of conduct.²⁰⁵

The general law contention that franchising contracts and arrangements are underpinned by the doctrine *good faith* should be given legislative effect.²⁰⁶

It was even suggested that the government go further than an obligation to act in good faith and impose a fiduciary duty on parties to a franchise relationship:

Rather than resisting measures relating to good faith in franchising, good franchisors and franchisees should welcome them, and go further – by introducing the concept of a **fiduciary duty** owed by a franchisor to all of its franchisees. That is, the parties to a franchise agreement should not only display good faith but also loyalty and trust. Franchisors are held out by the industry as supportive benefactors and guardians of their franchise systems and their franchisees.²⁰⁷

Some submissions and consultations did indicate scepticism about the actual versus perceived benefit of inserting a good faith clause into the Code. Others were against such a clause.

...it is difficult to see in practice what benefit a specific obligation to act in good faith across the Code can bring having regard to the extent to which a breach of any such duty might be proven or provide a basis for a cause of action or enforcement.²⁰⁸

Inserting a specific obligation to act in good faith into the Code may achieve nothing more than to elevate the potential for conflict in franchise relationships, where one party can accuse the other of a failure to act in good faith. ...therefore it is not recommended to include a specific definition of good faith in the Code.²⁰⁹

... imposition of a duty of good faith is seen as the answer to the perceived failings of Section 51AC. However, the Committee submits that it is both inaccurate to view such a duty as extending the law beyond what already exists, and premature to conclude that the existing unconscionable conduct provisions are ineffective.²¹⁰

Good faith is a term with capacity to mislead franchisees who would believe that it means what it says: good faith. It is impossible for franchisors and franchisees to approach all issues in good faith as their relationship is replete with conflicts of interest. ... It is optimistic to think it would be possible to monitor whether good faith has been adhered to in a franchise. ... I would delete Clause 23A that was inserted in 2010 as I believe it has the potential to delude the parties into a sense of unachievable entitlement.²¹¹

The FCA's view is that if there is a concern, the concern should be addressed by specific amendments to the Code, rather than some catch all general prohibition. There are already catch all prohibitions for misleading or deceptive conduct and unconscionable conduct in the Competition and Consumer

²⁰⁵ Philip Colman, submission to the review, p 5.

²⁰⁶ Franchisees Association of Australia Incorporated, submission to the review, p 11.

²⁰⁷ Colin Dorrian, submission to the review, p 9.

²⁰⁸ Victorian Small Business Commissioner, submission to the review, p 14.

²⁰⁹ Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, submission to the review, p 12.

²¹⁰ Law Council of Australia, Business Law Section, Competition and Consumer Committee, submission to the review, p 14.

²¹¹ Dr Jenny Buchan, submission to the review, pp 7 - 8.

Act. The FCA has supported improvements to disclosure as this is consistent with the policy framework for the Code, which supports rather than overrides the contractual process.²¹²

McDonald's Australia Limited claims that when the state of Iowa in the United States introduced a good faith obligation:

The detrimental effects of the law were felt almost immediately after introduction of the law, studies compared franchising activity, the pre-1995 changes against the post-1995 changes and found a significant decrease in the amount of new franchises being granted, and several companies halting expansion plans for Iowa or opting for a company-owned expansion model. It was claimed that the losses were 'not limited to the jobs and revenues that were expected to have been generated by franchise units. They... extended to include franchisee suppliers, real estate companies who... lost opportunities to sell property to franchisees, construction companies, and business developers. Furthermore, many companies... restricted themselves to opening company owned stores, which may not provide the same benefits to the local economy that a franchised unit would since profits from company owned stores are returned to corporate headquarters, which are usually located outside of Iowa.²¹³

The WA Small Business Commissioner noted as a possible consequence or disadvantage of a good faith obligation being inserted into the Code that there may be

...increasing pressure and expectations for the ACCC to act in relation to perceived breaches of the Code in areas that have previously been the domain of the parties to the contract (i.e. individual disputes between franchising parties).²¹⁴

The ACCC did not express a view on good faith in its submission to the review. In 2008, during the Joint Committee inquiry into franchising, the ACCC submitted that:

If a general provision of good faith were inserted into the code as a separate cause of action, the ACCC would have concerns about the practical implications such a clause could have on the operation of the code and the work of the ACCC. ... our view is that a general obligation to act in good faith should not be included in the code.²¹⁵

Regarding the interaction between unconscionable conduct and a duty or obligation to act in good faith, law firm, Minter Ellison submitted that an express obligation, to the extent that it would go further than current laws like misleading or deceptive or unconscionable conduct, or indeed the common law relating to good faith, would 'unnecessarily subject the franchising industry to a higher standard of conduct than other businesses. This would place the franchising industry at a comparative disadvantage...'.²¹⁶

It is noted that in 2010 the government's response to calls for good faith was to attempt to identify specific problematic behaviours in franchising and attempt to deal with those specific problems rather than introduce a new overarching standard of conduct.

²¹² Franchise Council of Australia, submission to the review, p 9. See also Yum! Restaurants Australia Pty Limited, submission to the review, p 3.

²¹³ McDonald's Australia Limited, submission to the review, pp 15 – 16.

²¹⁴ Western Australian Small Business Commissioner, submission to the review, p 10.

²¹⁵ Australian Competition and Consumer Commission, *submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising Code of Conduct*, September 2008, p 19.

²¹⁶ Minter Ellison, submission to the review, p 6.

Set out below is a list of selected problematic behaviours that were noted in submissions. Note, not all of these behaviours were mentioned in the context of good faith. Similarly, not all of these behaviours would necessarily breach any obligation to act in good faith. On the other hand, some may breach other laws such as the prohibitions on misleading, deceptive or unconscionable conduct and other provisions of the Code or franchise agreement. However, it is worth attempting to document some examples of anecdotal concerns or possible problematic conduct:

- the franchisor imposing unsafe practices for workers or customers;
- forcing franchisees to promote the franchisor's products in a way that diminishes the sale of other products sold by the franchisee;
- unfairly competing with franchisees in online environments (on this issue, see above Part Two – Disclosure);
- unnecessarily high risk activities resulting in permanent brand reputation damage;
- general mismanagement and waste of marketing funds; (see Part Four: Transparency of financial information in a franchise)
- 'Automatic Bailment Systems' which allow the franchisor to access funds in a financial facility held by a franchisee;
- long delays in giving effect to renewals even when there has been a commitment to renew in the notice under clause 20A;
- inappropriate attribution of legal costs (on this issue see Part Seven – Dispute resolution);
- representations inconsistent with the terms of the franchise agreement;
- extreme pressure to meet sales targets with repercussions for not meeting them;
- collecting marketing budgets based on prices at which goods are never sold – that is, reducing the advertised price of goods after invoicing for marketing;
- franchisees leaving franchise systems, de-branding their businesses and then using the franchisor's intellectual property to compete with the franchisor;
- franchisors setting unrealistic standards for work without regard to the franchisee's expertise (for example, a small regional franchisee who does not see as much of a particular kind of work may take longer than a city franchisee who regularly performs the same work but has to meet the same work or time standards);
- threatening the franchisee with breach, non-renewal, or competition from a new operator if certain conditions are not met;
- forcing inventory upon the franchisee and requiring it to sell products with unsustainable margins;
- forcing the franchisee to buy overpriced goods from the franchisor;

- 'An example of the unscrupulous behaviour of one franchisor was given to me: the shopping centre in which the franchisee operated was struggling to attract customers. To assist tenants, the owner reduced the rent. The franchisor, as head tenant, did not pass on the cost savings to the franchisee. This contributed to the eventual financial failure of the franchisee';²¹⁷
- cost shifting to the franchisee or not maintaining the franchisee's margin;
- franchisees using social media to post negative comments about their franchisor or their dispute with their franchisor; and
- franchisees indicating they have received advice as required under clause 11(2) of the Code (giving comfort to the franchisor) only to later allege that no such advice was obtained.

The following examples (which appear to be hypothetical) were provided by the South Australian Law Society as examples of conduct where it would be difficult to access or prove misleading, deceptive or unconscionable conduct, indicating a need for an obligation to act in good faith:

- differential treatment of a franchisee, which while isolated to that franchisee, could be justified under contract law but is taking place because a franchisee has raised matters of potential embarrassment to a franchisor;
- cases of bullying where numerous minor and immaterial breaches are constantly raised in an aggressive and intimidatory manner designed to extract concessions of various kinds, or cessation of complaint;
- responding to complaints in a dilatory manner and not within reasonable time frames; and
- when participating in mediations not providing any or only bare reasons in refusing proposals to settle a dispute. This response in mediations most often stifles and reduces mediations to a waste of time and money.²¹⁸

If there is an explicit obligation to act in good faith, who should it apply to?

Although, as noted above, calls for good faith in franchising have typically accompanied allegations of opportunistic conduct by franchisors, the great majority of submissions contended that any obligation to act in good faith should be mutual. That is, it should apply to both franchisors and franchisees.²¹⁹

Some franchisors saw benefits in franchisees being bound by an obligation to act in good faith.

Bakers Delight Holdings Ltd supports the introduction of a statutory obligation to act in good faith... Bakers Delight Holdings Ltd has been and is currently at, a severe disadvantage from former disgruntled franchisees who extensively use social media, traditional media outlets and local, state and federal politicians to influence their position prior to, and leading up to, and throughout the

²¹⁷ Peter Abetz MLA, submission to the review, p 8.

²¹⁸ Law Society of South Australia, submission to the review, p 4.

²¹⁹ See, for example, Franchisees Association of Australia, submission to the review, p 12; Bakers Delight Holdings Ltd, submission to the review, p 1.

mediation period. For this reason, [any] good faith obligation must be imparted to both the franchisor and the franchisee.²²⁰

Some of the first salvos fired in a 'good faith' environment will be by franchisors seeking to reign in the excesses of disruptive franchisees (Mr Young has franchisor clients making initial preparations for such action in the expectation of good faith being introduced).²²¹

Other submissions raised the issue of whether an obligation to act in good faith may apply to related entities or associates of the franchisor and franchisee even though they are not parties to the franchise agreement.

It is problematic to seek to extend that obligation to related entities and persons associated with the franchisor or franchisee who are not parties to the franchisee agreement.²²²

Arguments have been made whether the obligation of good faith should extend to related entities of the franchisor or to a narrower "*associate of the franchisor*" in supply of goods or services to franchisees. This is problematic as they are not parties to the franchise agreement and arguably therefore not bound by the Code even though they may be an associate.²²³

For example, is it an intended policy outcome that an associate of a franchisor (who might hold the intellectual property of the system or the lease of premises) must also act in good faith towards a franchisee, even if there is no direct contractual link between them?²²⁴

Possible scope of an obligation to act in good faith

The issue here is the scope of any obligation to act in good faith. That is, what actions, decisions or circumstances should attract the obligation?

Some submitters argued that any obligation to act in good faith should be narrow and apply to the exercise of particular rights or obligations under the Code:

It is more logical and less problematic that it should apply to certain specific problem areas such as clause 20 and clause 20A, clause 21, 22 and 23 and Part 4 (clauses 24 to 31).²²⁵

The Franchise Council of Australia (FCA) opposed the extension of any common law duty to the negotiation phase of a franchise agreement, or the resolution of disputes, noting that 'the prohibition on misleading or deceptive conduct already provides strong and comprehensive protection in relation to the negotiation and execution phase of the franchise relationship' and 'the Code already contains specific and quite detailed obligations in relation to disputes that extend far beyond any duty of good faith'.²²⁶

Further, the Law Institute of Victoria (LIV) stated that:

²²⁰ Submission from Bakers Delight Holdings Ltd. See also Peter Abetz, submission to the review, p 9; McDonald's Australia Limited, submission to the review, p 11 which also talks about franchisee behaviour during mediation being problematic (though McDonald's does not support an obligation to act in good faith).

²²¹ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 18.

²²² Derek Sutherland, submission to the review, p 3.

²²³ Derek Sutherland, submission to the review, p 29.

²²⁴ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 21.

²²⁵ Derek Sutherland, submission to the review, p 29.

²²⁶ Franchise Council of Australia, submission to the review, p 19.

If an explicit obligation of good faith is introduced, the LIV believes it should apply to both franchisees and franchisors and their conduct generally in relation to the franchise relationship. To limit the scope to particular areas such as entering into or ending a franchise agreement suggests that acting in “bad faith” in relation to other aspects is acceptable to some degree.²²⁷

Many submissions considered that the scope of the obligation should be wide, covering everything from the negotiation of a franchise agreement to after the expiration of the franchise agreement in relation to matters arising from the franchise agreement – such as disputes – and everything in between (including the exercise of rights and obligations pursuant to the Code or the franchise agreement).²²⁸

Some raised the possibility that applying the obligation to act in good faith to pre-contractual negotiations might widen the ambit of disclosure required.²²⁹ This is related to the view of the Franchise Council of Australia that literal compliance with the Code should not be argued to be a breach of good faith. In its view, a franchisee should not be able to argue that good faith obligation requires the franchisor to give reasons for a decision as issued in a clause 20A notice.²³⁰

Others noted that the unwritten law relating to good faith would not restrict actions which protect or promote the legitimate commercial interests of a party, stating that the obligation in the unwritten law may require a party to consider the interests of another, but it will not require that party to act against its own interests in doing so.²³¹

If there is an explicit obligation to act in good faith, should the obligation be defined?

A submission from experienced franchising lawyer Derek Sutherland noted that:

It is my perception that most lawyers who act predominantly for franchisors and master franchisees would argue that any determination of existence of that obligation and its meaning should be left to the common law to determine and the definition of "good faith" continue to evolve at the same time as the nature and extent of that implied obligation.

It is my perception that most franchisee lawyers would argue that it would be beneficial to have an express obligation of good faith apply to all dealings between the parties to a franchise agreement even if there is no comprehensive definition of what good faith is.²³²

Mr Sutherland went on to provide his view that “[w]hilst it is always beneficial to have clear meanings this concept, just like unconscionable conduct is not capable of a one size fits all meaning.”²³³

Others agreed with Mr Sutherland:

²²⁷ Law Institute of Victoria, submission to the review, p 7.

²²⁸ Franchisees Association of Australia, submission to the review, p 12. Philip Colman, submission to the review, p 5; Competitive Foods Australia Pty Ltd, submission to the review, p 15; New South Wales Small Business Commissioner, submission to the review, p 6.

²²⁹ Law Society of South Australia, submission to the review, p 5.

²³⁰ Ibid, p 7.

²³¹ Philip Colman, submission to the review, p 8.

²³² Derek Sutherland, submission to the review, pp 2 and 28.

²³³ Ibid.

We express concern that the imposition of a statutorily defined duty of good faith could result in a significant cost impact to participants in the franchising sector that wish to test the boundaries of that definition.²³⁴

The New South Wales Small Business Commissioner considered that a defined obligation would be better, submitting that:

...waiting for guidance from case law to develop the concept will not be adequate given that the findings often are not available for several years after the conduct occurs. For the Code to be most efficient, businesses need a set of standards now.²³⁵

The SA Small Business Commissioner similarly supported a defined obligation in 'plain English'.²³⁶

Competitive Foods Australia Pty Ltd submitted that if 'good faith' is not defined it will be a 'lawyers' picnic' because parties have to get legal advice about what it means.²³⁷

A key question in relation to whether any obligation to act in good faith should be defined is whether the common law is sufficiently certain for parties to have a reasonable idea of what may be expected if such an obligation is imposed.

Opinions differed on whether the common law relating to good faith is certain or uncertain, and what it may require. For example, the Franchisees Association of Australia Incorporated submitted that '[t]he doctrine of good faith is well known to the law and the suggestion it is not sufficiently certain is, with great respect, fallacious.'²³⁸

Most submissions, however, acknowledged some degree of uncertainty in the common law:

It is now time for action and certainty, rather than further delays and continued reliance of ambiguous and uncertain concepts in relation to good faith, such as the "unwritten law".²³⁹

Good faith has not been embraced by the courts or the legislatures of Australia. Whilst good faith is a part of broad contract and commercial codes in jurisdictions such as the United States and Germany, it is not part of the legal traditions of the UK or Australia.²⁴⁰

'Good faith' is a concept which is generally impossible to define and is therefore not a legal standard suitable for insertion as a statutory provision. Neither in Australia, nor elsewhere, is there a clearly defined, well understood, statutory doctrine of 'good faith'. This can only add to business uncertainty and put the conduct of many business affairs into the hands of the courts, therefore adding to the cost of doing business in Australia.²⁴¹

The issue at the moment is that although many of the Courts in various states and territories have clearly stated that there is an implied obligation to act in good faith in all franchise agreements, many

²³⁴ Quick Service Restaurant Holdings Pty Ltd, submission to the review, p 20.

²³⁵ New South Wales Small Business Commissioner, submission to the review, p 3.

²³⁶ South Australian Small Business Commissioner, submission to the review, p 4.

²³⁷ Competitive Foods Australia Pty Ltd, submission to the review, pp 12 – 13.

²³⁸ Franchisees Association of Australia, submission to the review, p 11.

²³⁹ Competitive Foods Australia Pty Ltd, submission to the review, p 2.

²⁴⁰ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 18.

²⁴¹ Shopping Centre Council of Australia, submission to the review, p 1. The Council cited a number of examples of academic writing to support their position.

franchisors do not accept that the implied obligation exists in all cases or jurisdictions or in fact to franchise agreements generally as opposed to other forms of contracts.²⁴²

Some claimed that the definitions proposed in state legislation – which focused on honesty, reasonableness, cooperativeness and fairness, would merely ‘codify’ (that is, expressly state) what the unwritten law already requires.²⁴³

Another option suggested was to set out indicia for good faith, in an approach similar to that taken in section 22 of the Australian Consumer Law with respect to unconscionable conduct. This is said to be better than leaving it to gradual evolution under the common law since this would ‘leave too much uncertainty, take too much time, and be at a cost to franchisee litigants who can often ill afford such debates’²⁴⁴.

If there is an explicit obligation to act in good faith, what should the consequences be for breaching the obligation?

There were a range of opinions expressed on what the consequences should be if an explicit obligation to act in good faith is introduced, and that obligation is breached.

The problem is that it all depends on the circumstances. One size does not fit all when it comes to relief and arguably that is why it is best left to the Courts to determine.²⁴⁵

Others supported the imposition of civil pecuniary penalties for breach, which would require the ACCC to take the breach to court (see Part Eight – Enforcement).²⁴⁶

Behaviours that may require a specific response

It is noted above that there are a number of problematic behaviours which may be addressed by an obligation to act in good faith. While this report cannot comprehensively consider each individual behaviour, noting that many complaints were isolated to only one submission, there were three behaviours which were of sufficient concern to stakeholders to warrant specific consideration. These three behaviours were:

- unilateral changes during the term of the franchise agreement that are ‘unfair’ or change the nature of the rights granted;
- franchisor attribution of legal costs to franchisees; and
- avoidance of the disclosure requirements regarding contact details for ex-franchisees.

The second of these matters is dealt with elsewhere in this report in the context of dispute resolution (see Part Seven – Dispute resolution).

²⁴² Queensland Law Society Franchising Law Committee, submission to the review, p 17.

²⁴³ Competitive Foods Australia Pty Ltd, submission to the review, p 17.

²⁴⁴ Law Society of South Australia, submission to the review, p 5.

²⁴⁵ Derek Sutherland, submission to the review, p 30.

²⁴⁶ Law Society of South Australia, submission to the review, p 6; Competitive Foods Australia Pty Ltd, submission to the review, p 23.

Unilateral changes during the term that are unfair or change the nature of the rights granted

The Code was amended in 2010 to add item 17A to Annexure 1, which requires franchisors to disclose to franchisees the circumstances in which the franchisor has unilaterally varied a franchise agreement in the last three financial years, and the circumstances in which unilateral variations to their agreement may take place in the future.²⁴⁷

The Expert Panel identified the issue of unilateral variation as a complex one involving competing perspectives:

There appears to be some level of consensus amongst franchisees and franchisors over changes to the franchise system that benefits the system as a whole, for example changes to occupational health and safety policy or changes to products that make the overall franchise business more profitable for all franchise participants. The panel considers that unilateral changes welcomed by both parties should not be subject to the additional compliance burden that may result if an absolute prohibition were to be implemented. Therefore, the panel considers that unilateral contract variations occur on a spectrum. On one extreme, the franchisee and franchisor may be in agreement about unilateral changes to the agreement. At the other, unilateral variation of a contract can represent inappropriate conduct.²⁴⁸

It also considered the possibility of unilateral contract variation being subject to a threshold requirement or test such as 'reasonableness'. However the Expert Panel considered that this type of test:

...runs the risk of deflecting the attention of franchising parties to a collateral dispute about the threshold itself, increasing transaction costs and the likelihood of disputes arising. If a dispute arises about a unilateral variation, the disputing parties would do better to focus on the variation itself, rather than on whether some threshold event had taken place to allow the variation.²⁴⁹

As a result, the Expert Panel expressed its broad support for disclosure by a franchisor of the circumstances in which unilateral variations to a franchise agreement may take place, and the circumstances in which the franchisor has unilaterally varied a franchise agreement in the past three financial years.²⁵⁰ This led to the insertion of item 17A into the Code in 2010.

Submissions to the current review process expressed concern that the 2010 amendments requiring franchisors to disclose details of unilateral contract variations, whilst positive, did not go far enough. The Victorian Small Business Commissioner noted that 'the inclusion of a unilateral variation clause in favour of the franchisor... adds enormous uncertainty to the commercial terms presented in disclosure.'²⁵¹ Whilst noting that a regime akin to the unfair contract terms regime under the Australian Consumer Law may be appropriate to address such unfair terms in business to business

²⁴⁷ Note item 17A is subject to transition arrangements. For further detail see the wording of item 17A.

²⁴⁸ Expert Panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, p 50.

²⁴⁹ Expert Panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, p 51.

²⁵⁰ Expert Panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, p xi.

²⁵¹ Victorian Small Business Commissioner, submission to the review, p 10.

contracts, the Victorian Small Business Commissioner also noted that there is difficulty in separating the legitimate from the illegitimate when considering potential variations.²⁵²

The New South Wales Small Business Commissioner also raised concerns about unilateral contract variation, proffering the view that '[t]he ability of franchisors to unilaterally vary the franchise agreement should be limited to non-material variations that do not effect the fidelity of the bargain'²⁵³.

Franchisees noted that such variations can be detrimental, noting they may be achieved by the franchisor changing the operations manual for its business:

Tatts ... have increasingly been using their unilateral right to change their Operations Manual to the detriment of franchisees.²⁵⁴

As far as the disclosure section of this review relates to 'Unilateral Contract Variation', the KFC franchisee network has huge concerns in the regard. The main aspect affecting franchisee/franchisor goodwill relates to the one-sided ability of the franchisor to make changes to the franchise agreement. Whilst these changes are not made directly to the franchise agreement, they are instead made via an annexed document referred to as the 'Operations Policy's Manual'. It is through this instrument or 'loophole' that the franchisor can change system standards, increase costs and fees passed onward to the franchisee, and determine how the franchisee should adhere to the franchise agreement. This is outside of the terms set out in the original agreement signed by both parties. It does not identify that this Operations Policy's Manual is the vehicle for imposing changes in unforeseen infrastructure investment, unilateral changes to recruitment and hiring policies, additional equipment and capital purchases or additional administration cost recovery from the franchisor. The way that this is accessed is via wording in the franchise agreement which states that policy's fees and costs are as per the Operations Policy's manual.²⁵⁵

One suggestion was to require changes proposed by a franchisor to be approved by a representative group of franchisees, such as an industry association, and placing an onus on the franchisor to present a commercial business case justifying increased costs they want to impose on franchisees.²⁵⁶

Others submissions raised concerns about practical problems with item 17A,, querying whether it was achieving the purpose for which it was put in the Code:

...this obligation is problematic for Yum Australia because its operations and policies manuals form part of the Franchise Agreement. Technically, the requirement now requires Yum to record and

²⁵² Victorian Small Business Commissioner, submission to the review, p 11. Section 23 of the ACL includes provisions to void unfair contract terms in standard form consumer contracts. If the contract is capable of continuing to operate without the unfair term, the contract will continue to bind the parties. Section 24 defines a term as 'unfair' if: '(a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and (c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.' These provisions apply to contracts with consumers only, not business to business contracts such as franchise agreements. Section 25 lists some examples of contract terms that may be regarded as unfair, which includes terms that allow unilateral variation of the contract.

²⁵³ New South Wales Small Business Commissioner, submission to the review, p 6.

²⁵⁴ Lottery Agents Association of Victoria, submission to the review, p 2.

²⁵⁵ KFC Franchisees Association, submission to the review, pp 1 – 2.

²⁵⁶ Lottery Agents Association of Victoria, submission to the review, p 4.

disclose all changes to its manuals, which might include minor changes to the systems, for example, a change to a particular packaging process for a product, a change to an incident reporting process, a change to a type of menu board etc. This is an onerous obligation and we do not believe that the benefit received by franchisees outweighs the effort required on Franchisor's behalf. The requirements to disclose this information to potential franchisees (as opposed to only existing franchisees) also forces us to disclose confidential information regarding our systems to persons who may not necessarily end up being franchisees. In our view, franchisors such as Yum Australia, should have the flexibility to make changes to their operating manuals and policies without having to record and disclose absolutely every change. This is necessary to ensure the system remains relevant to the market. We would therefore like to see this requirement amended so that the franchisor is only obliged to disclose unilateral variations to the franchise agreement that are "material", with that term being clearly defined.²⁵⁷

Further clarification is required to this amendment so that only unilateral changes in relation to the substantive franchise agreement need disclosure. Changes to subsidiary documents, like an operations manual, should not require disclosure under this section.²⁵⁸

Typically it is generally accepted that an amendment by the Franchisor or head franchisor to an Operations Manual (if it is expressed to form part of the franchise agreement or is incorporated by reference) would require disclosure under Item 17A. It would be beneficial to the sector that the Government understand this commercial practice as most franchise agreements do NOT now deem it to be part of the franchise agreement but as a separate set of policies and procedures that must be followed. ... If the Operations manual formed part of the franchise agreement then it would have to be disclosed by annexure to the Disclosure Document and the franchisee could keep it even after the term of the franchise despite any contractual obligation to return it. Franchisors do not want their intellectual property and core policies and procedures to be used, they want them kept confidential and returned if the prospective franchisee does not proceed or the agreement ends.

A more commercial way to deal with this is to require a franchisor to give access to the operations manual to a prospective franchisee before it signs the franchise agreement that will allow them to read it but not allow them to keep it.

You would need to separately define what an operations manual and change the provision in Item 23 to ensure it is clear they cannot keep it. If this occurred franchisors would be more likely to disclose changes to operations manuals under this Item. Also a simple change that requires the franchisee to return any intellectual property of the franchisor (such as the manual) within 7 days if the prospective franchisee does not proceed.²⁵⁹

Even significant unilateral contract variations are argued not to be an extension of the scope of a franchise agreement:

A unilateral amendment to a franchise agreement by a franchisor may not necessarily amount to an "extension of the scope of a franchise agreement" as that expression was intended to apply when it was added to the Code in the last 2010 amendments.

As a consequence the application of clauses such as clauses 6A(a), 11(1)(a), 11(3), 13(2) – cooling off, do not apply to unilateral variations that arise from the exercise of a right, power or discretion. An example may be where a franchisee has a defined Prime Marketing Area that is linked to a

²⁵⁷ Yum! Restaurants Australia Pty Limited, submission to the review, p 4.

²⁵⁸ McDonald's Australia Limited, submission to the review, p 11.

²⁵⁹ Derek Sutherland, submission to the review, p 16.

determination or discretion of the Franchisor to define it or amend it during the term. There may be no need to enter into an agreement to document it, the change occurs by notice, not by entering into an agreement to record it.

It is not uncommon in the motor dealership sector for KPI's (such as minimum sales or stock levels) and PMA's to be changed unilaterally and it may have a significant commercial affect on a dealer. That change may not "extend the scope" of the agreement but simply vary the contractual application of a right or obligation substantially so that in essence it is a significant variation to the commercial application of an obligation under an existing agreement.²⁶⁰

Avoidance of the disclosure requirements regarding contact details for ex-franchisees

The Code was amended in 2008 to require franchisors to disclose in disclosure documents the contact details for ex-franchisees, unless the franchisee has requested in writing that the details not be disclosed.²⁶¹

Many submissions and consultations raised the issue of franchisors avoiding the requirement to disclose contact details for ex-franchisees. Examples included:

Some franchisors are circumventing that requirement [to disclose the details of ex-franchisees] by encouraging all ex-franchisees to instruct the franchisor not to include their details. This then frustrates the Code's intention that prospective franchisees have access to ex-franchisees. Prospective franchisees should be concerned if no or few ex-franchisees contact details are disclosed (i.e. the number of ex-franchisees does not match the number of ex-franchisees whose details are disclosed) however often prospective franchisees don't understand the significance of this, especially if they do not seek professional franchise advice.²⁶²

The ACCC has become aware that, following a franchising dispute, some franchisors are inserting clauses into their deeds of settlement to the effect that the franchisee requests that their contact details not be disclosed in future disclosure documents. In some cases, such a clause may even be inserted into the franchise agreement itself. The practical consequence of this type of clause is that prospective franchisees may be prevented from contacting franchisees who have experienced serious issues with the franchisor. While it is important that past and current franchisees are able to keep their details confidential if they wish, the Government should consider ways to close this loophole to ensure that the written request from a franchisee that its details not be disclosed is in fact initiated by the franchisee.²⁶³

Many franchisors now include as a standard clause in a deed to be signed by a franchisee on their departure from the system, a provision under which the franchisee is making the request by signing the deed, that their name and contact details not be published in future disclosure documents. It has also become common practice that those franchisors would not agree for that provision to be deleted and require the franchisee to make that election.

The use of the provision of this kind which forces a franchisee to sign a provision may circumvent (if unilaterally imposed by the franchisor) the intention in the Code of allowing new franchisees to access details of previous franchisees to ascertain information about the franchisor. It is common for

²⁶⁰ Derek Sutherland, submission to the review, pp 17 – 18.

²⁶¹ See the Code, Annexure 1, item 6.

²⁶² Tim Hantke (Franchising Solutions), submission to the review, p 6; The Franchise Lawyer (Mr Peter Sanfilippo), submission to the review, p 6; Bedshed Franchising Pty Ltd, submission to the review, 59, p 6.

²⁶³ Australian Competition and Consumer Commission, submission to the review, p 9.

franchisors to seek consent for non-disclosure where a franchisee has left the system, other than on good terms.²⁶⁴

Observations

Consultation presented consistent anecdotal evidence of questionable behaviours in franchising. All of these behaviours may be addressed by a sensible obligation to act in good faith being incorporated into the Code. Some behaviours, however, may need specific remedies rather than relying on general notions of good faith. In circumstances where that is the case, the issues are discussed elsewhere in this report (the issue of attribution of legal costs and disclosure of online trading by the franchisor are two examples).

There would appear to have been a shift in the views of key industry representatives on this issue since the last review took place. For example, the Franchise Council of Australia (FCA), stated in its submission that it was prepared to contemplate an amendment to the Code to expressly incorporate the current common law duty of good faith into all franchise agreements, whereas previously the FCA has strongly opposed such an amendment.²⁶⁵

Views differ on the degree of uncertainty regarding the nature of any obligation to act in good faith under the common law in Australia – which by definition may mean that there is uncertainty regarding the nature of the obligation. It is probably accurate to say that franchisors and franchisees would generally need to obtain legal advice to understand how the obligations in the unwritten law affect their actions and their rights and obligations under the franchise agreement. To the extent that it exists, uncertainty can have both benefits and drawbacks. One benefit is that it promotes flexibility, by allowing judges to decide on a case-by-case basis whether there is an obligation to act in good faith, and if so whether that obligation has been breached. This approach allows sensitivity to the individual circumstances of each case. On the other hand, the uncertainty makes it more likely that two parties will have a different opinion about whether certain conduct was in good faith. It also makes it more difficult for franchisors and franchisees to know precisely what is required of them to comply with the law.

The question also arises of whether an obligation to act in good faith, particularly an undefined obligation, is consistent with the nature of industry codes. It is government policy that industry codes should clearly and unambiguously set out requirements and obligations, rather than aims and ideals.²⁶⁶ However, it is not unheard of for other industry codes to include good faith obligations. For example, the Oilcode, also a mandatory industry code prescribed under Part IVB of the CCA, provides that upon renewal of a fuel re-selling agreement, the terms and conditions, excluding duration, may differ from the original or current terms of the agreement, but any change must be reasonable and be made in good faith.²⁶⁷ Mediation under the Oilcode is also required to be carried out in good faith.²⁶⁸ Some voluntary industry codes, such as the Motor Vehicle Insurance and Repair Industry Code of Conduct, also contain principles relating to good faith, for example:

²⁶⁴ Queensland Law Society Franchising Law Committee, submission to the review, p 13.

²⁶⁵ Franchise Council of Australia, submission to the review, p 5.

²⁶⁶ This is a requirement set out in the *Policy Guidelines on Prescribing Industry Codes*, published by the Commonwealth Treasury in May 2011. See in particular page 6.

²⁶⁷ *Competition and Consumer (Industry Codes-Oilcode) Regulation 2006*, Schedule 1, clause 32(8).

²⁶⁸ *Competition and Consumer (Industry Codes-Oilcode) Regulation 2006*, Schedule 1, clause 45.

Insurers and Repairers agree to observe high standards of honesty, integrity **and good faith** in conducting their business with each other and in the provision of services to claimants.²⁶⁹
(Emphasis added)

As discussed above, franchisors and franchisees are bound by norms of conduct set out in fair trading legislation, which apply in addition to the Code. The key prohibitions relate to unconscionable conduct, and misleading or deceptive conduct. One significant question raised in the context of good faith is where the 'gap' lies between conduct that would be unconscionable under the Australian Consumer Law (ACL), and conduct which, although not unconscionable, may nonetheless breach any duty to act in good faith.

In addition, there are other potential reforms that could be introduced which, similarly to an obligation to act in good faith, may introduce 'elasticity' into contract law with regard to long-term relational contracts such as franchise agreements. It is sufficient to note that there has been debate about whether the unfair contracts protections for individual consumers under the ACL, or for independent contractors, should also be extended to business to business dealings. Some submissions supported such an approach,²⁷⁰ others did not.²⁷¹

It has also been asked whether an obligation to act in good faith should be implied broadly into all long-term commercial agreements.²⁷² It is not uncommon for overseas jurisdictions to have either a general concept of good faith in commercial contracts, or a specific concept of good faith which applies to franchise agreements, for example, in the context of pre-contractual negotiations and in mediations of disputes.²⁷³

As with many matters raised by the terms of reference for the review, the issue of good faith has many compelling arguments both in favour of, and against, the introduction of an explicit obligation. However, the weight of opinion supports the inclusion of such an obligation in the Code.

On balance, further changes to the regulation of unilateral contract variation is not warranted, assuming that the below recommendation with respect to good faith is accepted. However, a clarifying amendment should be made to the Code to ensure that it is clear what is meant by the phrase "extension of the scope of a franchise agreement". This would not be a change to the policy intent of clause 10, however it may provide some guidance to parties particularly in circumstances where there are significant unilateral amendments to a franchise agreement (see Part Eleven – Technical or minor changes to the drafting of provisions of the Code).

Otherwise unconscionable conduct, together with an obligation to act in good faith, sufficiently regulate the ability of a franchisor to unilaterally vary a contract. On the other hand, the issue of a franchisor avoiding the obligation to disclose contact details for ex-franchisees is a serious one, and should be directly addressed by an amendment to the Code.

²⁶⁹ See the Motor Vehicle Insurance and Repair Industry Code of Conduct, Clause 1, 'Principles'.

²⁷⁰ See, for example, Franchisees Association of Australia Incorporated, submission to the review pp 8 – 9.

²⁷¹ Franchise Council of Australia, submission to the review, p 6.

²⁷² See, for example, the Commonwealth Government Attorney-General's Department, *Exploring the Scope for Reforming Australian Contract Law: Long-term contracts and good faith*, Infolet 8, 2012 (accessed on the [Attorney-General's website](#), 11 April 2013).

²⁷³ *Review of the Disclosure Provisions of the Code of Conduct*, Report to the Hon Fran Bailey MP, Minister for Small Business and Tourism, October 2006, Attachment E.

Recommendations

9. The Code be amended to include an express obligation to act in good faith. Such an obligation should:
 - a. extend to the negotiation of a franchise agreement, the performance of a franchise agreement, the performance of obligations under the Code, and the resolution of any disputes between the parties whether or not there is a valid franchise agreement at the time of the dispute;
 - b. not be defined, instead the unwritten law relating to good faith should be incorporated in a manner similar to the unconscionable conduct prohibition set out in section 20 of the Australian Consumer Law;
 - c. apply to both the franchisor and the franchisee or prospective franchisee and the agents of these parties;
 - d. not be able to be limited or excluded by any provision of the contract between the parties (such provisions should be declared void);
 - e. be clearly stated as not preventing a party from acting in its legitimate commercial interests; and
 - f. expressly exclude an argument that a franchisor has not acted in good faith because there is no term in a franchise agreement specifying a right of renewal.

10. The Code be amended to ensure that a written request from a franchisee that its details not be disclosed to prospective franchisees has in fact been initiated by the franchisee, for example by prohibiting a franchisor from initiating, procuring or encouraging such a request from a franchisee.

Part Six – Transfer, renewal and end of term arrangements

Introduction

This part of the report looks at the amendments to the Code, mainly those introduced in 2010, concerning how the parties to the franchise agreement deal with the end of the arrangement.

Transfer and novation relate to how the change from an existing franchisee to an incoming franchisee can be managed by the parties. This, and novation in particular, is a highly technical area of the law. Novation was introduced into the Code in 2010, but in the short time it has been in place it has raised nascent concerns about how the provisions actually operate when placed up against what is happening in the marketplace. The section of this part addressing transfer and novation will look at the reasons for the introduction of these amendments and at the issues raised by them separately.

Renewal and end of term arrangements are primarily concerned with how the franchisor informs the prospective franchisee or the franchisee what will happen at the end of the term, what rights and obligations the parties have at the end of the term and how they may be exercised. This involves concepts such as churning, restraints of trade, compensation and goodwill. The section of this part addressing end of term arrangements will go into the reasons for the introduction of these amendments, explain the concept of churning and then consider whether the evidence shows that the amendments have been effective.

Transfer and novation

Introduction

The 2010 amendments to the Code

The 2010 amendments made the following changes to the Code to introduce the concept of novation in franchising:

- Clause 3 of the Code was amended to define ‘novation’ in relation to a franchise as ‘the termination of the franchise and entry into a new franchise with a proposed transferee on the same terms as the terminated franchise’ and a “transfer’ for a franchise to include ‘an arrangement in which the franchise is granted, transferred or sold’.
- Clause 20 of the Code was amended to state (amendments underlined):
 - (1) A request for a franchisor’s consent to transfer or novation of a franchise must be made in writing.
 - (2) A franchisor must not unreasonably withhold consent to the transfer or novation .
 - (3) For subclause (2), circumstances in which it is reasonable for a franchisor to withhold consent include:
 - (a) the proposed transferee is unlikely to be able to meet the financial obligations that the proposed transferee would have under the franchise agreement; or
 - (b) the proposed transferee does not meet a reasonable requirement of the franchise agreement for the transfer or novation of a franchise; or

- (c) the proposed transferee has not met the selection criteria of the franchisor; or
- (d) agreement to the transfer or novation will have a significantly adverse effect on the franchise system; or
- (f) the proposed transferee does not agree in writing to comply with the obligations of the franchisee under the franchise agreement; or
- (g) the franchisee has not paid or made reasonable provision to pay an amount owing to the franchisor; or
- (h) the franchisee has breached the franchise agreement and has not remedied the breach.

(4) The franchisor is taken to have given consent to the transfer or novation if the franchisor does not, within 42 days after the request was made, give to the franchisee written notice:

- (a) that consent is withheld; and
- (b) setting out why consent is withheld.

(5) In this clause:

transferee means a franchisee who seeks to acquire a franchise business through either transfer or novation of the franchised business.

- item 17D of Annexure 1 to the Code (relating to the ‘long-form’ disclosure document) and item 9D of Annexure 2 to the Code (relating to the ‘short-form’ disclosure document) now require the disclosure document to advise the prospective franchisee, or franchisee ‘[w]hether the franchisor will amend (or require the amendment of) the franchise agreement on or before the transfer or novation of the franchise.’

Reasons for the amendments

Novation was introduced into the Code at the instigation of the Expert Panel, in an endeavour to balance a franchisor’s rights to make changes to its agreements and to have incoming franchisees signed to its most recent agreement against the problems this created for franchisees attempting to sell the franchise.

In its report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, the Expert Panel stated that ‘it would likely be in the best interest of both the current franchisee and the franchisor to seek to expedite the sale of the franchised business’. Further it recognised:

...the potential difficulties current franchisees may face if their franchisor introduces changes when they are trying to sell the franchise. However, the panel also recognises that when a prospective franchisee signs an agreement they are entering their own arrangement with the franchisor; they are not entering the same agreement the current franchisee signed at the beginning of their term. As this would represent a new arrangement, there may be differences between the current and prospective franchisee agreements.²⁷⁴

²⁷⁴ Expert Panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, p 64.

The Expert Panel believed that this approach would ‘ensure there is adequate upfront disclosure, for prospective franchisees, on the processes that will apply if a franchisee seeks to sell the business.’²⁷⁵

It further recommended that ‘the Government should consider whether there are any circumstances in which it is always unreasonable to withhold consent to the transfer of a franchise agreement.’²⁷⁶

The Explanatory Memorandum for the 2010 Amendments stated:

The new item 17D recognises that franchisor initiated changes may arise during two different circumstances: on the transfer of a franchise agreement and before the novation of the current franchisee’s agreement and the execution of a new agreement with the proposed transferee. It should be noted that since **novation would involve the execution of a new agreement**, the prospective franchisee is entitled to all the rights afforded to a prospective franchisee entering a new agreement and a franchisor has the same responsibilities as if he were entering a new agreement. [emphasis added]

Cooling off periods (Subclause 20(4))

Evidence considered during the review

Subclause 20(4) of the Code states:

The franchisor is taken to have given consent to the transfer or novation if the franchisor does not, within 42 days after the request was made, give to the franchisee written notice:

- (a) that consent is withheld; and
- (b) setting out why consent is withheld.

Deemed consent to novation by the franchisor was raised by Derek Sutherland in his submission:

Often franchisees write to their franchisor seeking consent to a sale but they provide NO information about a potential purchaser or the intended terms of the contract of sale to enable the franchisor to make an informed decision whether to consent or not as it is unable to evaluate the proposed purchaser or guarantors.²⁷⁷

He proposed two solutions to this problem. Either the 42 day period should be stated to commence ‘when all information reasonably required by the franchisor under the franchise agreement has been provided’ or the franchisor should be allowed to:

...give a conditional consent subject to the parties complying with their obligations to supply documentation and information and comply with other provisions of the agreement even if to do so may take longer than 42 days from the initial written request.²⁷⁸

Observations

While no evidence has been produced to indicate that there has been a problem with the commencement of the 42 cooling off period, it is clear from the terms of subclause 20(4) that some

²⁷⁵ Expert Panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, p 64.

²⁷⁶ Expert Panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, p 65.

²⁷⁷ Derek Sutherland, submission to the review, p 21.

²⁷⁸ *Ibid.*, p 22.

confusion could result from the present wording. This is a simple matter to correct without causing any undue difficulty for franchisors or franchisees. In my view the first of Mr Sutherland's two suggested amendments is the simplest and most elegant solution to the problem.

Recommendation

11. That subclause 20(4) of the Code be amended to read:
 - a. The franchisor is taken to have given consent to the transfer or novation if the franchisor does not, within 42 days after the request was made, or all information reasonably required by the franchisor under the franchise agreement has been provided, whichever is the latter, give to the franchisee written notice:
 - (i) that consent is withheld; and
 - (ii) setting out why consent is withheld.
 - b. The franchisee should take all reasonable steps to provide all information required under the franchise agreement to enable the franchisor to be able to properly evaluate the request. [Amendments underlined]

Refusal to agree to novation by a franchisee

Evidence considered during the review

One of the unintended outcomes of the definition of novation in clause 3 of the Code, according to Derek Sutherland, is that there 'is no express obligation in the code for a franchisee to not unreasonably withhold its consent to a transfer or novation or interfere with a proposed sale of the network.'²⁷⁹ He stated that he came across this problem while acting for a franchisor in a sale.

He went on to note that:

Most franchise agreements do not have comprehensive or consistent provisions about how you handle a sale of the entire system or what happens to a franchisee who refuses to sign a novation deed and does not cooperate at all.²⁸⁰

In some cases, of which Mr Sutherland is aware, franchise agreements allow the franchisor to sign the novation deed and other documents if the franchisee refuses to.²⁸¹

Mr Sutherland stated that:

This makes the sale of a franchise network extremely difficult because the franchisor is selling and wanting to novate all of the franchise agreements to the purchaser.

... if franchisees have some right to refuse to sign up with a transferee or novatee why then do they also not have a corresponding obligation similar to that imposed on a franchisor not to unreasonably withhold its consent or cooperation. Arguably absent a share sale arrangement the sale of a franchise system by novation of existing agreements can be very complicated and difficult.²⁸²

Ideally, 'an outgoing franchisor could simply sign a novation deed with the buyer without having to get every franchisee to sign [but this] is not necessarily how assignment or novation works at law'. In

²⁷⁹ Derek Sutherland, supplementary submission to the review, p 10.

²⁸⁰ Ibid.

²⁸¹ Ibid.

²⁸² Ibid., p 23.

fact, he states that he is 'aware that in some instances novation of franchise agreements have occurred by conduct even where a franchisee has not signed a deed of novation or been given disclosure'²⁸³.

Observations

Clause 20 of the Code is clearly intended to address the role of the franchisor in the transfer and novation processes. The Expert Panel's report and the Explanatory Memorandum are both focused on the franchisor's actions, particularly in relation to having the incoming franchisee sign a new franchise agreement. It places no obligations on the franchisee.

Though there is no express statement in the Code that a franchisee may not unreasonably withhold consent to a novation. This does not mean a franchisee has 'some right to refuse to sign up with a transferee or novatee'.

There are arguments for and against an amendment being made to the Code to provide that a franchisee may not unreasonably withhold consent to a novation.

The refusal of a few franchisees, or even one, to agree to a novation may mean that the sale of the franchise system does not proceed. It could also be argued that the future of the franchise system as a whole is a matter for the franchisor, not franchisees and, as such, they should not be allowed to refuse novation involving the entire system.

On the other hand, the 2010 amendments to clause 20 appear to reflect the intention of the Expert Panel. If this is a problem for franchisors, there are a number of ways in which franchisors can deal with this potential problem. One is to insert appropriate clauses in the franchise agreement.

In the absence of evidence that this is a significant problem, it is believed that further regulation is not warranted on this point.

Renewal and end of term arrangements

Introduction

The 2010 amendments to the Code

In 2010, amendments to the Code were introduced in relation to end of term arrangements in franchise agreements following the Joint Committee report which stated:

Recommendation 5:

The committee recommends that the Franchising Code of Conduct be amended to require franchisors to disclose to franchisees, before a franchising agreement is entered into, what process will apply in determining end of term arrangements. That process should give due regard to the potential transferability of equity in the value of the business as a going concern.²⁸⁴

²⁸³ Derek Sutherland, supplementary submission to the review, p 9.

²⁸⁴ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 82.

When making this recommendation, the Joint Committee made it clear that it accepted that 'franchisors should be entitled to decline to renew franchise agreements on expiration if that is their choice', but also believed that:

...a franchisee should receive reasonable notice from a franchisor of any decision not to renew. Furthermore, a decision by a franchisor not to renew should not be designed to extract extra payments from a franchisee, nor to generate a windfall gain for the franchisor.²⁸⁵

The Government accepted this reasoning and recommendation. Consequently, in 2010 it inserted clause 20A and item 17 C of Annexure 1 into the Code, making significant amendments to the way in which end-of-term arrangements are managed.

Clause 20A requires franchisors to inform franchisees, at least six months prior to the end of the franchise agreement, or, if the term of the agreement is less than six months, at least one month before the end of the term:

- whether or not they will renew the franchise agreement; or
- if the franchise arrangement is to be continued, whether or not they will require the franchisee to enter into a new franchise agreement.

Item 17 C of Annexure 1 requires franchisors to disclose to franchisees:

- whether or not there is an option to renew or extend the agreement beyond the end of the term or to extend the scope of the agreement;
- 'the processes the franchisors will use to determine whether to renew, extend, or extend the scope of the franchise agreement or enter into a new franchise agreement';
- whether the franchisee is entitled to an 'exit payment' at the end of the agreement and, if so, how it will be determined;
- the arrangements for dealing with 'unsold stock, marketing material, equipment and other assets purchased when the franchise agreement was entered into';
- whether the franchisee will have the right to sell the business at the end of the franchise agreement and, if so, whether the franchisor has first right of refusal and how market value will be determined;
- if the prospective franchisee will have the right to sell the business at the end of the franchise agreement and, if so, whether the franchisor will have first right of refusal, and how market value will be determined; and
- whether the franchisor will consider any significant capital expenditure undertaken by the franchisee during the franchise agreement, in determining the arrangements to apply at the end of the franchise agreement.

²⁸⁵ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 81.

It should be noted that these disclosure requirements are intended to be phased in over a three year period, so that for a franchise agreement entered into before 1 July 2013, the franchisor is only required to provide information about significant capital expenditure since 1 July 2010. After 1 July 2013, the franchisor must provide information on significant capital expenditure undertaken by franchisees during the previous three financial years.

Similar arrangements apply to short-form disclosure documents under clause 9C of Annexure 2 of the Code.

Reasons for the amendments

The policy behind the 2010 amendments to the Code concerning end of term arrangements was explained in the Government Response to the Joint Committee report:

The Government recognises that prospective franchisees' expectations about renewal need to be better managed, and the financial implications of non-renewal need to be better understood, before fixed term franchise agreements are initially signed. The Government agrees that franchise agreements should clearly stipulate what (if any) the end-of-term arrangements and processes will be, and that these arrangements should be fully and transparently disclosed to prospective franchisees. The disclosure of this information is likely to assist in mitigating disputes where one party has an expectation (not shared by the other party) that the franchise agreement will be renewed. It will also help to address imbalances in power by assisting prospective franchisees to undertake their due diligence prior to entering into a franchise agreement.²⁸⁶

Evidence considered during the review

The efficacy of the 2010 amendments

There are disparate views on whether the 2010 amendments have been effective. The Franchising Council of Australia, an industry body representing franchisors, believes they have been effective:

By improving disclosure about, and management of, end of term arrangements, both parties are clearer about what will happen at the end of the term and how such decisions are made. Clarity and improved communication helps to reduce the opportunity for dispute.²⁸⁷

Submissions from franchisors generally agree that the amendments have provided franchisees with 'adequate disclosure and information about the end of term arrangements that will apply and adequate notice of non-renewal'²⁸⁸.

Other submissions express similar views. For example, submissions from two large law firms stated that the amendments 'ensure franchisees are aware of their position concerning the end of the term when they enter the agreement'²⁸⁹ and 'the level of transparency sufficiently protects the franchisees in relation to the end of term arrangements'²⁹⁰.

²⁸⁶ See [Government Response to the Joint Committee Report](#), November 2009, p 14.

²⁸⁷ Franchising Council of Australia, submission to the review, p 20.

²⁸⁸ Confidential submission to the review. For example, see also McDonald's Australia Limited, submission to the review, p 17; Bedshed Franchising Pty Ltd, submission to the review, p 11.

²⁸⁹ Minter Ellison, submission to the review, p 11.

²⁹⁰ DLA Piper, submission to the review, p 7.

On the other hand, an inference could be made that many stakeholders feel the amendments have not provided adequate protection for franchisees as intended. For example, a confidential submission relating the experience of a number of franchisees with a large chain, stated:

We regularly find that, after making such notification and requiring franchisees to sign an agreement to participate, our Franchisor does not undertake the necessary steps to enact those 'end of term arrangements' in a timely manner. Many franchisees are subjected to unnecessary and extended delays (sometimes years) by the Franchisor to enact the agreement.²⁹¹

Mr Peter Abetz MLA, also referred to how, according to information he has received, franchisors are subverting the intention of the amendments:

Following the introduction of the 2010 amendments requiring disclosure of the end of agreement information, I was shown contracts which clearly stated that the franchisee has no rights whatever, neither explicit nor implied of any kind. Yet the franchisor, I was told, said to the franchisee that of course if he did a good job, they would renew the agreement.²⁹²

This may raise concerns of misleading or deceptive conduct as discussed in Part One of this report.

Dr Elizabeth Spencer and Simon Young observed in their submission that:

Inappropriate conduct has not abated since these changes were introduced. Franchisor behaviour has not been affected because the amendments did not define the acceptable contractual behaviour as it relates to end of term arrangements...Stronger and more precise regulation of end of term arrangements is necessary to address the problem.²⁹³

They also believed that '[the] range of problems cannot be solved through disclosure alone.'²⁹⁴

A similar assessment was made by the Queensland Law Society:

The amendments regarding end of term arrangements and renewal notices have not been effective in addressing concerns about inappropriate conduct at the end of the term of franchise agreements.

The Society considers that rather than further amending disclosure requirements in this regard, the issue of end of term arrangements and renewal notices is an ongoing issue for franchise education.²⁹⁵

Other submitters commented on the efficacy of the 2010 amendments. Mr Sutherland, in commenting on end of term arrangements, indicated they have not been in place long enough to see how they operate. They apply only to agreements that started after 1 July 2010, which usually have 3 or 5 year terms.²⁹⁶ Further the Franchise Advisory Centre submitted that the ACCC has experienced a decline in complaints concerning inappropriate end of term conduct which suggests

²⁹¹ Confidential submission to the review.

²⁹² Peter Abetz MLA, submission to the review, p 7.

²⁹³ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, pp 22 - 23.

²⁹⁴ Ibid., p 22.

²⁹⁵ Queensland Law Society, submission to the review, p 20.

²⁹⁶ Derek Sutherland, submission to the review, p 32.

the 2010 amendments had an effect, however, the full effect of the provision cannot be known at the moment.²⁹⁷

Concerns about end of term arrangements

Problems with end of term arrangements were highlighted by Dr Spencer and Mr Young in their submission to the review. It is worth quoting the submission at some length:

There is an ongoing lack of understanding among franchisees regarding the fact that the grant of franchise is for a fixed term and is not indefinite. Further, any option to extend the franchise is not, strictly speaking, a renewal (and the term is misleading) but rather a 'first option' to continue the franchised business under the then current terms of the franchisor's system.

There are fundamental misconceptions on the part of both franchisees and franchisors. Franchisees assume that their long term contribution to the franchise system creates rights to continue using the franchisor's intellectual property whereas franchisors tend to act as if they have acquired rights to the franchisee's business. (Although in fact they may have where the franchise agreement provides that all goodwill in the business is the property of the franchisor. The language of these agreements do not exclude site or personal goodwill.) It is the clash of these erroneous positions that has driven much of the disputation about end of term arrangements.

The [2010] amendments do not alter the contractual positions of the parties and the errors of perception are best addressed by pre-purchase advice and education rather than attempting to re-write contracts to suit the needs of one party over another *ex post*.

More concerning is the increasing trend for franchisors to include options to purchase the franchisee's business at the end of the term; quite often the franchisor writes in very favourable terms for the purchase – payment for goodwill is excluded and plant & equipment is paid at market value (or even at depreciated value).

When coupled with the right to take any lease (if the franchisor does not hold a head lease already) and franchisee's restraints of trade there is a growing problem that many franchisees could be required to sell their businesses to their franchisor for nothing more than the value of stock, plant & equipment.²⁹⁸

A number of other submissions to the review were also keen to make this same point²⁹⁹, including this statement by the Hon Adam Searle MLC:

The absence of clear or definitive rights on termination or expiry of a franchise agreement will not properly prepare a prospective franchisee for the range of detrimental outcomes that may arise either at the expiry of the agreement or if the relationship breaks down and is terminated.³⁰⁰

It is apparent that in the majority of cases the end of a franchise agreement is managed to the satisfaction of both parties. The *Franchising Australia 2012* report found that:

²⁹⁷ Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence, joint submission to the review, p 15.

²⁹⁸ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 11.

²⁹⁹ For example, Bakers Delight Holdings Lid, submission to the review, p 2; Philip Colman, submission to the review, p 9 and Colin Dorrian, submission to the review, p 10.

³⁰⁰ The Hon Adam Searle MLC, submission to the review, p 6.

Consistent with 2010 survey results, the average length of time that a franchisee remains in the system is 7 years with the majority of franchisees spending between 6 and 10 years in their franchise system. No discernible differences were evident amongst industries. Given that the average term for franchise agreements is 5 years, there is clear evidence that franchisees are renewing their franchise agreement at least on one occasion.³⁰¹

Some submissions to the review made similar points:

In most cases ANRA members report that the end of the term of an agreement is a straightforward matter, with very few instances in their own networks where a franchisee wanted to renew an agreement but the franchisor did not. This was the case even before the new notification period was added because successful franchisees and franchisors regularly communicate about the business and its future, well in advance of the end of term.³⁰²

Specific changes to the Code in relation to the [termination without good cause and lack of clarity about the franchisee's entitlements at the end of the agreement] would be legislating to the exception not the rule... '[C]hurning' is not at the level it might be perceived to be.³⁰³

It is also worth noting that there is little to no evidence of franchisees expressing concern about end of term arrangements in the franchising sector prior to the 2010 amendments... [The evidence] showed that franchisees secured an extension of the term of their franchise agreement on expiry of the fixed term in well over 90% of cases.³⁰⁴

Churning

One of the most controversial alleged practices in franchising is churning. To some extent this discussion is hampered by the use of different definitions of churning.

The Joint Committee defined churning as:

Churning is a practice in which a franchisor sells and re-sells a unit franchise, making a profit each time the business changes hands regardless of the profitability of the unit franchise.

The ACCC defines churning as:

...the repeated selling of a franchise site by a franchisor in circumstances where the franchisor would be reasonably aware that the site is unlikely to be successful, regardless of the individual skills and efforts of the franchisee. Such conduct may raise concerns about misleading and deceptive conduct or unconscionable conduct.³⁰⁵

Franchising commentator Jason Gehrke has suggested that there are two definitions of churning, depending on the intentions of the franchisor:

At its worst, churning is recognised as the deliberate setting-up of a franchisee to fail so that their business can be resumed and resold by the franchisor.

³⁰¹ *Franchising Australia 2012*, Griffith University, Asia-Pacific Centre for Franchising Excellence, p 46

³⁰² Australian National Retailers Association, submission to the review, p 12.

³⁰³ McDonald's Australia Limited, submission to the review, p 17.

³⁰⁴ Franchising Council of Australia, submission to the review, p 20.

³⁰⁵ Australian Competition and Consumer Commission, *Franchise Agreements* (discusses churning under the heading what is 'churning'), [ACCC website](#), (accessed 19 April 2013).

The reasoning behind this view is that a franchisor who is able to reclaim and resell the business will enjoy greater profits than from any ongoing royalties that might have been generated by the business. The more times the business sells, the more the franchisor makes. In other words, the franchisee's failure is a planned outcome designed to unjustly enrich the franchisor, irrespective of the financial and other costs incurred by the franchisee.

At the other end of the scale, churning has also been used to describe the practice of franchisors buying back profitable franchise operations at lower-than-market values to increase their portfolio of company-owned outlets in a strategy also designed to increase their own ongoing profits.³⁰⁶

There are disparate views within the industry about whether churning exists and its prevalence.

The Joint Committee considered whether churning existed, citing evidence from franchisees that it had happened:

Concerns raised during the inquiry about opportunistic termination and 'churning' of franchisees by exploiting the termination provisions of the Code are legitimate. Although most franchisors succeed on the basis of mutually beneficial relationships with their franchisees, evidence from the inquiry suggests a small element of franchisors seek financial gain through opportunistic termination.

However, the committee does not propose to address this problem directly by recommending changes to the circumstances in which franchisors are presently able to terminate agreements under the Code. Franchisors need to retain the ability to protect the value of their brand across the network by being able to terminate agreements that are not deriving benefit for the network. Furthermore, the committee is of the opinion that it would be sensible to allow recent changes to the disclosure provisions of the Code, which enable prospective franchisees to access information about the history of the franchise site (including contact details of former franchisees) and were designed to help alert franchisees to the possibility that churning is taking place, to have an effect before recommending any further changes designed specifically to address this problem. Instead, the committee seeks to reduce opportunistic behaviour through the introduction of broad good faith requirements, as discussed in Chapter 8.³⁰⁷

One view, expressed by an experienced franchising lawyer, is that, effectively, franchisors cannot churn the business as it is theirs to deal with.³⁰⁸

There is also a strong view amongst current and former franchisees that it does happen. To give two examples of such claims, the review has received evidence that:

[If] a franchisor has to pay fair market value to a franchisee upon termination (for whatever reason), that might reduce the incidence of franchise churning that exists in many franchise systems.³⁰⁹

and

³⁰⁶ Jason Gehrke, Franchise Advisory Centre, [Churning: the Dark Side of Franchising](#), 12 August 2008 (accessed 25 January 2013).

³⁰⁷ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 82.

³⁰⁸ Philip Colman, submission to the review, p 11.

³⁰⁹ Colin Dorrian, submission to the review, p 10.

Any incentive to work at the relationship is heavily outweighed by the massive cash injection that a franchisor makes when he gets a divorce. The reviewer must consider that franchisors sell businesses not products, it follows that some franchisors run their business on not much more than their key business strategy of buying and selling businesses.

This very profitable exercise, allows the franchisor to work against franchisees, and routinely terminate a percentage of their network at any time during the contract. The potential for a rogue franchisor to churn all franchisees in his network is very real. The consequences of the franchisor's actions are absolutely catastrophic for franchisees. The franchisee has in many cases mortgaged the family home to raise enough capital to buy into the 'proven business model'.³¹⁰

It should be noted that the review did not receive submissions from ex-franchisees that directly stated that they had been subject to churning, though a confidential submission described a similar situation involving a franchisee in the submitter's system:

A recent example of the above within my own franchise was a failed outlet taken back by the franchisor for around \$60,000 and churned on to a new owner a few months later for \$290,000. The franchisor continues to pursue the failed franchisee for six weeks outstanding royalty payments despite the profit made on the resale of the business. The franchisee has been ruined financially including the loss of the family home. This is only one example of many such incidents.³¹¹

Commenting on the need for a law to govern churning, even if it is not considered a widespread practice, Mark Maumill, an experienced franchisee and member of the ACCC's Franchising Consultative Committee, stated, during a consultation meeting, 'There aren't too many murders in Australia, but it is still illegal. The fact that it is a small number of people, doesn't mean we shouldn't protect people.'³¹²

During a consultation meeting on 24 February 2013, the ACCC discussed a number of scenarios and discussed whether, in its view, the conduct may raise concerns of unconscionable conduct on the part of the franchisor. It was asked to put its views in writing, which it did in its supplementary submission. Three of those scenarios involved conduct that may be considered churning.³¹³

Scenario 1: A franchise has failed twice in the last year. Both franchisees had raised concerns about the viability of the franchise. The franchisor puts the franchise on the market at a heavily discounted price. The franchisor accurately explains the reasons for the failure of the two previous franchisees. The franchisee decides to purchase the franchise but it fails months later.

ACCC view: This conduct is less likely to raise concerns under the ACL. The franchisor has sold the franchise at a significant discount and explained the challenges to the prospective franchisee.

Scenario 2: A franchisor has an absolute discretion over a franchisee's 'right of renewal' for a \$10 000 fee. This is made clear in the agreement and the disclosure document. The

³¹⁰ Narelle Walter, submission to the review, pp 2-3.

³¹¹ Confidential submission to the review.

³¹² Meeting with Mark Maumill, 7 March 2013, Melbourne.

³¹³ Scenario 1: Australian Competition and Consumer Commission, p 2; Scenarios 2 and 3: Australian Competition and Consumer Commission, letter to the review, 25 March 2013.

franchisee has not breached the agreement and wishes to renew. The franchisor declines to do so and after its expiration sells the franchise to another franchisee for \$400 000.

ACCC view: 'This conduct is unlikely to raise concerns under the ACL or the [Franchising] Code. The franchising agreement makes it clear there is no automatic right of renewal.'

Scenario 3: A franchisor has an absolute discretion over a franchisee's 'right of renewal' for a \$10 000 fee. This is made clear in the agreement and the disclosure document. The franchisee has not breached the agreement, has the highest turnover figures in the system and wishes to renew. The franchisor declines to do so and, after its expiration takes over the franchise itself. *ACCC view: 'This conduct is unlikely to raise concerns under the ACL or the [Franchising] Code. The franchising agreement makes it clear there is no automatic right of renewal.'*

Payment of compensation and/or goodwill to franchisees

Introduction

The Joint Committee considered whether the franchisee should be entitled to compensation or a payment for goodwill at the end of the franchise agreement but did not make a recommendation addressing that point.

In its view, end of term arrangements would be better addressed by improved disclosure, so that franchise agreements:

...clearly stipulate what the end of term arrangements and processes are, and these arrangements should be fully and transparently disclosed to prospective franchisees. In particular, the committee is of the view that pre-agreement disclosure documentation should explicitly discuss the transfer process that will apply to equity in the value of the business as a going concern at the time the agreement ends.

The present situation where a franchisee's contribution to their business has a market value prior to the end of the agreement which can be arbitrarily reduced to an amount determined by the franchisor afterwards is inequitable. At the end of an agreement, a franchisee has already committed considerably to the franchise system, financially and through their hard work, and is financially tied to the business. Franchisees stand to lose the prospect of returns on their capital investment, which in many cases is substantial.³¹⁴

The Joint Committee addressed this by recommending that the franchisee should be given the right to sell the business for market value, should the franchisor determine not to renew the agreement.³¹⁵

As a result, item 17C.1(e) requires a franchisor to disclose to a prospective franchisee, whether, at the end of the franchising term:

³¹⁴ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 81.

³¹⁵ See Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 82.

..the prospective franchisee will have the right to sell the business at the end of the franchise agreement [and] whether the franchisor will have first right of refusal, and how market value will be determined.

The term 'compensation' has generally been used during the review to mean a payment to a franchisee for the work they have performed or loss suffered in operating the franchise. 'Goodwill' is considered to be something different and is well known in business. It is variously defined as:

...an intangible, saleable asset arising from the reputation of a business and its relations with its customers, distinct from the value of its stock, etc.³¹⁶

...the premium which the buyer must be prepared to pay for the firm over and above its asset value, because of the firm's trade contacts, reputation, established brand names, management expertise and general 'know-how'.³¹⁷

and

...the advantage or benefit that is acquired by the business beyond the mere value of its capital stock or property in consequence of the patronage it receives from its customers...In another sense, it is 'the probability that the old customers will resort to the old place'.³¹⁸

In franchising terms, there are considered to be three sorts of goodwill:

- product/brand goodwill;
- site goodwill; and
- operator/personal goodwill.³¹⁹

For the sake of simplicity, this report will refer to both payments of compensation and goodwill as a 'compensation payment', unless a different intention is clear.

To make a compensation payment at the end of a franchise agreement, it would be necessary to determine, firstly, whether the value of the business has risen during the term of the franchise agreement. If so, what part of that increase in value is attributable to the work of the franchisee and what is attributable to the work of the franchisor.

Evidence considered during the review

Some representative views from submissions in favour of compensation payments include:

I remind that it is the franchisees who are responsible for virtually all investment in franchising. It is the franchisees who are major contributors to the economy. It is franchisees who are major

³¹⁶ Macquarie Dictionary, 4th Ed, 2005.

³¹⁷ Collins Dictionary of Business, 2006.

³¹⁸ Collins Dictionary of Law, 2006.

³¹⁹ See Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 73, referring to evidence of Dr Jenny Buchan, *Committee Hansard*, 9 October 2008, p 73.

employers. And it is franchisees who contribute to local economies and community sporting teams and charities.³²⁰

Further, what does a franchisee get by working hard to improve and/or solidify the brand? In this case the franchisee enters into an agreement, works hard for the good of the company during the term of the agreement, and leaves the company in a stronger, more robust state.³²¹

This may present situations whereby the franchisee enters an immature marketplace and incurs losses for many years, and over time and exhaustible hours of hard work may bring the business to a position of breakeven or even profitability. Over time and years, the suburb or township grows and the population base increases and the business grows with it up to a point where the business may for a small number of years be profitable. Then at the point of 20 years, after all of the years of losses, stress and family commitment that goes into a small business operation, the franchisor can walk straight in and assume control of the business - without offering any financial compensation to the family who has built the business. This is wrong and needs to be stopped, with proper protection for the franchisee's property rights.³²²

However, even many advocates for franchisee compensation have argued that it should not be automatic but rather apply only when warranted by the actions of the franchisee.

There are cases where the franchisor has good cause for not renewing a franchisee (eg, under-performance).³²³

One confidential submission commented that it is franchisees that have

...invested in the purchase, building of systems, development and ongoing running costs to make the business what it is' as opposed to what it was when they invested in it which in many cases was less than a smooth functioning, profitable and systemised business and in those circumstances, they should be compensated for the 'goodwill' they brought to the business.³²⁴

Another submission stated:

[T]here should be only very limited circumstances where compensation should be considered e.g. a franchisor not granting a new franchise to a fully complying existing franchisee but to another new franchisee in the same territory.³²⁵

There are largely three arguments against compensation being paid to franchisees:

1. it would be contrary to the nature of the franchising relationship;
2. it would be contrary to property laws to require a franchisor to pay compensation to a franchisee for something that franchisor already owns; and
3. this matter should be dealt with in the franchise agreement, which can be negotiated to include compensation from the outset.

³²⁰ Ray Borradale, submission to the review, p 3.

³²¹ Aleksandar Trajceski, submission to the review, pp 9-10.

³²² Greg Fisher, KFC Franchisees Association, submission to the review, p 3.

³²³ Competitive Foods Australia Pty Ltd, submission to the review, p 18.

³²⁴ Confidential submission to the review.

³²⁵ Solomon Bampton, submission to the review, p 1.

The first argument was put by a number of submissions, for example:

Compensation at the end of the term is opposed as this would fundamentally change franchising. It would also discourage overseas franchises from having a presence in Australia....³²⁶

The concept of franchising is based upon the premise that the franchisor grants the right to a franchisee to conduct the business for a period of time. Upon expiration the franchisee has no further rights and no right to any compensation. Changing this premise fundamentally changes franchising and would have tremendous ramifications for the sector.³²⁷

[T]he notion that franchise agreements should automatically be renewed or a franchisee is entitled to compensation if an agreement is not renewed turns the notion of contract law on its head. A franchise agreement is a contract and, like any other contract, the parties are legally bound to fulfil its terms – no more, no less... Like any other contract, the franchise agreement has a finite life and implies no ongoing right to possession or occupancy.³²⁸

The second point relies on the view that the goodwill belongs to the franchisor. Bakers Delight Holdings Ltd stated in its submission that '[w]ith an established franchise network such as the one Bakers Delight Holdings Ltd manages, the goodwill is attributable to the franchisor's efforts over a long period of decades (not the individual franchisee's).'³²⁹

In relation to the third point, as noted above, a franchise agreement is a contract between two parties. As such, the terms of the contract are open to negotiation between them. Generally speaking the franchisee has the greatest bargaining power before first entering into an agreement because they can argue for insertion of a compensation clause.

This point was made by the Shopping Centre Council in its submission to the review:

If a franchisee requires a longer term in order ensure an adequate return on their investment, then they should be prepared to negotiate a longer term at the outset and to take on the additional business risk that comes from that longer term.³³⁰

Law firm DLA Piper made a similar argument:

...recognition for any contribution by the franchisee should be left to the parties to negotiate.

44. In our view, any attempt to codify rights for franchisees in the Code (such as transfer of proprietary rights in the franchise system or in the brand, intellectual property and reputation of the franchisor or of a third party) would effectively override contractual terms negotiated between the parties.

45. Classic contract theory emphasizes the freedom of parties to contract on terms of their choice.³³¹

³²⁶ Tim Hantke (Franchising Solutions), submission to the review, p 12.

³²⁷ Australian Franchising Systems, submission to the review, p 2.

³²⁸ Shopping Centre Council of Australia, submission to the review, p 5.

³²⁹ Bakers Delight Holdings Ltd, submission to the review, pp 2-3.

³³⁰ Shopping Centre Council, submission to the review, p 1.

³³¹ DLA Piper, submission to the review, p 7.

On the other hand, a number of industry participants have suggested that franchisees have very little bargaining power at any stage:

Contracts are the glue that holds the franchise network together. The franchisor's mantra is that both parties are business people and that franchisees can negotiate terms to protect themselves. But, franchise agreements are not 'negotiated'; they are standard form contracts drafted by the franchisor. 'Standard form contracts are typically used by parties who are in a strong bargaining position. They are able to prescribe the terms on which they are prepared to contract on a 'take it or leave it' basis'. They protect the franchisor's interests.³³²

It is argued that franchisees can negotiate to have a 'goodwill' clause inserted into their franchise agreements before signing, but franchise agreements are 'generally not negotiable', with the exception only of 'territory rights, location and opening dates.' Given the number of people going into franchising 'there is little need for a franchisor to engage in bargaining to secure a franchisee.' Thus, it is argued, 'there is almost no scope for a potential franchisee to negotiate for the inclusion of [a goodwill] term' in a franchise agreement. It has to be there at the start.³³³

None of the submissions to the review advocating the payment of compensation discussed how it would be calculated. McDonald's Australia Limited stated in its submission that:

It would be impossible to determine how much goodwill can be attributed to the franchisee's efforts (if any) compared to the goodwill generated by the franchisor and the general brand and promotional efforts.³³⁴

On the other hand, the Hon Judi Moylan MP, noted that goodwill is calculated in franchising systems ten times larger than Australia's and calculating goodwill is common practice when a partnership is dissolved or in the sale of any business.³³⁵

Only a few submissions commented on the relationship between the requirement in items 17C of Annexure 1 and 9C of Annexure 2 that franchisors advise franchisees whether significant capital expenditure will be considered by it in determining the arrangements to apply at the end of the franchise agreement and the payment of compensation to the franchisee.

In its submission to the review, McDonald's Australia Limited saw the two concepts as, essentially 'conflated', stating it was 'against the introduction of a requirement for franchisees to be paid an 'exit fee' or be 'compensated' for any significant capital expenditure undertaken during the term.'³³⁶

Bakers Delight Holdings Ltd indicated in its submission that it opposed compensation to franchisees at the end of the franchise agreement. In relation to item 17C it stated:

The inclusion of Section 17C in the disclosure document has provided a summary to franchisees of what will occur at the end of a franchise agreement, however, in our experience, this section is not being clearly understood at the point at which the franchise agreement ends for whatever reason (ie when it finishes, the franchisees, mostly, do not realise what is/is going to occur).

³³² Dr Jenny Buchan, submission to the review, pp 11-12.

³³³ The Hon Judi Moylan MP, submission to the review, p 4.

³³⁴ McDonald's Australia Limited, submission to the review, p 18.

³³⁵ The Hon Judi Moylan MP, submission to the review, p 4.

³³⁶ McDonald's Australia Limited, submission to the review, p 18.

It may be more appropriate to include a statement in the warning on the front page of the Disclosure Document, that the franchise agreement only gives a franchisee rights to operate a franchised business for a finite period of time and, naturally, no one (including the franchisor) will guarantee their business' value at the end. It is a business, not a property.³³⁷

In the opinion of the Hon Adam Searle MLC, the franchisee 'can lose out financially, sometimes to a significant degree' if it is required to make payments of unforeseen capital expenditure but are not entitled to an exit payment or a fair payment for unsold stock at the end of the agreement. This, he stated, 'can compound the financial loss and render the whole agreement harsh or unfair in the way it operates.'³³⁸

One concern raised by franchisees is the capacity of a franchisor to retake the franchise at the end of the term. This view is expressed by a former franchisee, Narelle Walter:

At any time during or at the end of the contract a franchisor can terminate the agreement. Walk into a business lock franchisee out (the writer has experienced firsthand this abuse of power). The franchisor can then open the next day and continue trading with a new franchisee using the good will, a fully stocked business and all the equipment; while the franchisee is left with the debt and a cheque for the written down value (not negotiable) for the equipment.³³⁹

A number of franchisees proposed a solution to this perceived problem - that the franchisor would be required to repurchase the franchise at market value. A sample of the views expressed are:

A franchisee, who successfully builds up a business, should be able to sell that business to his/her preferred purchaser, provided that purchaser is a reasonable person. Franchisors have far too much power over change overs and this needs urgent review.³⁴⁰

One possibility for improvements to the Code in this area might be to have it that the existing franchisee has the right to sell his franchise at its going concern market value to the franchisor, who has the first right of refusal, or to a third party with the co-operation of the franchisor.³⁴¹

If the franchisor buys back the business at fair market value, then the draconian restraint of trade clauses that I see in many franchise agreements could be justified and enforceable, but my view few such clauses are enforceable because, apart from anything else, they lack consideration. The franchisee agrees to leave the area and/or the industry and receives nothing in return.³⁴²

...where the franchisor is set to make a windfall gain, or seeks to re-franchise the territory (even with no gain), franchisees should be given a first right of refusal to continue with the business. Obviously there would need to be certain conditions in circumstances where the franchisor has legitimate reasons for wanting the franchisee out of the system, such as that the franchisee must not be in breach of the franchise agreement.³⁴³

In relation to the sale of the franchise system, the Franchise Council of Australia stated:

³³⁷ Bakers Delight Holdings Ltd, submission to the review, p 2.

³³⁸ The Hon Adam Searle MLC, submission to the review, p 7.

³³⁹ Narelle Walter, submission to the review, p 3.

³⁴⁰ Confidential submission to the review.

³⁴¹ Don Randall MP, submission to the review, p 2.

³⁴² Colin Dorrian, submission to the review, p 10.

³⁴³ M+K Lawyers, submission to the review, p 4.

Few franchised businesses have much value above stock and fixed assets (which themselves are highly customised and rarely of much value except in the specific business and location) if the business ceases to operate, as most of the assets are essentially intangible.³⁴⁴

Automatic renewal and minimum terms of franchise agreements

Automatic renewal and minimum terms of franchise agreements were widely addressed in consultation. Typically, there were views falling on both sides of this question.

Support for automatic renewal rights is often not unconditional. The Lottery Agents Association of Victoria, for example, supported an automatic right of renewal of a franchise agreement provided 'certain performance expectations [are] met (inc. the need for the franchisee to maintain tenure of their location)'. This, it argued, would enable the franchisee to maintain the value in their business, which 'deteriorates significantly as the end of a franchisee agreement approaches, which is the opposite of what should happen assuming the business is running acceptably.'³⁴⁵ It believed that automatic renewal could operate in a similar way to a retail lease with options.

A typical argument against an automatic right of renewal was that there should not be an automatic right of renewal of a franchise, as parties should not be forced into contractual relations with each other. This is more so in franchising that relies more greatly on trust and cooperation.³⁴⁶

The Joint Committee specifically rejected the proposition of automatic renewal for the same reason.³⁴⁷

A number of arguments against automatic renewal were also put forward by the Shopping Centre Council in its submission to the review:

...the notion that franchise agreements should automatically be renewed or a franchisee is entitled to compensation if an agreement is not renewed turns the notion of contract law on its head. A franchise agreement is a contract and, like any other contract, the parties are legally bound to fulfil its terms - no more, no less.

The franchise agreement is a contract between the franchisor and the franchisee for the use of the business system, for an agreed price, for an agreed term, and on agreed conditions. Like any other contract, the franchise agreement has a finite life and implies no ongoing right to possession or occupancy.

If a franchisee requires a longer term in order to ensure an adequate return on their investment, then they should be prepared to negotiate a longer term at the outset and to take on the additional business risk that comes from that longer term...franchisors need the right to not renew a franchise agreement in order to take account of changed commercial circumstances.³⁴⁸

The discussion around automatic terms of renewal relates to concerns that the franchise term should reflect the investment made by the franchisee:

³⁴⁴ Franchise Council of Australia, submission to the review, p 20.

³⁴⁵ Lottery Agents Association of Victoria, submission to the review, p 5.

³⁴⁶ Federal Chamber of Automotive Industries, submission to the review, p 6.

³⁴⁷ See Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 81.

³⁴⁸ Shopping Centre Council of Australia, submission to the review, p 5.

Where a franchisor has the power to require a franchisee to make a capital expenditure during the term of the franchise agreement, they must give a corresponding term of the agreement that allows the franchisee to depreciate the expense. Allowing a franchisor to require a capital expenditure without the ability to write it off gives a significant advantage to the franchisor in the end-of-term negotiations. For example I am aware of situations where a franchisee has been required to spend \$1 million on capital expenditure whilst only being given a one year term.³⁴⁹

The idea of minimum terms for franchise agreements was commented upon by DLA Piper:

...it is our view that the Code requirements in respect of disclosure as to end of term arrangements and minimum notice periods of non-renewal effectively ensure that franchisees are informed of any end of term arrangements and mandate a minimum notice period for non-renewal. Accordingly, DLA Piper submits that any end of term arrangements should properly remain a matter for commercial agreement between the parties.³⁵⁰

Automatic renewal and minimum terms are issues of particular interest to motor vehicle dealerships and are dealt with in Part Nine – Particular issues for franchisees in the motor vehicle industry.

Restraint of trade clauses

The effect of restraint of trade clauses was considered by the Joint Committee. It noted that franchisees may not have sufficient bargaining power to address restraint of trade clauses during the negotiation of the franchise agreement. Though the Joint Committee did not recommend any changes to the Code in this regard. it did observe that it:

...recognises the commercial arguments underlying the application of restraint of trade clauses during the time in which a franchisee and franchisor have a working relationship, it is the view of the committee that it may not be appropriate in all circumstances for such restraints to apply once the franchise agreement has ended. The committee notes the severe restrictions that such restraints might impose on the ability of former franchisees to generate income as independent business people.³⁵¹

Derek Sutherland also commented on restraint of trade clauses, in the context of goodwill payments to a franchisee:

It is always problematic to enforce restraints of trade and arguably the restraint is intended to protect the legitimate commercial interests of the franchisor if the business closes, is sold or the franchise is terminated.

...A restraint of trade imposed under the franchise agreement is usually only enforceable to the extent necessary to protect the legitimate commercial interests of the franchisor. This would include protection of the brand and goodwill in the brand and is often cited as grounds to support the restraint being reasonable. Under a franchise agreement a restraint would apply irrespective of whether the franchisor bought back the franchise business as a going concern. It is also an unfortunate reality that many franchisees seek to avoid the restraint applying to them at end of term and often structure themselves to deliberately avoid it and continue to trade through another entity.

³⁴⁹ New South Wales Small Business Commissioner, submission to the review, p 6.

³⁵⁰ DLA Piper, submission to the review, p 7.

³⁵¹ See Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 58.

I believe that non-compete restraints and claims for an entitlement to claim a payment goodwill would need to be considered together as it would be clearly unfair to require a payment for good will when there is no ability to enforce a restraint.³⁵²

In Mr Sutherland's view, 'If any form of payment for goodwill is made (and I do not think that there should) it must include some right to enforce a restraint of trade to make that work in practice.'³⁵³

Bedshed Franchising also commented on this matter in the context of end of term arrangements more generally. It stated that, in its view, '[c]ontractual restraints are commonly understood to be either unenforceable or expensive for franchisors to enforce. This conduct would breach the obligation to act in good faith.'³⁵⁴

Former franchisee, Trevor Banks, advocated, in his submission to the review 'the removal of any, and all non-compete and equipment ownership clauses once the Franchise Agreement has expired' as he believed this, along with other suggestions:

...would curb some of the immoral acts that are currently being perpetrated by some Franchisors to varying extents, and would provide a simple, yet effective information base for anyone wanting to carry out complete due diligence.³⁵⁵

It suggested that the requirement on a franchisor to give notice of an intention to renew or not to renew 'would also be useful to address inappropriate conduct by franchisees at the end of term, e.g. not renewing and then de-branding, not complying with restraints'.³⁵⁶

Timing of renewal advice

As noted above, the 2010 amendments to the Code require franchisors to advise franchisees of their intention in relation to renewal of the franchise agreement at least six months prior to the end of the term.

³⁵² Derek Sutherland, supplementary submission to the review, pp 6-7.

³⁵³ Ibid., p 8.

³⁵⁴ Bedshed Franchising Pty Ltd, submission to the review, p 9.

³⁵⁵ Trevor Banks, submission to the review, p 2.

³⁵⁶ Bedshed Franchising Pty Ltd, submission to the review, p 11.

A submission believed that the amendment had been effective:

Further, the notice of non-renewal clause which requires the franchisor to notify a franchisee at least 6 months before the end of the term of the franchisor's decision to renew or not, or enter a new agreement (or 1 month if the term is for less than 6 months) is entirely appropriate in our view.³⁵⁷

Some submissions, on the other hand, suggested that the notice period could be increased from six months to twelve:

The suggestion that 6 months out from end of term negotiations can take place is inadequate. My recommendation is that this could happen 12 months before the end of term. At that point, negotiations need to take place so the franchisor can either assist a non-compliant franchisee to sell or assist him to comply and ensure there is full understanding on the payments of the franchise fee for a further term and payment of any costs towards image upgrade or bringing the business up to the current group standards.³⁵⁸

The requirement to issue renewal notices could be extended to 12 months before the end of the term, to give time to consider payment of any renewal fee or new fee, any refurbishment obligations and the need to be compliant, etc. This also has benefits for the franchisees as it protects their goodwill.³⁵⁹

It would also be useful to address inappropriate conduct by franchisees at the end of term, e.g. not renewing and then de-branding, not complying with restraints etc.³⁶⁰

At the opposite end, a submission from an experienced franchising lawyer, Peter Sanfilippo, suggested that:

...consideration ought to be given to reducing the 6 month period for notification, perhaps to 2 months. This would allow the conventional renewal exercise period of 6 to 3 months to be retained in franchise agreements.

This, he believed, would remove the 'administrative burden' when it was not known, at the time notification was given, whether the franchisee wished to renew the agreement. Further, taking into account current practice that the franchisee's notice period under the agreement is usually six months before the end of the term, the amendment would 'allow franchisors to consider conduct of franchisees subsequent to the renewal notice that may fairly be relevant to the decision whether or not to renew the franchise agreement.'³⁶¹

One issue raised with renewal was a technical point that the amendment to clause 20A does not specify that notice should be in writing. This is dealt with in Appendix E to the report (Appendix D: Technical or minor changes to the drafting of provisions of the Franchising Code).

³⁵⁷ DLA Piper, submission to the review, p 6.

³⁵⁸ Stephen Hansen, submission to the review, p 6.

³⁵⁹ Tim Hantke (Franchising Solutions), submission to the review, p 12.

³⁶⁰ Bedshed Franchising Pty Ltd, submission to the review, p 11.

³⁶¹ The Franchise Lawyer (Peter Sanfilippo), submission to the review, p 8.

ACCC comments on non-renewal of franchises

At the request of the reviewer, the ACCC was asked to provide comments on non-renewal of a franchise agreement at the end of the term. It did so in the form of guidance on eight scenarios involving non-renewal of franchises.³⁶²

Scenario 1: The franchise agreement is due to expire in ten months. The franchise is not renewed, after the franchisor is advised that company-owned stores are far more profitable.

ACCC view: This behaviour is unlikely to raise concerns under the ACL or the Code. The franchisor has provided more than the amount of notice required under the Code (six months) and is making a genuine business decision.

Scenario 2: The franchise is in the final year of its term. The franchisee has breached its agreement on several occasions. Seven months before the end of the agreement, the franchisor advises the franchisee that it will not be renewing his agreement

ACCC view: This conduct does not raise concerns under the Code or the ACL. The franchisor has provided the franchisee with sufficient notice and is making a genuine business decision to protect the value of its brand.

Scenario 3: A franchisee is in the ninth year of a 10 year term. The franchisor decides not to renew the agreement 18 months before its expiration but under the terms of the agreement the franchisor requires the franchisee to build a new showroom. Eight months from the end of the agreement, before the showroom is completed, the franchisor advises the franchisee that his agreement will not be renewed.

ACCC view: So long as the possibility of unforeseen capital expenditure is disclosed in the disclosure document, there has not been a breach of the Code. However, the conduct could amount to unconscionable conduct under the ACL. The franchisor has forced the franchisee to outlay \$300 000 for a new showroom, knowing that it does not intend to renew the franchisee's agreement.

Scenario 4: Because of concerns that he may not be able to recoup his investment within the five year term, a franchisee sought assurance that his agreement would be renewed. The franchisor provided a verbal guarantee that if the franchisee did not breach his agreement it would be renewed, which was repeated each year. In fact, the franchisor intended to offer the franchise to his brother, unless his brother was not interested. After four years, despite the franchisee having never breached the agreement, the franchisor advises the franchisee that he won't be renewing the agreement for personal reasons.

ACCC view: This conduct is likely to raise concerns under the ACL (e. g. misleading or deceptive conduct). It is unlikely that the franchisee would have purchased the franchise had the franchisor not been willing to guarantee the renewal of the agreement.

Scenario 5: A franchise has failed twice in the previous year. Both franchisees had raised concerns with the franchisor about the viability of the franchise. Each time the franchise was

³⁶² Australian Competition and Consumer Commission, supplementary submission to the review, pp 2-3.

sold for the full price. The franchisor misrepresents the reasons the previous franchisee left the franchise. The new franchisee fails months later.

ACCC view: This conduct is likely to raise concerns under the ACL (e. g. misleading or deceptive conduct and/or unconscionable conduct). The franchisor has sold the franchise for its full price despite knowing it is likely to fail, and has lied about the reason for the previous operator exiting the system.

Observations

Consideration of renewal and end of term arrangements is conditioned, to some extent, by matters discussed elsewhere in this report, such as franchisee education, good faith, enforcement and franchisor failure. To take one example, the terms of an agreement relating to the making of an end of term payment to the franchisee will clearly be affected should the franchisor become insolvent.

Some submissions have expressed the view that the 2010 amendments to clause 20A of the Code and clause 17C of Annexure 1 to the Code concerning the giving of notice of end of term arrangements have not been in place long enough for a proper assessment of their efficacy to be made.

Despite the relatively short period in which they have been in place, a number of stakeholders have concluded that they are not working. Many of those submissions have been based on the submitter's own poor experience as a franchisee. They are heartfelt and raise real concerns that the actions of some franchisors may amount to unconscionable conduct. With that in mind, the ACCC was asked to provide its views on whether some of that conduct might amount to a breach of the ACL. Its advice is summarised above. Of course, these were provided for guidance only and it would be inappropriate to read too much into the opinions expressed.

It is believed that conflict generated by an alleged lack of understanding by franchisees of the terms of the franchise agreement and their implications is compounded by a mismatch between the expectations of franchisees and the reality of the franchise system.

The Code does not dictate how the agreement must end or what will happen when it does. This is in keeping with some basic principles of contract law – firstly, that a franchise agreement is a contract between two parties; secondly, that the parties to any contract are, by-and-large, free to negotiate the terms of the agreement themselves; and, thirdly, that the law will not force parties to engage in contractual relations against their will.

Instead, the 2010 amendments to the Code relating to end of term arrangements sought to regulate what information is available to franchisees about:

- what will happen at the end of an agreement, so that they can make an informed decision about how they wish to proceed;
- when that information is to be provided, to give the parties sufficient time to consider their options; and
- the respective rights of franchisee and franchisors should a franchisee wish to sell the franchise.

The review was specifically asked to look into 'the rights of franchisees at the end of the term of their franchise agreements, including recognition for any contribution they have made to the building of the franchise'. Accordingly, this topic was widely canvassed in submissions with many of the submissions making arguments for the right of franchisees to receive a compensation payment being recognised in the Code.

Nonetheless, there should not be a general overarching right to compensation for franchisees at the end of a fixed term franchise agreement. Making such a recommendation would substantially and fundamentally change long established legal principles of property and contract law. There would also be a risk of greater cost and uncertainty in the industry and possible unintended consequences from any such change to contractual rights.

While appreciating the contribution made by franchisees to the development of their franchise site or territory, a franchisee should expect that the franchise period should be no longer than the negotiated terms of the contract. Any equitable right to compensation for a franchisee whose franchise is not renewed must lie with the courts and any statutory right that may exist under the ACL.

Arguably, adequate remedies already exist if a franchisor fails to renew a franchise agreement in a situation where the franchisee has complied with all the conditions for renewal. Unlawful refusal will amount to a breach of the agreement by repudiation or possibly unconscionable conduct. However, if the agreement does not provide for renewal, the franchisee knows before entering into the agreement that the franchisee's rights under the agreement will terminate on the expiry of the term. In that situation the franchisee should not be entitled to compensation.

It is recognised that a franchisee can add value to the franchise site or territory the subject of the franchise agreement, in certain cases as well as to the franchise system as a whole. There is case law to establish that a franchisee can obtain goodwill for their contribution to building the franchise system. In some cases a franchisee may not be in breach of the franchise agreement but the agreement may still not be renewed, though the evidence suggests that it is not a common scenario.

The Joint Committee and the government response did not support giving franchisees an automatic right of renewal, on the basis that it was not appropriate to force parties to be in business together that do not wish to be in business together. It is noted that no evidence has been received by the review that supports a different conclusion.

Based on the evidence presented to the review, it is not necessary to amend the Code to require franchise agreements to be offered for a minimum term are not necessary. The parties should remain free to negotiate the terms of their contract and make their own decisions regarding the viability of the investment and the discounted rate of return which is acceptable to each party. It is up to the parties to obtain their own advice about the agreement, so that they are aware of its terms. Each party is free to either accept the agreement or not to do so but must abide by the terms of the agreement once it is entered into. There is further discussion of minimum terms for franchise agreements in relation to motor vehicle dealerships in Part 9 this report.

The decision to renew a franchise agreement is a matter for the parties to a franchise agreement. However, further consideration should be given to the scenario where a franchisor decides that it

does not wish to renew a franchise, the franchisee has not breached the franchise agreement and the franchisee would have liked to continue the arrangement.

In that situation, and assuming that all other aspects of the franchise agreement have been complied with, it might be asked whether an ex-franchisee should be prevented from developing their own, similar business in the vicinity of the franchise site or territory. Put another way, should a franchisor be entitled to enforce a non-compete clause against a compliant franchisee when it is the franchisor that has decided not to renew the franchise.

The scenario being contemplated may not be common. It is more than likely that a well-performing franchisee that is not in breach of the agreement will have its franchise renewed, if it wants it renewed. And if the franchisee is not performing well, the franchisor has little to fear from their starting up a competing business.

It should be remembered that competition is an inherently good thing and should be encouraged where possible. It has been argued that the removal of non-compete clauses may, on the other hand, lead to an increase in franchise fees, as the franchisor covers against the former-franchisee going into competition with a new franchisee. However, if it is in fact the case, as argued by some franchisors, that a franchisee has no goodwill in the franchised business, a franchisor could not logically object to a franchisee commencing a similar business in another location, even one that is proximate. At the same time, the franchisee should not be able to engineer the non-renewal of the franchise to avoid a restraint of trade clause.

There may be some technical concerns about the recommended amendment. However, it is believed that the benefits that are likely to result outweigh the potential problems it may cause.

Overall, the amendments have not been in place sufficiently long to be able to determine the impact and effectiveness of the 2010 amendments based on good data and experience. The government may wish to reconsider end of term arrangements at some time in the future. Future review of the Code generally is discussed further in Part 10.

Following further assessment of those amendments, consideration could be given to assessing the timing of a renewal notice to a franchisee before the end of the term.

Recommendation

12. The Code be amended to state that, if all of the following conditions are satisfied:
- a. the franchisee wishes to have the franchise agreement renewed on substantially the same terms;
 - b. the franchisee is not in breach of the agreement;
 - c. the agreement does not contain provisions allowing a franchisee to make a claim for compensation in the event that the franchise is not renewed;
 - d. the franchisee abides by all confidentiality clauses in the agreement and does not infringe the intellectual property of the franchisor; and
 - e. the franchisor does not renew the franchise agreement;

any restraint of trade clauses in the franchise agreement which prevent the franchisee from carrying on a similar business in competition with the franchisor, are not enforceable by the franchisor against the franchisee.

Part Seven – Dispute resolution

Introduction

Disputes can arise out of a large number of issues, including genuine legal issues of breach and default, commercial financial stress, relationship issues or simply a cry for help by a party. The essential reasons for dispute include:

- mismatched expectations;
- perceived misrepresentations by either party;
- lack of suitability for the particular business system;
- lack of undertaking of one's rights, duties, liabilities, costs and obligations under the agreement that the parties have entered into;
- ethnic and cultural issues; and
- poor professional advice regarding legal, accounting and industry issues; ignoring advice received; or no advice obtained at all.

The Code encourages parties to resolve a dispute themselves. To assist with this, Part 4 of the Code outlines a procedure that either party to a franchise agreement may invoke to resolve a dispute and provides for the Minister to appoint a Franchising Mediation Adviser. The Office of the Franchising Mediation Adviser (OFMA) provides a range of dispute resolution services including the appointment of mediators and a free early intervention service to assist parties involved in a dispute to address their concerns and seek advice before becoming entrenched in a dispute. OFMA also provides a small scale dispute resolution service which allows parties meeting certain criteria to access formal mediation services at a reduced fee, facilitating faster and cheaper dispute resolution.

In addition to the procedures included in the Code and the services offered by OFMA, franchising parties can also lodge a complaint with the ACCC where they believe that the other party may have breached the Code or the Australian Consumer Law (ACL) (see Part Six: Enforcement of the Code). Parties can also access alternative dispute resolution services from other providers, such as a state small business commissioner.

The 2010 amendments to the Code sought to encourage franchising parties to approach mediation in a reconciliatory manner. While the efficacy of these amendments is the main focus in relation to dispute resolution in this review, many submissions also raised concerns about the broader operation of the dispute resolution provisions under Part 4 of the Code. Given the importance of mitigating the risk of dispute, particularly at critical points in the franchising relationship (such as prior to the relationship starting; following the franchise commencing; and the end of an agreement term), some of these issues are also discussed in the report.

This part of the report considers:

- the 2010 amendments to the Code;
- use of other services to mediate;

- alternative dispute resolution mechanisms other than mediation;
- confidentiality of dispute resolution; and
- franchisor attribution of legal costs to franchisees.

The 2010 Amendments to the Code

Introduction

Evidence was presented to the 2008 Joint Committee that some parties to a dispute may be stalling negotiations and acting to deplete resources of the other party to frustrate the dispute resolution process under the Code. The Committee believed that:

...many of the issues which lead to franchising disputes, and hence the need for mediation or alternative dispute resolution mechanisms, may be mitigated by the introduction of an explicit obligation into the Code for all parties to a franchise agreement to act in good faith.³⁶³

The government did not accept the Joint Committee's recommendation, however the Code was subsequently amended to insert clause 23A to provide that nothing in the Code limits any obligation imposed by common law, applicable in a state or territory, on the parties to a franchising agreement to act in good faith.

The government also committed to the inclusion of 'a list of necessary and desirable behaviours aimed at discouraging behaviour which may impede the effectiveness of the dispute resolution process under the Code'.³⁶⁴

Accordingly, in 2010, subclause 29(8) was inserted into the Code to clarify that a party will be taken to be trying to resolve a dispute, as required by the Code, if the party approaches the resolution of the dispute in a reconciliatory manner, including doing any of the following:

- attending and participating in meetings at reasonable times;
- at the beginning of the mediation process, making its intention clear as to what it is trying to achieve through the mediation process;
- observing any confidentiality obligations that apply during or after the mediation process;
- not taking action which has the effect of damaging the reputation of the franchise system during the dispute, including by providing inferior goods, services, or support; and
- not refusing to take action during the dispute, including not providing goods, services or support, if the refusal to act would have the effect of damaging the reputation of the franchise system.

³⁶³ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p xv.

³⁶⁴ Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, p 5.

The 2010 amendments also went further to clarify subclause 31(2) of the Code which notes that '[t]he parties are equally liable for the costs of mediation under this Part unless they agree otherwise.' Subclause 31(4) was inserted into the Code to clarify the meaning of 'costs of mediation' to include:

- the cost of the mediator;
- the cost of room hire; and
- the costs of any additional input (including expert reports) agreed by both parties to be necessary to the conduct of mediation.

Evidence considered during the review

The unwillingness and refusal of franchisors and franchisees to attend mediation and resolve the dispute was raised by several submissions to the review and in many cases they did not believe that changes to the Code have necessarily had a positive impact on behaviour.

It was stated that the approach taken by some parties to mediation is one of 'formal compliance only'³⁶⁵, with others stating that franchisor representatives must be prepared to negotiate, 'rather than simply stonewall'³⁶⁶. Other submissions stated:

Compelling 'genuine, reconciliatory participation' in mediation is a contradiction in terms; for mediation to be genuinely successful (and successful in the long term) participation must be genuine and consensual. But no law can enforce a state of mind.³⁶⁷

The Code currently does not require the parties to engage in dispute resolution in good faith only in a reconciliatory manner.³⁶⁸

While there may be benefit in enshrining a duty to act in good faith in relation to conduct at mediation... it is difficult to see in practice what benefit a specific obligation to act in good faith across the Code can bring...³⁶⁹

The amendments are vague as to the concept of acting in a "reconciliatory manner" and the Society suggests more direction should be given to parties as to what this actually means, and whether there are any consequences from ignoring the requirements.³⁷⁰

...too much is expected of mediation as a one size fits all solution and that the gap between consensual resolution and all out Court warfare is too large.³⁷¹

The behaviour of franchisors during mediation has not changed since the introduction of the 2010 amendments of the FCC. The parties to disputes frequently fail to reach a settlement. The failure rates of disputes through the OFMA are unsatisfactory.³⁷²

³⁶⁵ The Hon Adam Searle MLC, submission to the review, p 8.

³⁶⁶ Post Office Agents Association Ltd, submission to the review, p 5.

³⁶⁷ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 25.

³⁶⁸ Derek Sutherland, submission to the review, p 32.

³⁶⁹ Victorian Small Business Commissioner, submission to the review, p 14.

³⁷⁰ Law Society of South Australia, submission to the review, p 8.

³⁷¹ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 24.

³⁷² Post Office Agents Association Ltd, submission to the review, p 5.

Some fine-tuning is required for clauses 29 and 30 of the Code to make the mediation process fairer and more effective.³⁷³

Consultation raised inequality of bargaining power and financial resources between franchisees and franchisors as significant factors in resolving disputes between the two parties. Many believed that despite the 2010 amendments to the Code, there has been 'no change in the inherent power imbalance between the parties.'³⁷⁴

The Victorian Small Business Commissioner stated:

A fundamental cause for disputes in the franchise relationship appear to stem from 'communication failure' on the part of the franchisor interacting with 'understanding deficiency' on the part of the franchisee.³⁷⁵

Others disagreed and believed that the dispute resolution arrangements under the Code are working well. OFMA stated 'we believe those processes are operating effectively and have no suggestion for any further changes'.³⁷⁶

The dispute resolution process set out in the Code as a whole seems to be effective and the obligation on parties to approach mediation in this manner may be assisting in this regards.³⁷⁷

We believe that the status and importance of mediation has significantly increased as a result of the 2010 amendments and we have, in our experience noticed a preference for parties to resolve disputes via mediation. We regard the mediation process as a very effective means to reach a suitable outcome between parties otherwise locked in dispute. We have no concerns regarding the operation of the amendments. We consider that the amendments are very clear and adequately set out the obligations of the parties so that there can be no doubt as to the matter (*sic*) in which mediation must be approached.³⁷⁸

Access to justice for franchising parties in dispute has improved in recent years with the establishment of the Small Business Commissioners and ADR services for small businesses in various jurisdictions, including Western Australia. In general, various ADR services now available provide low-cost, speedy access to the resolution of franchise-related disputes, and can work in parallel with the services provided by the federally-sponsored OFMA and those offered by the private sector.³⁷⁹

In our view, the requirement for the parties to act in a 'reconciliatory manner' has had little impact. ... However, the requirement for both parties to attend mediation has been beneficial in order to force mediation and avoid an otherwise protracted disagreement. Mediation is an effective and proven dispute resolution tool.³⁸⁰

³⁷³ Competitive Foods Australia Pty Ltd, submission to the review, p 2.

³⁷⁴ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 24.

³⁷⁵ Australian Small Business Commissioner, submission to the review, p 5.

³⁷⁶ Office of the Franchising Mediation Adviser, submission to the review, p 1.

³⁷⁷ Law Institute Victoria, submission to the review, p 8.

³⁷⁸ Quick Service Restaurants Holdings, submission to the review, Attachment E, p 10.

³⁷⁹ Western Australian Small Business Commissioner, submission to the review, p 10.

³⁸⁰ M & K Lawyers submission to the review, p 4.

Observations

As discussed in Part Five – Good faith, submissions presented consistent anecdotal evidence of questionable behaviours in mediation. It needs to be kept in mind that some parties approach the dispute resolution process with a view to literal compliance to the requirements, while others are genuine in their desire to reach an outcome and approach mediation in a reconciliatory manner.

Unfortunately there is no quantitative research available to confirm these claims. However, all of these behaviours may be addressed by an obligation to act in good faith being incorporated into the Code (see Part Five – Good faith). Given the recommended obligation to act in good faith would apply to dispute resolution, a separate recommendation to insert a good faith obligation into Part 4 of the Code is not necessary.

Use of other services to mediate

Introduction

In recent years, several state governments have established small business commissioners and other agencies to assist small business with dispute resolution. The Victorian Small Business Commissioner (VSBC) established in 2003, is the only state based service that was in place prior to the last federal review of the Code.

Since that last Code review, the New South Wales Small Business Commissioner (NSWSBC), the South Australian Small Business Commissioner (SASBC) and the Western Australia Small Business Commissioner have established alternative dispute resolution services which are available to franchisors and franchisees. These state based services, along with those provided by independent private mediators, have expanded the options available to parties in dispute and provide a complement to OFMA services. As these last three state services are still in their infancy, statistics on dispute resolution success rates are not substantial or detailed.

Mediation success rates for state government agencies

The VSBC submission states that ‘settlement outcomes at mediation involving a franchisee or franchisor are not fundamentally different to those for all mediations...’³⁸¹. The VSBC annual reports provide statistics about the success rate of disputes referred to mediation, and these show that the rate has remained between 70 and 80 per cent, only fluctuating to a low of 71 per cent, and a high of 79 per cent.³⁸²

The NSWSBC submission reports a dispute resolution success rate of 89 per cent for all disputes³⁸³; and the SASBC 2011-12 annual report indicates an overall dispute resolution success rate of 85 per cent for all disputes.³⁸⁴

Australian Competition and Consumer Commission

The ACCC submission sets out a wide range of issues raised with the ACCC in relation to franchising complaints. In particular, and of relevance to this part of the report, complaints received by the

³⁸¹ Victorian Small Business Commissioner, submission to the review, p 5.

³⁸² Statistics taken from [Victorian Small Business Commissioner Annual Reports](#) for 2003-04; 2004-05; 2005-06; 2006-07; 2007-08; 2008-09; 2009-10; 2010-11; and 2011-12.

³⁸³ New South Wales Small Business Commissioner, submission to the review, p 4.

³⁸⁴ South Australian Small Business Commissioner, Annual Report 2011-12, p 5.

ACCC during the periods 1 March 2008 to 30 June 2010 and 1 July 2010 to 31 December 2010 relating to dispute resolution issues were low compared with other issues raised, such as breaches of the *Competition and Consumer Act 2010* (CCA) or ACL. Allegations that the franchisor refused to attend mediation represented only 1.6 and 1.4 per cent respectively for the two periods; and allegations that the franchisor did not comply with the mediation settlement represented only 0.8 and 0.2 per cent respectively.

Evidence considered during the review

The NSW SBC believed that:

OFMA is constrained by procedures in the Code, whereas the Office of the NSW Small Business Commissioner on the other hand is able to take a more tailored approach to dispute resolution. The extensive intake processes of the OSBC are in part responsible for my Office's high dispute resolution rate, with 89 per cent of all disputes being successfully resolved. The Code allows the parties to appoint their own mediator and as a result some franchise disputes come through the OSBC.³⁸⁵

It was raised during consultations that parties using non-OFMA services do not have to comply with the mediation requirements set out in the Code.

Presently, it is possible for a franchisee to instigate mediation under State Small Business Commissioner laws, yet not be restricted by the rules of behaviour set out in clause 29(8) of the Code.³⁸⁶

There is some anecdotal evidence from at least one lawyer I have spoken to of an example where a dispute that was referred to a state Small Business Commissioner by a franchisee is being dealt with by way of a mediation and conducted under their legislation. The Small Business Commissioner involved apparently was advised by the Franchisor's solicitors that the franchisor wanted the dispute resolution to be conducted in accordance with Part 4 of the Code or the method set out in their franchise agreement and this was refused.³⁸⁷

Several submissions argued that a protocol should be established for any disputes considered by non-OFMA mediators.

If this is correct then the ACCC and the small business commissioners need to have a protocol on how franchise disputes are to be resolved or it means the whole Part 4 process of the Code is useless if a dispute is referred to a state small business commissioner.³⁸⁸

It would be helpful to make it clearer in the Code that a franchisor has complied with the mediation requirements of the Code if the parties agree to mediate through nominated services, including those provided by the various State-based Small Business Commissioners.³⁸⁹

³⁸⁵ New South Wales Small Business Commissioner, submission to the review, p 4.

³⁸⁶ Philip Colman, submission to the review, p 5.

³⁸⁷ Derek Sutherland, submission to the review, p 32.

³⁸⁸ Ibid.

³⁸⁹ New South Wales Small Business Commissioner, submission to the review, p 4.

Observations

The evidence presented to the review indicates franchisors and franchisees benefit from the availability of dispute resolution services. It is encouraging to see the development of these services by the state agencies over recent years, which assist franchisors and franchisees to access a wider range of dispute resolution services.

With the increasing availability of alternative dispute resolution services offered by a range of government and non-government providers, it is important that the intention of the 2010 amendments to the Code to introduce reconciliatory behaviours for parties involved in alternative dispute resolution, are maintained.

A positive point to note is that results show that the mediation success rates for dispute resolution services offered by the state agencies, are on par with the OFMA results, which are in the range of 70 to 90 per cent. This is above the 'international bench mark internationally of 60 per cent'.³⁹⁰

There is merit in ensuring that the Code requirements for parties to mediate in a reconciliatory manner during mediation, are applied to all dispute resolution processes regardless of the setting.

Recommendation

13. The Code should be amended to provide that clause 29(8) applies to participation in any alternative dispute resolution process whether under OFMA, state small business commissioners, privately retained; court appointed or otherwise.

Alternative dispute resolution mechanisms

Introduction

Alternative forums for the resolution of disputes in addition to mediation, was an issue raised during consultations. Although this falls outside the scope of the review, a number of submissions raised concerns about the difficulty for franchisees in paying the costs of litigation to enforce their rights against franchisors. One solution put forward to address this problem was the establishment of mechanisms for dispute resolution between mediation and litigation, for example:

- arbitration;
- dispute resolution with a ruling/binding outcome;
- establishment of a franchise ombudsman;
- establishment of a franchise board;
- the formation of a franchising specific tribunal, or allowing franchising disputes to more easily access existing state tribunals.

³⁹⁰ Meeting with Franchise Council of Australia, 12 February 2013, Melbourne.

Evidence considered during the review

The Hon Judi Moylan MP, proposed the creation of a mechanism allowing:

...franchising disputes to be lodged directly with Australian Competition Tribunal or the creation of a low cost alternative dispute resolution system that has the ability to rule on disputes [and that] any such system should be accessible without the need to engage legal professionals and the rules of evidence and procedure should reflect this intention.³⁹¹

The Australian National Retailers Association suggested:

If further enforcement steps are to be considered for those matters that cannot be resolved by mediation, ANRA would be more supportive of a tribunal type system –rather than any additional formal legal steps being made available to the ACCC.

This Tribunal should be staffed by legal experts with experience in franchise arrangements. The Tribunal would need to have the confidence of both franchisees and franchisors and act in a fair manner to resolve ongoing disputes.

ANRA's preference for a Tribunal is because tribunals tend to provide greater access to remedies for all parties and are reasonably quick and inexpensive compared to traditional litigation through the court system. The use of tribunals to improve speed and cost efficiencies in commercial dispute resolution has already been proven in the context of retail leasing disputes.³⁹²

In addition, it is believed that a tribunal would be less complex than court processes and that there is the option for the tribunal process to be 'lawyer free'. A sample of comments is:

The tribunal model is a worthwhile starting point for this type of forum as it is less complex than courts (not being bound by the strict rules of evidence), allows the parties to express their position in the own words, is generally 'lawyer free' and presumes that each party will pay their own costs.³⁹³

...even better would be a forum where the parties were not required to use (but were not prevented from engaging) legal representation in the first instance. The parties to disputes in franchising need to be able to participate in dispute resolution processes other than mediation without lawyers representing their interests.³⁹⁴

Any such system should be accessible without the need to engage legal professionals and the rules of evidence and procedure should reflect this intention.³⁹⁵

Some submissions saw a benefit in the appointment of a franchising ombudsman or board and see the role as including the provision of education to the industry; dispute resolution and the provision of binding rulings on disputes; keeping track of the outcomes of dispute resolution processes, including litigation; and archiving disclosure documents and franchise agreements. Two former franchisees, Peter Hayes and Trudi Martin, stated:

We see the need to appoint a franchise ombudsman so that franchisees or franchisors can contact such a person for a ruling on a particular dispute or matter.³⁹⁶

³⁹¹ The Hon Judi Moylan MP, submission to the review, p 6.

³⁹² Australian National Retailers Association, submission to the review, p 14.

³⁹³ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 26.

³⁹⁴ Ibid., p 25.

³⁹⁵ The Hon Judi Moylan MP, submission to the review, p 6.

In a meeting on 22 February 2013, Professor Lorelle Frazer, said that, in her opinion, the 'idea of an ombudsman has merit, but the question is always one of resourcing.'³⁹⁷

More generally, the VSBC suggested that 'alternative or extended mechanisms are needed to deal with the vast majority of disputes and alleged breaches under the Code'.³⁹⁸ It went on to state:

Providing more equitable access to civil litigation if mediation is unsuccessful. The likelihood of a franchisee (in particular) taking civil action following a mediation which was unsuccessful or where the franchisor did not mediate in good faith, will be affected by the likely cost of taking further action.³⁹⁹

On a related point, another issue raised is that of parties receiving binding outcomes from mediation. Two submissions to the review stated:

A body should be created that allows for franchisees to seek binding rulings on a dispute without having to either complain to the ACCC or engage in costly litigation.⁴⁰⁰

The mediation process should not be used to delay a resolution which will be of financial detriment to either party. The parties should not be precluded from agreeing to mediate privately or being subject to a compulsory mediation imposed by a Court.⁴⁰¹

Alternatively, during extensive consultations, others stated that a tribunal system, ombudsman or board would simply add another layer to the dispute resolution process, adding further delay and would not add anything to enhance the current system.

Seeking to establish a separate Tribunal for franchising has been posed even using the existing regimes such as VCAT or QCAT. Unfortunately consistency in decisions and allocation of resources to hear them expeditiously would be an issue.⁴⁰²

The strength of the current systems will be improved by increased experience and expertise. Spreading the disputes and complaints over a greater number of bodies will reduce the skill and efficiency of the current bodies without a commensurate benefit. There is no benefit for the Victorian Civil and Administrative Tribunal to hear franchising matters nor of a franchising ombudsman. The systems currently in place are many and varied.⁴⁰³

Observations

A dispute between a single franchisee and a franchisor may have potential impact on the entire franchise system, not only affecting the value of the franchisors brand and value, but the value of potentially other franchisees in the system as well. For example, it will be more difficult for a franchisor to sell new franchises in a system which is riddled with disputes and or litigation. Similarly,

³⁹⁶ Peter Hayes and Trudi Martin, submission to the review, p 2.

³⁹⁷ Meeting with Professor Lorelle Frazer, Asia-Pacific Centre for Franchising Excellence, 22 February 2013, Brisbane.

³⁹⁸ Victorian Small Business Commissioner, submission to the review, p 15.

³⁹⁹ Ibid., p 16.

⁴⁰⁰ The Hon Judi Moylan MP, submission to the review, p 6.

⁴⁰¹ SME Business Law Committee of the Business Law Section, Law Council of Australia, submission to the review, p 3.

⁴⁰² Derek Sutherland, submission to the review, p 33.

⁴⁰³ Franchise Council of Australia, submission to the review, p 22.

it will be difficult for a franchisee who wishes to sell its franchise to obtain the best price for the franchise when the system or the franchisee is in dispute with the franchisor.

In 2009, the Australian Government's *Strategic Framework for Access to Justice* was released. Access to justice in this sense includes accessing information and support to prevent and resolve disputes; resolution of a dispute through informal processes, such as third party facilitators or mediators; and resolution through the formal justice system, which includes courts and tribunals.

The Framework is based on five key principles of accessibility, appropriateness, equity, efficiency and effectiveness. The Framework aims to encourage the resolution of disputes without the need to resort to litigation, by providing better information and dispute resolution assistance, such as through early intervention and other alternative dispute processes.

The Framework is overseen by the Attorney-General's Department and 'encourages policy makers to take a broad approach to new initiatives and reforms that aim to improve access to our justice system.'⁴⁰⁴

Early consideration of dispute resolution options, including the use of alternative dispute resolution, is consistent with the objective of the *Civil Dispute Resolution Act 2011* (CDR Act). The CDR Act, which commenced on 1 August 2011, encourages parties to take genuine steps to resolve disputes before commencing certain proceedings in the Federal Court of Australia and the Federal Magistrates Court of Australia.

The CDR Act requires agencies to file a 'genuine steps' statement indicating what steps (if any) they have taken to resolve a dispute before commencing legal proceedings. In addition, it sets out examples of what are considered to be 'genuine steps' to resolve a dispute.

The dispute resolution processes under the Code are consistent with the approach of encouraging early resolution of disputes and providing avenues for parties to avoid resorting to litigation.

Instead of recommending a tribunal or ombudsman system, and the associated additional layer of complexity this would involve, there is merit in making recommendations to improve the current dispute resolution process.

⁴⁰⁴ See Attorney-General's website: <http://www.ag.gov.au/LegalSystem/Pages/Accessstojustice.aspx>

Confidentiality of dispute resolution

Introduction

The Expert Panel reviewed confidentiality clauses as part of its inquiry into the five franchising behaviours. It noted:

...there is limited empirical evidence as to the extent to which confidentiality clauses pose a problem in franchising. The panel also notes that confidentiality clauses are used in a wide variety of industries and business agreements, and in many cases represent a genuine business need to protect assets such as intellectual property, including trade secrets.⁴⁰⁵

Since there are legitimate interests that confidentiality clauses may protect, it is not appropriate to consider an outright prohibition of such clauses, or a prohibition that carves out intellectual property as the sole interest which may be protected through confidentiality clauses.⁴⁰⁶

The panel (suggested the insertion of) a statement into the Franchising Code alerting prospective franchisees to the use of confidentiality clauses, and the type of information they typically cover.⁴⁰⁷

Evidence considered during the review

The confidentiality of the dispute resolution process was raised in consultation. Several disadvantages of this were noted, including that if a dispute ends up going to court, confidentiality of the process makes it difficult for courts to know whether the parties have acted in a reconciliatory manner during mediation. Other difficulties raised are discussed below.

Submissions also pointed out that confidentiality clauses make it difficult for potential new franchisees and others researching the industry:

On settlement of a mediated dispute the parties sign confidentiality agreements. This prevents franchisees ... giving candid responses to intending franchisees who make contact to seek information about 'what's it like being a franchisee in the system'?⁴⁰⁸

A franchisor thus may have been involved in mediations with numerous franchisees and there is no way for potential franchisees to discover that fact, or what the disputes were about.⁴⁰⁹

Confidentiality of the dispute resolution process has also resulted in the lack of detailed and accurate information about the outcomes of disputes. Even when a dispute is settled through mediation there is no information about what the parties agreed; and if a dispute does not get resolved at mediation, there is no information about what happens next. The question was asked during consultations, of whether there is some way of collecting de-identified information and data to gain a better understanding of the disputes occurring in the industry:

Mediation does not offer precedent as litigation can, to send a message to or guide others who may be involved in similar conflicts. This is historically a concern with any private or confidential form of dispute resolution.⁴¹⁰

⁴⁰⁵ Refer to the *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct* report, February 2010, p 76.

⁴⁰⁶ *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct* report, February 2010, p 77.

⁴⁰⁷ *Ibid.*, p 78.

⁴⁰⁸ Dr Jenny Buchan, submission to the review, p 7.

⁴⁰⁹ *Ibid.*, pp 5-6.

All details of mediation conducted to satisfy the requirements of the Code remain confidential including the names of the parties. Thus information about franchisors other than information they supply in disclosure or on their own websites is difficult and/or expensive to obtain, and breaches of the disclosure regime are usually impossible to detect unless they lead to litigation.⁴¹¹

This was also noted in the context of disclosure, where some parties thought there should be greater disclosure of the outcomes of mediation in the disclosure document (Part Two - Disclosure).

Observations

The review consultation process only raised the negative aspects of confidentiality clauses. However, there are positive aspects to imposing confidentiality arrangements in the dispute resolution process. For example, parties may feel that they can be more open about their situation and provide frank commentary on the complaint. In addition, confidentiality would ensure that details of a vexatious claim that is unfounded are kept out of the public arena and do not result in negative publicity for either party or the franchise system as a whole.

Although the evidence put forward in submissions to the review sets out concerns in this area, the evidence is not persuasive enough to indicate a need for change. The findings of the Expert Panel in relation to confidentiality clauses are still sound and no significant evidence has been presented during this current view to suggest any change from the position taken by the Panel on this issue.

Franchisor attribution of legal costs to franchisees

Introduction

The Expert Panel reviewed attribution of legal costs as part of its inquiry into the five franchising behaviours. It stated that it:

...is aware that attribution of legal costs clauses can be found in a wide variety of industry and business agreements, and that there may be legitimate business reasons to include such a clause, which might be reflected for example in a lower franchise fee under the agreement. Consequently, the panel is hesitant to suggest that steps should be taken to prohibit or restrict such provisions in franchising, without fully understating the possible implications for the wider business community.⁴¹²

Evidence considered during the review

Many submissions to the current review believed that the 2010 amendment did not go far enough, and may even have had a negative impact on the position of franchisees. The VSBC cited examples of this in a number of franchise agreements, stating that:

To enable a fair and equitable mediation process to occur, it is unreasonable and unacceptable if one party's costs of initiating, participating and concluding the mediation are at the other's expense. Such an inequality may encourage the indemnified party to over utilise legal resources, as there is no or lowered cost disincentive to do so.⁴¹³

Other submissions concurred with the view that the Code should be changed to prevent a franchisor from passing on costs in a dispute situation in the absence of a court order:

⁴¹⁰ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 24.

⁴¹¹ Dr Jenny Buchan, submission to the review, p 6.

⁴¹² *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct* report, February 2010, p 69.

⁴¹³ Victorian Small Business Commissioner, submission to the review, p 8.

This amendment has resulted in a number of franchisors modifying their systems to require franchisees to pay such costs where previously the agreement was silent on the issue or the franchisor had been prepared to bear the cost. **This amendment has had an overall negative effect on franchisees and has increased the power imbalance between the parties in a dispute i.e. increased the financial disincentive for the franchisee to pursue a dispute.** The payment of legal or other dispute resolution costs should not be a matter for the franchise contract but reserved for a Court of competent jurisdiction. A presumption that each party should pay their own costs and contribute equally to third party costs (such as mediators) should be applied. This Disclosure should be removed as an inadequate response to the harm being experienced by franchisees in this area, and the Code should be changed to prevent a franchisor from passing on costs in a dispute situation in the absence of a Court Order.⁴¹⁴ (Emphasis added)

...I strongly believe that franchisors should bear their own cost of dispute resolution with franchisees. If they are not responsible for this cost they do not have the same motivation to resolve matters at the earliest possible point.⁴¹⁵

The intent of the Code under Part IV 31(2), whereby the parties are equally liable for the costs of dispute resolution unless they agree otherwise may be undermined by requiring consent to an alternative arrangement from the franchisee on entering the franchise relationship through inclusion of a relevant clause in the franchise agreement.⁴¹⁶

[Item13B] talks about costs of dispute resolution NOT Reimbursement of legal costs generally. Arguably it deals only with costs of dispute resolution that goes to mediation (as opposed to breach notices that do not go on to mediation under Part 4 of the Code). This is because Part 4 talks about resolving disputes and giving dispute notices rather than notices of breach issued under clause 21 that may not escalate to a notice of dispute under Part 4.⁴¹⁷

The section also does not provide for disclosure of every obligation under the franchise agreement or other documentation to reimburse for other legal costs such as for reimbursement for legal costs for a new grant of for documenting renewals, transfers, amendments requests for consent to a transfer that does not proceed or to a relocation or for other agreements such as leases occupancy agreements or other documents like charges and security agreements etc. It could have dealt with these as well to give meaningful disclosure. In many cases it is included in Item 13.6 but quite often it is general and limited to things such as costs of documenting grants, renewals and transfers or novations.⁴¹⁸

This issue was also said to extend to clauses mandating the jurisdiction for determination of franchising disputes:

A lot of franchise agreements I see require the franchisee to litigate any proceedings arising in the home state of the franchisor. I advise the prospective franchisee to negotiate an amendment to terms to allow them to litigate in their home territory, but again these matters are rarely negotiated. In most circumstances it is probably necessary to enact amendment legalisation or regulation to give franchisees the right to litigate and bring alternative dispute resolution proceedings in their home State, and that the laws of their home State govern the franchise. There is a simple justification for

⁴¹⁴ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 6.

⁴¹⁵ New South Wales Small Business Commissioner, submission to the review, p 5.

⁴¹⁶ Franchise Advisory Centre and Asia-Pacific Centre for Franchising Excellence at Griffith University, joint submission submission to the review, p 6.

⁴¹⁷ Derek Sutherland, submission to the review, p 10.

⁴¹⁸ Ibid.

this, namely, if a franchisor chooses to do business in a particular State, they should abide by that State's laws and submit to the jurisdiction of its courts.⁴¹⁹

Observations

Restricting the ability of franchisors to attribute the costs of dispute resolution unless by court order, would assist with reducing the costs of dispute resolution for franchisees and improve their access to justice. Requiring parties to mediate in the jurisdiction where the franchise is operated not only reduces the travel and other associated costs, but also ensures both parties know about other legislative and regulatory requirements that apply to them. These mechanisms are put forward as a more direct means of reducing the cost to franchisees of raising a dispute with their franchisor. It also helps to restore the power imbalance between franchisors and franchisees in resolving disputes and improve access to justice.

Recommendation

14. Amend the Code to ensure that franchisors cannot:
 - a. attribute the legal costs of dispute resolution to a franchisee unless ordered by a court;
 - b. require a franchisee to litigate outside the jurisdiction in which the franchisee's business primarily operates.

⁴¹⁹ Colin Dorrian, submission to the review, p 10.

Part Eight – Enforcement

Introduction

The Franchising Code of Conduct (the Code) is a mandatory industry code, made by regulation under the *Competition and Consumer Act 2010* (CCA).

Section 51AD of the *Competition and Consumer Act 2010* (CCA) states that a person ‘must not, in trade or commerce, contravene an applicable industry code’, including the Code. A breach of the Code is a breach of the CCA and the enforcement of the Code is through the CCA. This means that, as with the CCA, responsibility for enforcement of the Code lies with the Australian Competition and Consumer Commission (ACCC).

The Code is not, however, solely responsible for the regulation of the franchising industry. The conduct of parties to a franchise agreement is also subject to the Australian Consumer Law (ACL), the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001*, as well as the unwritten law.

This Part will set out the current enforcement framework, including the changes to enforcement made by the government in 2010. It will look at the evidence produced to the review that addresses the three main questions surrounding enforcement:

1. Should a court have the option of imposing a civil pecuniary penalty for a breach of the Code?
2. If so, should the ACCC be able to issue an infringement notices for a breach of the Code?
3. If so, should the same penalty apply to all breaches of the Code and what should that penalty be?

It will also examine the ACCC’s role in enforcement of the Code, which has been raised in a number of submissions.

The current enforcement framework

Policy considerations

As an industry code, the the Code does not contain enforcement provisions. This is based on the policy that industry codes, by their nature, are:

...co-regulatory measures, designed to achieve minimum standards of conduct in any industry where there is an identifiable problem to address. Industry codes can be used as an alternative to primary legislation in instances where a market failure has been identified.⁴²⁰

Further, industry codes are intended to be:

...complementary to general prohibitions on unfair practices that may occur in trade or commerce, and should encourage compliance and focus on remedies rather than simply seeking to punish contraventions.⁴²¹

⁴²⁰ See Commonwealth Treasury, *Policy Guidelines on Prescribing Industry codes under Part IVB of the Competition and Consumer Act 2010*, May 2011, p 3.

Enforcement legislation

As outlined above, the enforcement of the Code is through the enforcement provisions of the CCA. Where it determines that a party has breached section 51AD of the CCA a court can:

- order the payment of compensation for loss caused by the contravening conduct: section 82 of the CCA;
- grant an injunction that requires a party to do or stop doing an act: section 80 of the CCA;
- make remedial orders, such as an order voiding the whole or part of a contract; varying a contract; refusing to allow the enforcement of some provisions of the contract or requiring the payment of refunds and/or damages to the aggrieved party: section 87 of the CCA; and
- make non-punitive orders, such as a community service order, a probation order, a disclosure order and/or the publication of corrective advertisements: section 86C of the CCA.

A party can give the ACCC undertakings under section 87B of the CCA. These undertakings do not require the party to admit a breach of the CCA or the ACL and can be given in conjunction with court orders. However, the ACCC is not obliged to accept undertakings it is offered. Once an undertaking is accepted, it becomes enforceable at the option of the ACCC.

Alternatively, conduct that breaches the Code can be dealt with as a breach of other provisions of the ACL if it also contravenes that legislation. In that case, the conduct may result in a court imposing a civil pecuniary penalty. An example of conduct which breaches the Code and might also be dealt with as a breach of the ACL is where a disclosure document contains a false or misleading representation.

What this means is that, where a party engages in conduct that breaches both the Code and a provisions of the ACL, the ACCC has the option of taking legal proceedings against that party under the ACL and seeking an order for civil pecuniary penalties, if it is a contravention of a penalty provision.

The following table sets out the significant breaches of the ACL for which a pecuniary penalty can be applied.

Table of provisions of the Australian Consumer Law relevant to the Franchising Code of Conduct

Section	Provision
Part 2-1	Misleading or deceptive conduct
18	Prohibits a person, in trade or commerce, from engaging in misleading or deceptive conduct.

⁴²¹ See Commonwealth Treasury, *Policy Guidelines on Prescribing Industry codes under Part IVB of the Competition and Consumer Act 2010*, May 2011, p 9.

Part 2-2	Unconscionable conduct
20	Prohibits unconscionable conduct within the meaning of the unwritten law, from time to time.
21	Prohibits unconscionable conduct in connection with the supply of goods or services to a person.
Part 3-1	Unfair practices
29	Prohibits a person making a false or misleading representation in trade or commerce, about goods or services, including that: <ul style="list-style-type: none"> • goods are of a particular standard, quality, value, grade, composition, style or model or have had a particular history or particular previous use; • services are of a particular standard, quality, value or grade; • goods are new; • a particular person has agreed to acquire goods or services; • purports to be a testimonial by any person relating to goods or services; • goods or services have sponsorship, approval, performance characteristics, accessories, uses or benefits; and • the person making the representation has a sponsorship, approval or affiliation.
37	Prohibits a person engaging in misleading conduct in relation to ‘the profitability, risk or any other material aspect of any business activity’ that it has been represented can be carried on at home.

2010 amendments to the CCA

In 2008, the Joint Committee recommended the introduction of pecuniary penalties for a breach of the Code. It made this recommendation based on its view of the evidence before it that ‘the lack of pecuniary penalties for breaches of the Code means there is insufficient deterrence for conduct that contravenes the Code.’⁴²²

Additionally, recommendation 11 stated:

The committee recommends that the ACCC be given the power to investigate when it receives credible information indicating that a party to a franchising agreement, or agreements, may be engaging in conduct contrary to their obligations under the Franchising Code of Conduct.⁴²³

⁴²² Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 125.

⁴²³ Ibid.

It made this recommendation because it saw 'value in increasing the ACCC's powers to conduct proactive investigations, particularly in cases where franchisees fear retribution if they provide information directly to the regulator.'⁴²⁴

The government determined not to implement Recommendation 10 in relation to pecuniary penalties for breaches of the Code. It took the view that:

Industry codes are a more flexible form of regulation that, while not a substitute for direct legislation, involve industry, consumers and other stakeholders in a co-regulatory approach to problems identified in specific industries, including the franchising industry. In order to ensure that industry codes adequately address these problems, as outlined in this response, the Government will act to make their enforcement more effective.⁴²⁵

Its specific reason for rejecting the Joint Committee's recommendations was:

When a party to a franchise agreement fails to meet that minimum standard [of fairness], and the other party suffers as a result, it is appropriate that the law provide a mechanism for the wronged party to achieve redress. This redress can be achieved through the payment of compensation or the rectification of contravening conduct.⁴²⁶

However, in 2010 the government introduced a range of amendments to the enforcement powers and remedies available to the ACCC under the CCA that affected the enforcement of the Code, including adopting the intent of the Joint Committee's recommendation around improving the ACCC's investigation powers. The package of measures adopted as part of the government response included giving the ACCC the power to:

- issue substantiation notices that require a person to provide 'information and/or produce documents that could be capable of substantiating or supporting a claim or representation made by the person';
- randomly audit parties bound by industry codes for non-compliance with the applicable code;
- apply for civil pecuniary penalties in response to certain breaches of the CCA and the ACL, including unconscionable conduct and false or misleading representations, with maximum penalties of \$1.1 million for corporations and \$220 000 for individuals;
- apply to a court for an order providing redress to all affected franchisees, without requiring every franchisee to be party to the legal proceeding; and
- issue a public warning notice alerting the public to conduct which may be in breach of certain provisions of the ACL, where it has 'reasonable grounds to suspect' that a party has contravened the Code and it is 'satisfied that one or more persons has suffered, or is likely to suffer, detriment as a result of the conduct (and) it is in the public interest to do so'.

⁴²⁴ See Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, pp 124-125.

⁴²⁵ See [Government Response to the Joint Committee Report](#), November 2009, p 10.

⁴²⁶ See [Government Response to the Joint Committee Report](#), November 2009, p 11.

The issues

There are three key enforcement options that apply to a contravention of the CCA or the ACL that do not also apply to a breach of the Code:

- the imposition of a civil pecuniary penalty by a court;
- the issue of an infringement notice by the ACCC; and
- a court order disqualifying a person from acting as a director of a corporation.

The terms of reference for the present review address the enforcement provisions of the CCA as they relate to enforcement of the Code generally. In practice, the question of whether the enforcement provisions of the CCA are adequate to the needs of franchisees in the current environment is looked at as a series of questions:

1. Should a court have the option of imposing a civil pecuniary penalty for a breach of the Code?
2. If so, should the ACCC be able to issue an infringement notices for a breach of the Code?
3. If so, should the same penalty apply to all breaches of the Code and what should that penalty be?
4. What other enforcement options can be utilised in relation to breaches of the Code?

Evidence considered during the review

Should a court have the option of imposing a civil pecuniary penalty for a breach of the Code?

Arguments for pecuniary penalties

The main argument in favour of allowing a court to impose a pecuniary penalty for a breach of the Code is that it would improve compliance with the Code by franchisors, and act as a deterrent to breaches by franchisors. It is sufficient to quote from just one submission which is representative of this viewpoint:

...further protection for franchisees... in the form of civil penalties for breaches of the Code should be considered. Such penalties would further act as a deterrent and ensure full compliance with the Code, acting as another means to discourage opportunistic and unethical conduct in the franchising sector.⁴²⁷

The ACCC stated that it receives complaints of Code breaches and franchise systems being operated as licensing or distribution arrangements, with franchisors arguing the Code does not apply to them. It further stated that the lack of civil pecuniary penalties means there is little to deter franchisors from continuing to engage in this conduct. The ACCC submits that the amount of any penalty would be a matter for the court, proportionate to the seriousness of the conduct.⁴²⁸

⁴²⁷ Don Randall MP, submission to the review, pp 1-2.

⁴²⁸ Australian Competition and Consumer Commission, submission to the review, p 6.

Michael Terceiro, a legal practitioner with experience as a Director of Enforcement at the ACCC, argued that the willingness and ability of the ACCC to enforce the Code would be 'significantly enhanced' if it had access to civil pecuniary penalties and that increased successful actions by the ACCC will lead to increased general deterrence.⁴²⁹

Some submissions indicated that the need for a deterrent is emphasised by the difficulty franchisees have in taking legal action against a franchisor in relation to a breach of the Code. Concerns about the operation of the legal system were articulated by the Hon Adam Searle MLC:

The law continues to assume that the commercial landscape is populated only with legally sophisticated parties dealing with one another as equals. The reality is often otherwise, with the small business operator being in reality a sole trader, or a mum or dad or family operation.⁴³⁰

These observations, he felt, applied particularly to franchising:

Often these behaviours [unfair practices] are not illegal or contrary to any commercial contract they have entered into and often is not the kind that is susceptible to remedy under existing laws...Even where it does breach those legislative regimes, franchisees lack the capacity to enforce the law due to knowledge or financial constraints.⁴³¹

A number of other submissions from franchisees and former franchisees referred to their own difficulties in taking action over breaches of the Code. A former franchisee, Aleksandar Trajceski, stated:

There must be more serious consequences to obvious breaches of the law. In most cases pecuniary penalties are the only option with the desired affect. It should not be discounted just because it may put additional strain on the franchise system. The intended message should be that if you make a serious breach or consistent breaches then you should pay a price for such conduct. Franchisees in the system have shown their confidence and approval in their management team by the fact they invested all their money in them. Any penalty imposed should have a deterrent effect.⁴³²

Another former franchisee stated that a franchisee has to be able to afford to lose \$100 000 before they can take legal action and '[If] you cannot do that and the ACCC will not take action, where do you go for justice.'⁴³³

A former franchisee, and lawyer with experience in franchising, Colin Dorrian, put the position this way:

When franchise abuses occur, franchisees have little choice but to look to organisations such as the ACCC to protect their rights. However, the ACCC has a poor reputation for enforcing what little franchise regulation there is in Australia. The fact is that all of the remedies that a private litigant can

⁴²⁹ Terceiro Legal Consulting Pty Ltd, submission to the review, p 4.

⁴³⁰ The Hon Adam Searle MLC, Small Business Commissioner and Small Business Protection Bill 2012, Second Reading speech, p 14303.

⁴³¹ The Hon Adam Searle MLC, *ibid*, p 14304.

⁴³² Aleksandar Trajceski, submission to the review, p 3.

⁴³³ Confidential submission to the review.

seek from a court are fine, but if you cannot afford to see a lawyer let alone issue court proceedings, it is pretty pointless.⁴³⁴

Industry body, the Franchising Council of Australia (FCA), also indicated that it 'would support the inclusion of a small number of explicit penalties for specific breaches of the Code'.⁴³⁵ This represents a change from the position put forward in its submission to the Joint Committee, which stated:

The FCA does not support the amendment of the *Trade Practices Act 1974* to prescribe penalties for breaches of the Franchising Code of Conduct. The ACCC may currently take action at any time against a franchisor for non-compliance with the Code, including seeking court enforceable undertakings, injunctions or court orders and declarations. The Trade Practices Act provides for further powerful remedies in relation to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct.⁴³⁶

Support for pecuniary penalties as a general proposition came from a franchisor also:

Not just in relation to disputes, but in a general sense, McDonald's supports the introduction of civil penalties for breaches of the Code. Such penalties should apply only to serious or wilful breaches of the Code and they should apply equally to franchisors and franchisees.⁴³⁷

A joint submission to the review from the Franchise Advisory Centre and the Asia-Pacific Centre for Franchising Excellence (APCFE) stated that 'the introduction of financial penalties for breaches of the Code may assist to deter franchisors from non-compliant behaviour.' It is noted that the Franchising Advisory Centre's submission to the 2008 Joint Committee stated that it supported 'the existing legislative and enforcement framework in place for the Franchising Code of Conduct'⁴³⁸. The APCFE did not comment on enforcement issues in its submission to the 2008 Joint Committee.

Arguments against pecuniary penalties

One of the main arguments against the introduction of pecuniary penalties put to the review is that there are already adequate enforcement options available for a breach of the Code.

For example, although it accepts that some level of pecuniary penalties are appropriate for a limited number of breaches of the Code, the FCA pointed to a number of options available to businesses to address breaches of the Code, including complaints to the ACCC and state and Commonwealth small business commissioners; mediation; its own member standards process; media involvement and the use of blogs and internet forums.⁴³⁹

This is a similar view to the one that '[there] is no cause for regulatory intervention when there is a lack of evidence of overwhelming franchising disputes in the areas of good faith or end of term

⁴³⁴ Colin Dorrian, submission to the review, p 11.

⁴³⁵ Franchising Council of Australia, submission to the review, p 21.

⁴³⁶ Franchising Council of Australia, Submission No. 103 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Franchising Code of Conduct, p 23.

⁴³⁷ McDonald's Australia Limited, submission to the review, p 12.

⁴³⁸ Franchise Advisory Centre, Submission No. 132 to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Franchising Code of Conduct, p 9.

⁴³⁹ Franchising Council of Australia, submission to the review, p 22. See also Yum! Restaurants Australia Pty Limited, submission to the review, p 9; DLA Piper, submission to the review, pp 7-8; Federal Chamber of Automotive Industries, submission to the review, pp 9-10.

arrangements⁴⁴⁰, an opinion expressed in a number of submissions. The argument against penalties generally relies upon the following claims:

- the percentage decreases in complaints and enquiries over time concerning franchising matters to the ACCC;
- the small number of proceedings by the ACCC against franchisors, particularly alleging breaches of the Code; and
- the relatively small number of franchising disputes reported in *Franchising Australia 2012*.⁴⁴¹

Other reasons for opposing the introduction of pecuniary penalties for a breach of the Code cited in various submissions include:

- it would be inconsistent with the government's stated policy on industry codes;⁴⁴²
- pecuniary penalties may have an adverse effect on the franchisor and the franchise system as a whole;⁴⁴³
- 'penalties (whether it be for breach of disclosure obligations or otherwise) may prove counterproductive and may fail to enhance best franchising practice';⁴⁴⁴ and
- compliance with the Code might be boosted by reducing the burden on franchisors, rather than the imposition of penalties for breaches of the Code.⁴⁴⁵

Some submissions, though not supportive of the introduction of pecuniary penalties, contended that, if pecuniary penalties were to be introduced, there needs to be greater precision in the Code before penalties could be imposed, pointing to inadequacies in the definitions of a franchise agreement and a motor vehicle, as well as the scope of a franchise agreement.⁴⁴⁶

Statistical information

The *Franchising Australia 2012* report, published by APCFE, estimated the proportion of franchisees in dispute with their franchisor in 2011 as 1.5 per cent. This figure has remained relatively constant over the last decade.⁴⁴⁷

The ACCC's submission indicated that it has taken successful court action against more than 20 franchisors and received court enforceable undertakings under section 87B of the CCA from more

⁴⁴⁰ McDonald's Australia Limited, submission to the review, p 5.

⁴⁴¹ *Franchising Australia 2012*, Asia-Pacific Centre for Franchising Excellence, submission to the review, p 13.

⁴⁴² Australian National Retailers Association, submission to the review, p 14; Minter Ellison, submission to the review, p 9.

⁴⁴³ Real Estate Institute of Australia, submission to the review, pp 5-6.

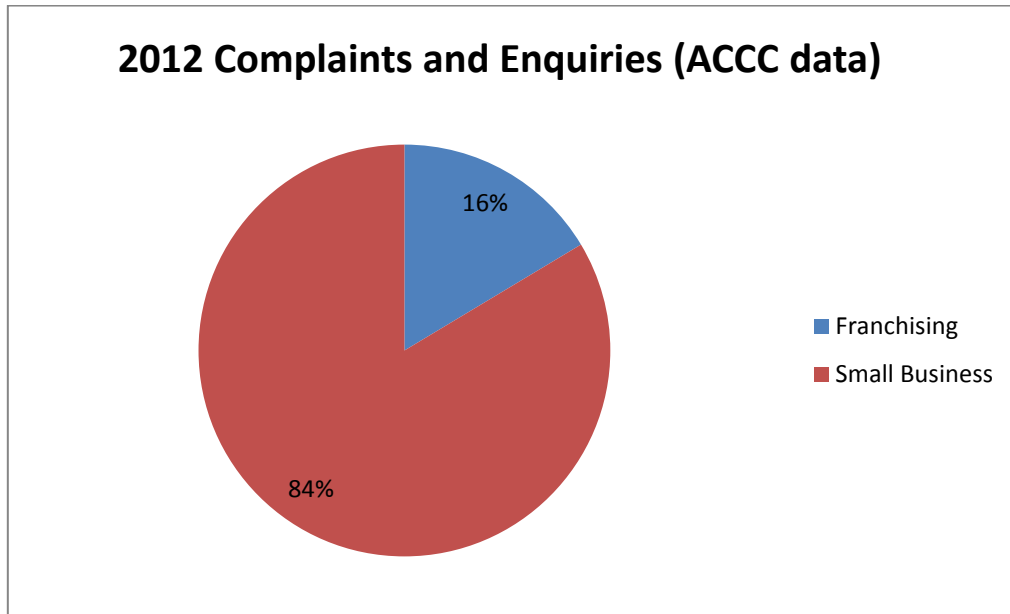
⁴⁴⁴ Queensland Law Society, submission to the review, p 20.

⁴⁴⁵ Avis Budget Group, submission to the review, p 6.

⁴⁴⁶ Competition and Consumer Committee, Business Law Section, Law Council of Australia, submission to the review, p 23. See also, Queensland Law Society, submission to the review, p 17 and Jani-King Australia Pty Ltd, submission to the review, p 8.

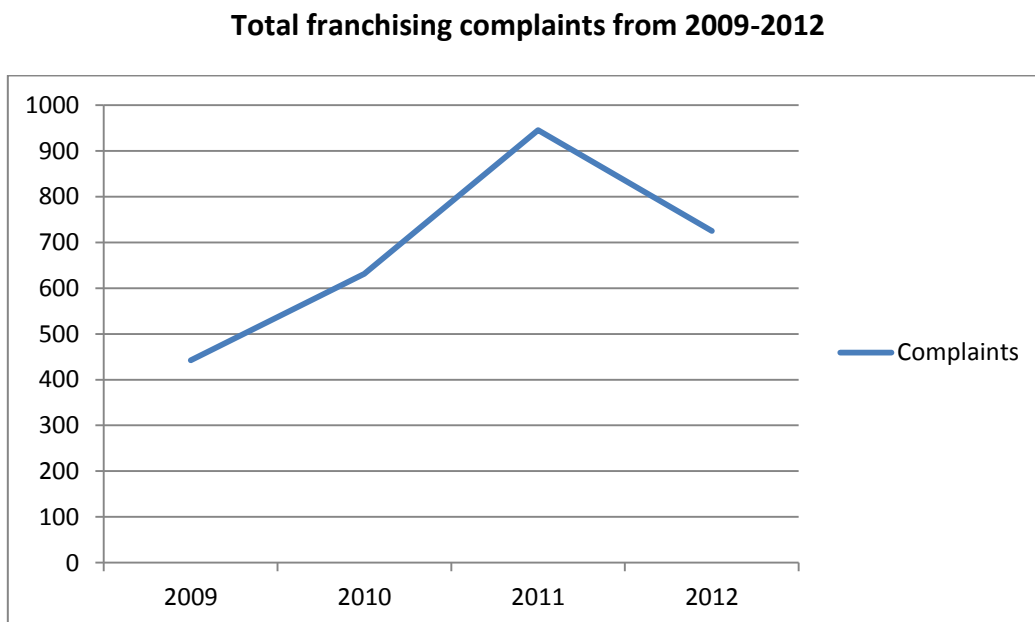
⁴⁴⁷ *Franchising Australia 2012*, Asia-Pacific Centre for Franchising Excellence, p 13.

than ten franchisors.⁴⁴⁸ Its statistical research shows that 16 per cent of all small business-related complaints and enquiries it received concerned the franchising industry and that the total number of franchising-related complaints has been dropping recently.



Source: Australian Competition and Consumer Commission, submission to the review.

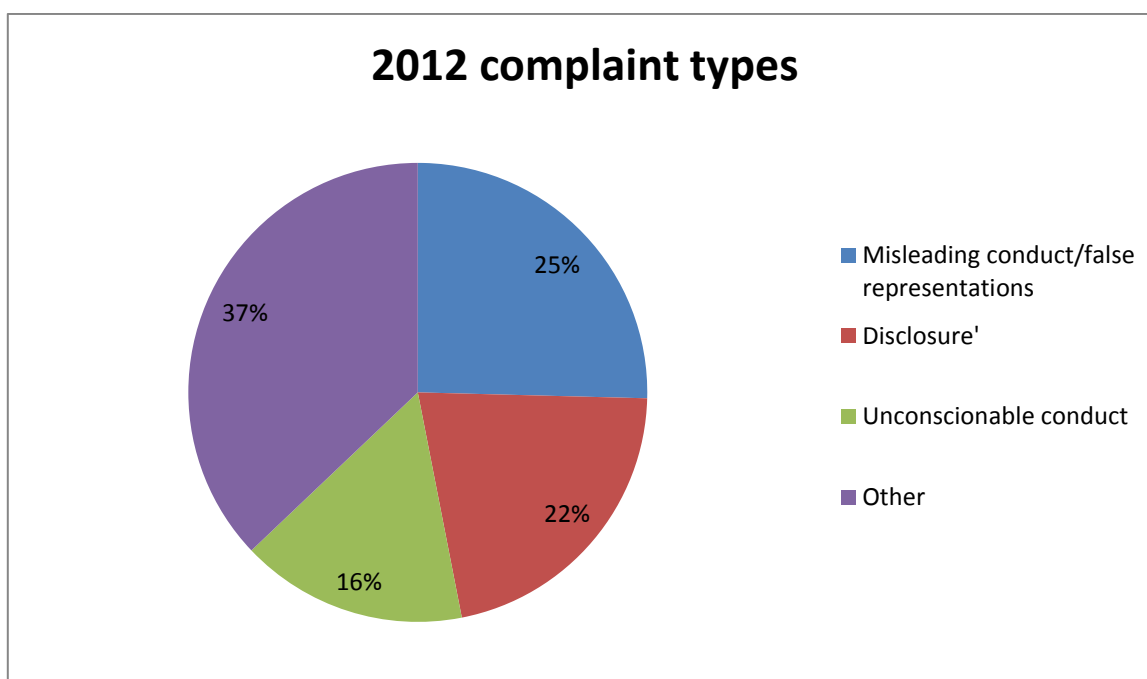
Franchising complaints as a whole decreased over the last year:



Source: Australian Competition and Consumer Commission, submission to the review, Figure 1, p 2. Figures are approximate.

⁴⁴⁸ Australian Competition and Consumer Commission, submission to the review, p 4.

Statistics produced as part of the ACCC's submission to the review showed that:



Source: Australian Competition and Consumer Commission, submission to the review.

Issues raised in complaints received by the ACCC:⁴⁴⁹

	For the period March 2008-June 2010		For the period 1 July 2010-31 December 2012	
Issue	Total	Percentage of total issues raised (Rounded up)	Total	Percentage of total issues raised (Rounded up)
Code	281	21.19	478	23.81
CCA	613	46.22	639	31.38
Contract	297	22.39	544	27.10
Other	135	10.18	346	17.23
TOTAL	1 326 Issues (1 109 complaints)		2007 issues (1 937 complaints)	

Source: Australian Competition and Consumer Commission, submission to the review, Figure 2, pp 2-3.

The ACCC served 33 audit notices on franchisors, with the vast majority found to be in compliance with the Code.⁴⁵⁰

⁴⁴⁹ Some complaints raised multiple issues. The percentage figures represent the number of separate issues raised in complaints in this period.

It is noted that complaints to the ACCC about franchisor conduct do not appear to primarily relate to breaches of the Code.⁴⁵¹

The ACCC's January 2013 *Small Business in Focus* report states that it audited 13 franchisors in the six months to 31 December 2012, and that the majority were found to be complying with the Code. It is noted for comparison that *Franchising Australia 2012* estimated that there are around 1 180 franchise systems in Australia.⁴⁵²

Franchising Australia 2012 also indicated that:

Substantial disputes (those referred to an external advisor for action) were reported by 18 percent of franchisors, who were in dispute with an average of two franchisees. Hence, across the sector the proportion of franchisees in dispute with their franchisor was estimated at 1.5 percent.⁴⁵³

The Queensland Law Society argued that the statistics do not indicate the need for further regulatory intervention in the franchising sector.⁴⁵⁴

The ACCC's enforcement of the Code

In commenting on the enforcement of the Code, submissions to the review included frequent reference to the efficacy of the ACCC as the regulatory body in the franchising industry. This goes to the question of whether the ACCC needs additional enforcement tools, such as pecuniary penalties, or whether there is simply a need for better utilisation of existing tools.

Evidence considered during the review

A confidential submission made on behalf of a group of franchisees commented:

We have been told the ACCC has collected a history of complaints against our Franchisor and yet nothing effective seems to be done to bring the Franchisor into line. How many breaches have to occur before we see the ACCC require the franchisor to take remedial action?⁴⁵⁵

Other submissions outline that it appears to them that the ACCC may be under resourced to conduct the number of investigations necessary for it to effectively conduct its regulatory role.⁴⁵⁶

Derek Sutherland observed that '[g]reater allocation of human and financial resources to the ACCC could assist to implement improvements to compliance.'⁴⁵⁷

Franchisees have also called for increased resources for the ACCC so they can conduct more thorough investigations. One submission from a former franchisee, Aleksandar Trajceski, stated:

⁴⁵⁰ Australian Competition and Consumer Commission, submission to the review, p 4.

⁴⁵¹ See ACCC [Small Business, Franchising and Industry Codes Half Yearly Report \(July – Dec 2012\)](#). Note the *Franchising Australia 2012* survey (see below) suggests that 'compliance with the system' is the cause of 46 per cent of disputes (p 61). It is not clear from this survey whether 'compliance with the system' is equivalent to compliance with the Code.

⁴⁵² See ACCC [Small Business, Franchising and Industry Codes Half Yearly Report \(July – Dec 2012\)](#).

⁴⁵³ *Franchising Australia Survey 2012*, p 13.

⁴⁵⁴ Queensland Law Society, submission to the review, p 21; DLA Piper, submission to the review, p 8.

⁴⁵⁵ Confidential submission to the review.

⁴⁵⁶ Examples include The Hon Judi Moylan, submission to the review, p 4, Franchising Advisory Centre and Griffith University, submission to the review, p 17, and confidential submission to the review.

⁴⁵⁷ Derek Sutherland, submission to the review, p 34.

More ACCC representatives are needed for adequate enforcement. At present, the ACCC seldom comes in contact with the franchisee whom has intimate knowledge of his own complaint. If maybe the ACCC representative can interview the complainant or complainants, then he is in the position to decide whether more serious action should be taken against the alleged offenders.⁴⁵⁸

Despite this, there were a number of stakeholders in the industry who believe current regulation is proving effective. In its submission law firm DLA Piper cite the relatively low level of dispute in franchising and the fact franchising was not identified as a 'key area of focus in the medium term' by the ACCC chairman Rod Sims in the ACCC's 2011-2012 Annual Report.⁴⁵⁹

Additionally, the Competition and Consumer Committee, Business Law Section of the Law Council of Australia (LCA) stated:

Despite complaints by franchisees, it is unclear that significant breaches of the Code and ACL are occurring...Over sixty five percent of franchising complaints made to the ACCC related to non Code related issues...for which penalties are available.⁴⁶⁰

It would appear from the ACCC's submission that it has not initiated court action against a franchisor relevant to the franchisor-franchisee relationship since July 2011.

There were also concerns regarding the level of understanding that those in the industry have of the role of the ACCC.⁴⁶¹ Dr Elizabeth Spencer and Simon Young observed:

...the ACCC is often used as a 'complaints ombudsman' where (usually) a franchisee has no other options to pursue apart from expensive and uncertain litigation. This is not the ACCC's role, however, as the industry watchdog it is expected to deal with all dissatisfaction experienced by franchise participants where no other remedy has availed.⁴⁶²

The ACCC states its main goals in enforcing compliance with provisions of the CCA are to maintain and promote competition and remedy market failure, and protect the interests and safety of consumers and support fair trading in markets.⁴⁶³

The ACCC states it:

...cannot pursue all the complaints it receives about the conduct of traders or businesses and the ACCC is unlikely to become involved in resolving individual consumer or small business disputes. While all complaints are carefully considered, the ACCC's role is to focus on those circumstances that harm the competitive process or result in widespread consumer detriment. The ACCC therefore exercises its discretion to direct resources to the investigation and resolution of matters that provide the greatest overall benefit for competition and consumers.⁴⁶⁴

⁴⁵⁸ Aleksandar Trajceski, submission to the review, p 12.

⁴⁵⁹ DLA Piper, submission to the review, p 8.

⁴⁶⁰ Competition and Consumer Committee, Business Law Section, Law Council of Australia, submission to the review, p 17.

⁴⁶¹ Dr Elizabeth Spencer & Mr Simon Young, submission to the review, p 27.

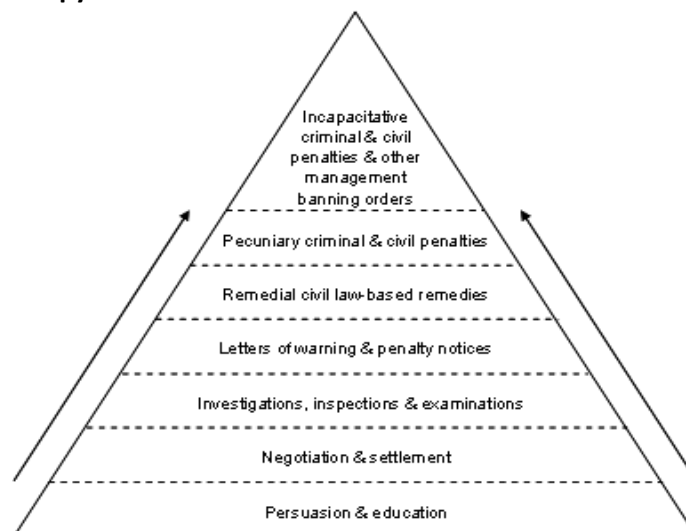
⁴⁶² Ibid.

⁴⁶³ See Australian Competition and Consumer Commission, *Compliance and Enforcement Policy*, 20 February 2013.

⁴⁶⁴ Ibid.

The ACCC's enforcement policy broadly follows the standard outline of the regulatory enforcement framework. This is outlined in the Australian Government's Productivity Commission Issues Paper released in early 2013 (see below).⁴⁶⁵

Regulatory enforcement pyramid



Appendix I (ACCC Compliance and enforcement strategy) to this report details the ACCC's compliance policy in its entirety.

The ACCC has recommended two measures to improve its capacity to enforce the Code:

- the introduction of civil pecuniary penalties and infringement notices as remedies for breaches of the Code; and
- an increase in the audit powers of the ACCC to allow it to better assess the level of franchisor compliance with the Code.⁴⁶⁶

Should infringement notices be available as a remedy for a breach of the Code?

Introduction

Some submissions address the question of whether infringement notices should also apply to breaches of the Code.

Section 134A of the CCA provides that where the ACCC has reasonable grounds to believe a person has contravened certain provisions of the ACL, including those relating to false or misleading representations about business activities and unconscionable conduct, it can issue the person with an infringement notice. The recipient of the notice can choose to pay the amount specified in it. Payment of the notice prevents further action being taken by the ACCC in relation to the same conduct. If the notice is not paid, the ACCC has the option of taking the recipient to court in relation to the substantive breach of the ACL. The main difference between a pecuniary penalty and an infringement notice is that a pecuniary penalty is imposed by a court, whereas an infringement notice can be issued by the ACCC without the involvement of the courts. For this reason, the amount

⁴⁶⁵ See Productivity Commission, *Regulator Engagement with Small Business: Issues Paper*, January 2013, p 7.

⁴⁶⁶ Australian Competition and Consumer Commission, submission to the review, p 7.

payable under infringement notices is usually much less than might be awarded by a court when ordering a pecuniary penalty.

The CCA further states that payment of an infringement notice is not an admission by the recipient that they have breached the ACL. The penalty amount in an infringement notice will vary, depending on the alleged contravention, but in most cases is fixed at \$6600 for a corporation (or \$66 000 for a listed corporation) and \$1320 for an individual for each alleged contravention.

Presently, the ACCC cannot issue an infringement notice for a breach of the Code.⁴⁶⁷

Evidence considered during the review

The ACCC, as the industry regulator, has argued that it should be able to issue infringement notices, in addition to being able to seek pecuniary penalties, for a breach of the Code:

The availability of infringement notices for Code breaches would also allow the ACCC to quickly and efficiently address certain types of breaches.

For example, the ACCC receives many complaints from franchisees alleging that they received an inaccurate or incomplete disclosure document from their franchisor. While many of these complaints can be resolved administratively (court action would usually be excessive), the payment of an infringement notice in these circumstances would make the matter public and would act as a deterrent to other franchisors.⁴⁶⁸

The South Australian Small Business Commissioner, in his submission, pointed out that the *Fair Trading Act 1987 (SA)* allows for the issuing of the equivalent of an infringement notice, a 'civil expiation notice'. The intention of such notices is to deter breaches of mandatory codes but also provide a cost effective and quick way of dealing with alleged breaches. The legal effect of 'expiation' is similar to that of an infringement notice. Expiation fees can be up to \$6000 for a company or \$1200 for an individual. It is noted that no industry codes have been established under the *Fair Trading Act 1987 (SA)*, at the time of writing.

The LCA stated that, in addition to its general objections to the inclusion of civil pecuniary penalties for a breach of the Code, it is 'generally opposed to the use of infringement notices... because they effectively reverse the onus of proof and thereby risk undermining fundamental principles of justice.'⁴⁶⁹

One concern with allowing the ACCC to issue infringement notices for a breach of the Code is that it may issue multiple notices for similar conduct. In this regard, the FCA stated:

The ACCC would also need to publish clear enforcement guidelines so that the sector knew the potential consequences of its actions, and there was some rigour around enforcement activities that could be open to abuse. In this context we have heard of the ACCC "bundling" Infringement Notices, meaning that they issue multiple Infringement Notices for essentially a single breach. A \$1,000 Infringement Notice for failing to include certain important information in a disclosure document

⁴⁶⁷ For more information see Australian Competition and Consumer Commission, *Infringement notices - Guidelines on the use of infringement notices*, 16 October 2012.

⁴⁶⁸ Australian Competition and Consumer Commission, submission to the review, p 6.

⁴⁶⁹ Competition and Consumer Committee of the Business Law Section of the Law Council of Australia, submission to the review, p 24.

might seem reasonable and appropriate, but not if the ACCC issues one Infringement Notice for every affected franchisee.⁴⁷⁰

This is of particular concern in the franchising industry where a breach concerning a disclosure document, for example, could be repeated throughout the entire system. The LCA felt that this 'is not, in the Committee's view, an intended outcome of the infringement notice remedy, being the imposition of a penalty through an administrative process rather than through the courts' and would be 'undesirable from the point of view of certainty and proportionality.'⁴⁷¹

The LCA also stated a further objection to infringement notices:

...there must be clear direction issued to the regulator in the legislation that the issue of such a notice cannot be accompanied by the regulator extracting an enforceable undertaking in relation to the matter under dispute under the relevant legislation, for to do so undermines immediately the assertion by the Government that the issue of an infringement notice does not carry with it an implication of guilt on the part of the person to whom the notice is issued.⁴⁷²

The ACCC addressed these concerns in its supplementary submission to the review:

The ACCC may issue multiple infringement notices where it considers it appropriate to do so, taking into account all of the circumstances. In deciding whether to issue more than one infringement notice, the ACCC takes into account a range of considerations including:

- whether the ACCC believes that there have been multiple contraventions of infringement notice provisions where the contraventions have occurred in a number of states or territories;
- where the contraventions have involved the use of different types of media, such as online, television, radio, magazines and newspapers, outdoor advertising; and
- whether there are circumstances which make it desirable to issue multiple notices to deter similar conduct by the specific business involved or the broader industry.⁴⁷³

Should the same penalty apply to any breach of the Code for which it has been determined a penalty could be imposed?

Many of the submissions that support the introduction of pecuniary penalties for a breach of the Code have not discussed whether they should apply to any breach or only to some.

The FCA did address this question, tempering its support for the introduction of civil pecuniary penalties by stating that it:

...would support the inclusion of a small number of explicit penalties for specific breaches of the Code, notably:-

- (1) failure to prepare a disclosure document - \$30 000;

⁴⁷⁰ Franchising Council of Australia, submission to the review, p 5.

⁴⁷¹ Competition and Consumer Committee of the Business Law Section of the Law Council of Australia, submission to the review, pp 21 and 25.

⁴⁷² Competition and Consumer Committee of the Business Law Section of the Law Council of Australia, submission to the review, p 25.

⁴⁷³ Australian Competition and Consumer Commission, submission to the review, p 6.

(2) failure to update a disclosure document - \$5000; and

(3) failure to provide a disclosure document to a prospective franchisee - \$2000.⁴⁷⁴

Other submissions suggested there should be some limit on the breaches for which a pecuniary penalty could be imposed, including:

If penalties are introduced, they should be balanced, not apply to technical breaches or situations where no loss was suffered. It must not be a 'strict liability' system.⁴⁷⁵

Financial penalties are required for clear breaches of the Code but would not be appropriate for more subjective breaches.⁴⁷⁶

The Society strongly opposes the introduction of penalties for breaches, however if penalties were to be introduced... the provisions for the penalties would need to be very clear about when they are to apply and be commensurate⁴⁷⁷ with the breach so that a small breach did not lead to a large penalty.⁴⁷⁸

Enforcement of the Code should be aimed at encouraging compliance, not punishment. However, a civil pecuniary penalty or expiation should be available in relation to a breach of a duty of good faith.⁴⁷⁹

...the Franchising Code should impose reasonable and appropriate penalties for specific and blatant breaches.⁴⁸⁰

The ACCC was also alert to the argument, stating 'the amount of the penalty should be proportionate to the seriousness of the conduct, and that this would be determined by the court.'⁴⁸¹

The question of the potential effect of large pecuniary penalties on franchisors, and its flow on effects on the franchise system more generally, was addressed by the Hon Adam Searle MLC:

[The] fact there are not pecuniary penalties specifically for breaching the Code is an impediment to its effectiveness...While the imposition of large penalties on a franchisor may have the potential to affect the viability of the business, the level of penalty imposed in any given instance is a matter for a court and the financial position of a franchisor would be a factor relevant to deciding the level of any penalty.⁴⁸²

How should pecuniary penalties be calculated?

Pecuniary penalties for breaches of the CCA or ACL are imposed by the court on the application of the ACCC. The ACCC seeks orders from the court, including pecuniary penalties, in accordance with its Compliance and Enforcement Policy⁴⁸³, which is reviewed annually and published on its

⁴⁷⁴ Franchising Council of Australia, submission to the review, pp 21-22.

⁴⁷⁵ Jani-King (Australia) Pty Ltd, submission to the review, p 8.

⁴⁷⁶ Tim Hantke (Franchising Solutions), submission to the review, p 14.

⁴⁷⁷ Jani-King (Australia) Pty Ltd, submission to the review, p 8.

⁴⁷⁸ Queensland Law Society, submission to the review, p 21.

⁴⁷⁹ Law Society of South Australia, submission to the review, p 21.

⁴⁸⁰ Law Institute of Victoria, submission to the review, p 8.

⁴⁸¹ Australian Competition and Consumer Commission, submission to the review, p 6.

⁴⁸² The Hon Adam Searle MLC, submission to the review, p 9.

⁴⁸³ See Appendix G: ACCC Compliance and Enforcement Policy.

website.⁴⁸⁴ Under the policy, the ACCC gives enforcement priority to matters that demonstrate one or more of the following factors:

- conduct of significant public interest or concern;
- conduct resulting in a substantial consumer (including small business) detriment;
- unconscionable conduct, particularly involving large national companies or traders;
- conduct demonstrating a blatant disregard for the law;
- conduct involving issues of national or international significance;
- conduct detrimentally affecting disadvantaged or vulnerable consumer groups;
- conduct in concentrated markets which impacts on small business consumers or suppliers;
- conduct involving a significant new or emerging market issue;
- conduct that is industry-wide or is likely to become widespread if the ACCC does not intervene;
- where ACCC action is likely to have a worthwhile educative or deterrent effect; and/or
- where the person, business or industry has a history of previous contraventions of competition, consumer protection or fair trading laws.

It has prioritised the following areas of its work, relevant to the franchising industry:

- online competition and consumer issues including conduct which may impede emerging competition between online traders or limit the ability of small businesses to effectively compete online;
- competition and consumer issues in highly concentrated sectors, in particular in the supermarket and fuel sectors;
- credence claims, particularly those in the food industry with the potential to have a significant impact on consumers or the competitive process;
- misleading carbon pricing representations;
- the ACL consumer guarantees regime; and
- consumer protection issues impacting on Indigenous consumers.

⁴⁸⁴ See Australian Competition and Consumer Commission, *Compliance and Enforcement Policy*, 20 February 2013.

In its supplementary submission to the review, the ACCC outlined its approach to seeking pecuniary penalties:

In general terms, legal proceedings are taken where, having regard to all the circumstances, the ACCC considers litigation is the most appropriate way to achieve its enforcement and compliance objectives. The ACCC is more likely to proceed to litigation in circumstances where the conduct is particularly egregious (having regard to the factors set out in its Compliance and Enforcement Policy), where there is reason to be concerned about future behaviour, or where the party involved is unwilling to provide a satisfactory alternate resolution to the matter.

Where contraventions of the CCA are alleged to have occurred, and those contraventions attract a civil pecuniary penalty, the ACCC ordinarily seeks civil pecuniary penalties where those matters proceed to court. This approach is appropriate as matters that proceeded to litigation are the more significant issues arising from alleged non-compliance with the law. Civil penalties are designed to provide general and specific deterrence.⁴⁸⁵

After having determined that a trader has contravened a provision of the CCA or the ACL that carries a pecuniary penalty, it remains a matter for the court to decide whether a penalty is appropriate and the quantum of that penalty.

The judgment of Justice Perram in *Australian Competition and Consumer Commission v Singtel Optus Pty Ltd (No 4)* is most instructive in terms of explaining how the court will generally approach the task of calculating the appropriate civil penalty to impose in a consumer protection case under the ACL.⁴⁸⁶ The factors he outlined include:

1. the size of the contravening company;
2. the deliberateness of the contravention and the period over which it extended;
3. whether the contravention arose out of the conduct of senior management of the contravener or at some lower level;
4. whether the contravener has a corporate culture conducive to compliance with the CCA or the ACL, as evidenced by educational programmes and disciplinary or other corrective measures in response to an acknowledged contravention;
5. whether the contravener has shown a disposition to co-operate with the authorities responsible for the enforcement of the CCA in relation to the contravention;
6. whether the contravener has engaged in similar conduct in the past;
7. the financial position of the contravener;
8. whether the contravening conduct was systematic, deliberate or covert;
9. the effect of the contravening conduct on a functioning market together with any other economic effects of the contravening conduct; and

⁴⁸⁵ Australian Competition and Consumer Commission, supplementary submission to the review, p 6.

⁴⁸⁶ *Australian Competition and Consumer Commission v Singtel Optus Pty Ltd (No 4)*, [2011] FCA 761.

10. the degree of market power of the contravener as evidenced by its market share and the ease of entry into the market.

ACCC audit powers

Introduction

Section 51ADD of the CCA states:

- (1) This section applies if a corporation is required to keep, to generate or to publish information or a document under an applicable industry code.
- (2) The Commission may give the corporation a written notice that requires the corporation to give the information, or to produce the document, to the Commission within 21 days after the notice is given to the corporation.
- (3) The notice must:
 - (a) name the corporation to which it is given; and
 - (b) specify:
 - (i) the information or document to which it relates; and
 - (ii) the provisions of the applicable industry code which require the corporation to keep, to generate or to publish the information or document; and
 - (c) explain the effect of sections 51ADE, 51ADF and 51ADG.
- (4) The notice may relate to more than one piece of information or more than one document.

The government explained its reason for inserting the provision in its response to the Joint Committee Report:

At present, franchisees wishing to complain about franchisors not complying with the Franchising Code may fear reprisal from franchisors. The ACCC's random audit powers will strengthen franchisor compliance with the Franchising Code, while relieving franchisees of the fear of retaliation against them for complaining to the ACCC about franchisor behaviour.⁴⁸⁷

The ACCC will be given the power to request copies of documents or other information from persons subject to an industry code. The ACCC will not be required to have any belief about compliance with the Franchising Code before conducting an audit. To minimise compliance costs, the power will be restricted to information that is required to be kept under a prescribed industry code. For example, the ACCC will be able to request a franchisor to produce a copy of its disclosure document. The Franchising Code provides that such a document must be kept, and allowing the ACCC to request copies of disclosure documents, at random, will enable it to ensure compliance with the Code's obligations. The ACCC's random audit powers will also relieve franchisees of the risk of retaliation against them for complaining to the ACCC about franchisor behaviour.

Where the documents obtained by the ACCC uncover information that justifies further investigation, the ACCC will be able to use its existing and additional investigative powers (for example, its power to obtain information, documents and evidence under section 155 of the Trade Practices Act, or the

⁴⁸⁷ See [Government Response to the Joint Committee Report](#), p 3, November 2009.

power to issue substantiation notices) to pursue the matter further and, if warranted, take enforcement action.⁴⁸⁸

The Explanatory Memorandum to the 2010 amendments to the CCA stated:

This investigation power will assist the ACCC in situations where significant imbalances in bargaining power between industry participants makes less powerful participants hesitant to report instances of contraventions of industry codes by more powerful industry participants to the ACCC, for fear of retaliatory action by those more powerful participants. This investigation powers allows the ACCC to monitor compliance with applicable industry codes without relying on complaints by other industry participants.⁴⁸⁹

Evidence considered during the review

In its submission to the review, the ACCC stated that 'the audit power does not allow the ACCC to assess the franchisor's compliance with all aspects of the Code.'⁴⁹⁰

The ACCC cited three situations where this was a concern:

1. where the franchisor is not required to produce a written document. For example, clause 20A of the Code requires a franchisor to give a franchisee notice whether it intends to renew an agreement, it is not obliged to provide notice in writing. This means the audit power may not assist the ACCC in determining whether the franchisor has complied with this requirement;
2. where it is not the franchisor who must produce the document, such as a signed statement from the prospective franchisee that it has received independent advice about the agreement, in accordance with subclause 11(2) of the Code; and
3. the ACCC cannot use its audit powers to require a franchisor to provide it with documents or other information that supports the information set out in a disclosure document. This prevents it from ascertaining the accuracy of statements in the disclosure document, such as the number of franchise agreements terminated in the previous three financial years or rebates received from suppliers.⁴⁹¹

It noted that it could compel a franchisor to provide that information under section 155 of the CCA when:

...it has reason to believe that a person is capable of furnishing information, producing documents or giving evidence relating to a matter that constitutes, or may constitute a *breach* of [the CCA].

In other words, the ACCC cannot use its existing powers to demand documents and information merely to test a franchisor's compliance with the Code if it does not have reason to believe that there may have been a breach of the CCA.

The ACCC's use of its random audit powers was commented on in a joint submission from Lottery Agents Association of Tasmania (LAAT) and Australian Newsagents' Federation (ANF) South Australia:

⁴⁸⁸ See [Government Response to the Joint Committee Report](#), p 10, November 2009.

⁴⁸⁹ Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010, p 414.

⁴⁹⁰ Australian Competition and Consumer Commission, submission to the review, p 6.

⁴⁹¹ *Ibid*, pp 6-7.

We are of the belief that in the case of large franchise groups (for example with many hundreds of stores like the lotteries franchise that we are part of) that the ACCC should be made to use its power to randomly audit parties bound by industry codes for non-compliance with the applicable code, not less than every 2-3 years. This should occur randomly in these periods and it should include direct consultation with business owners and their associations as part of this process.⁴⁹²

Making franchisor directors liable for breaches of the Code

Making directors of franchisor corporations and management more responsible for breaches of the Code was raised in submissions.

A confidential submission to the review argued:

Sanction should reach not only legal persons (typically a corporation) who is a party to the franchising arrangement but should also reach directors, officers or persons relevantly concerned with the management of franchisor corporations.⁴⁹³

The Post Office Agents Association Ltd stated that '[i]n line with some OHS laws and company laws, directors and individual franchisor managers and representatives must be held responsible for breaches.'⁴⁹⁴

Franchising specific remedies

In her submission to the review, the New South Wales Small Business Commissioner stated:

For the Code of Conduct to operate more effectively there is the need for greater natural consequences to be incurred by the party that is proved to have breached the Code.

There is a particular need for franchisee's to be able to unravel false disclosure. An effective way of doing so would be to utilise a combination of implementing penalties and ensuring that natural consequences occur. A natural consequence would be where undisclosed or improperly disclosed costs could not be charged to the franchisee.⁴⁹⁵

A similar point was raised by the Expert Panel in its 2010 report:

...industry-specific problems deserve industry-specific solutions rather than changes to the generic law which, if ill-considered, operate indiscriminately across industries and can harm business certainty for the whole of the economy. At the same time, this is not a reason for pursuing industry-specific regulation at all costs when there are widespread problems to be addressed and the generic law is suited to the task.

Section 86C of the CCA allows the ACCC to make non-punitive orders, including in relation to community service, probation, information disclosure and corrective advertising. A probation order under section 86C can include an order for the establishment of a compliance program, education and training programs for employees and/or requiring the revision of a business' internal operations. Section 87 of the CCA allows a court to:

⁴⁹² Lottery Agents Association of Tasmania (LAAT) and Australian Newsagents' Federation (ANF) South Australia, submission to the review, pp 5-6.

⁴⁹³ Franchisees Association of Australia, submission to the review, p 5.

⁴⁹⁴ Post Office Agents Association Limited, submission to the review, p 15.

⁴⁹⁵ New South Wales Small Business Commissioner, submission to the review, p 2.

...make such order or orders as it thinks appropriate against the person who engaged in the conduct or a person who was involved in the contravention (including all or any of the orders mentioned in subsection (2) of this section) if the Court considers that the order or orders concerned will compensate the first-mentioned person in whole or in part for the loss or damage or will prevent or reduce the loss or damage.

Subsection 87(2) provides for a range of non-exclusive remedial orders, including:

- an order declaring the whole or any part of a contract void;
- varying a contract and the date from which the variation has effect;
- preventing the enforcement of a provision of a contract; and
- refunds, the return of property, compensation for damage or loss, repair of goods, supply of services.

Observations

As a general statement of principle in relation to the enforcement of the Code, the view expressed by the Australian Small Business Commissioner, Mark Brennan, is sound:

...as a general proposition... a facilitative approach to regulation is most appropriate in regulation of business... A crackdown on non-compliance by pecuniary or disciplinary measures may be effective in certain circumstances. However, where the business environment is one where business efficacy is served by certainty of rights and obligations and unfettered by prescriptive compliance, as should be aspired for the franchise sector, non-compliance incidents may better be addressed by a facilitative approach tending to educate to comply rather than punishing non-compliance.⁴⁹⁶

The introduction of civil pecuniary penalties as a remedy for breaches of the Code has been recommended by almost every major review of the Code, most recently the Joint Committee.⁴⁹⁷ Indeed, as early as 1979, the Blunt Review recommended a range of franchising specific amendments to the then *Trade Practices Act 1974* that included pecuniary penalties for a breach of proposed pre-franchise disclosure provisions.

The evidence received by the review indicates that there is widespread industry support for allowing a court to impose a civil pecuniary penalty for some, but not all, breaches of the Code. This support is not overwhelming, however, it is convincing.

The consequences of some breaches of the Code have the potential to significantly disadvantage existing or prospective franchisees. Examples of some such breaches include:

- failing to provide a disclosure document meeting the requirements of the Code;
- inadequate or incomplete disclosure;

⁴⁹⁶ Australian Small Business Commissioner, submission to the review, p 6.

⁴⁹⁷ See Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, pp 124-125; [Franchises, SA Parliamentary Committee Report](#), May 2008, p 42; and [WA Inquiry into Franchise Businesses](#), April 2008, p 31.

- not providing a franchisee with a copy of the lease when the franchisee leases premises from the franchisor or an associate of the franchisor;
- failing to prepare audited financial statements of marketing and other cooperative funds when required to do so; and
- not notifying a franchisee of the end of term arrangements that will apply or whether the franchisor intends to renew the franchise agreement at least six months before the end of the term.

Allowing a pecuniary penalty to be imposed will indicate to the industry that the government considers breaches of the Code to be serious matters that have consequences.

It has been argued that the imposition of a pecuniary penalty may have an adverse effect on the franchisor and the franchise system, as a whole. However, this is not a good argument for not allowing the option of pecuniary penalties. As is presently the case with pecuniary penalties for breaches of the CCA or ACL, the court is best placed to take all the relevant factors into account, including the financial position of the franchisor, and determine the appropriate penalty in light of all the circumstances. It should be noted, though, that the imposition of a pecuniary penalty will not directly advantage the franchisee affected by the conduct. They would still have to take action to obtain compensation or a refund.

A mandatory code which lacks adequate enforcement powers will not adequately deter improper conduct and inappropriate behaviour. Parties who comply with the Code should not be concerned about any enforcement powers conferred upon the regulator.

One point of note is that the evidence provided to the review shows that there has been a demonstrable shift in the views of some key industry stakeholders since the Joint Committee's review of the Code, particularly by the FCA.

It should be made clear that the imposition of a civil pecuniary penalty, including an infringement notice, should only be sought by the ACCC as a last resort after other non-pecuniary penalty remedies have been considered. The argument that the existing enforcement regime is adequate relies heavily on statistics regarding disputes and complaints. This reasoning can be questioned on a number of bases:

- it assumes the statistics are accurate and can be relied upon completely. A number of commentators have made the point that the Franchising Australia surveys do not involve franchisees, current or former; only a small percentage of franchisors respond, and even then responses to individual questions is voluntary. There is also no mechanism for checking the accuracy of responses;
- while the percentage of franchising related complaints to the ACCC has dropped in recent years, the absolute number of complaints and inquiries have actually increased markedly, suggesting that the percentage falls may be attributable to the growth in the sector, rather than better behaviour by parties to a franchising relationship; and

- most recent estimates are that there are approximately 73 000 franchise units in Australia, meaning that disputes involving 1.5 per cent is still 1095 businesses.⁴⁹⁸

The data from the ACCC covering the 2008-2012 period referred to above shows that complaints spiked in 2011 with a high of approximately 110 complaints in August 2011. Although the volume has reduced since that time, the average number of complaints received is still significantly higher on average than in 2008 and 2009 respectively. It is unclear what has caused the increase post-2011; potential impacts are the increase in franchisees and the Global Financial Crisis. Notwithstanding these factors, it is apparent the 2010 amendments to the Code have not resulted in a significant reduction in complaint volumes as intended.

A number of submissions raised policy concerns around the introduction of pecuniary penalties for a breach of the Code. Civil pecuniary penalty proceedings 'are concerned with public wrongs and moral culpability, and not merely conduct causing damage'⁴⁹⁹ and their purpose is to deter⁵⁰⁰ and 'punish the offender.'⁵⁰¹

The government's *Policy Guidelines for Prescribing Industry Codes* contains nothing explicit stating that industry codes cannot be subject to pecuniary penalties, however, this could be inferred from the following statement:

Industry codes are complementary to general prohibitions on unfair practices that may occur in trade or commerce, and should encourage compliance and focus of remedies rather than simply seeking to punish contraventions.⁵⁰²

It is clear from submissions that the distinction between an industry code and primary legislation is either not recognised or not considered important by any industry stakeholders. It would be unusual, but not unprecedented, for an industry code or a regulation to include the option of pecuniary penalties for a breach. The government's current policy on industry codes does not support the enforcement of codes through civil pecuniary penalties. One size does not fit all and each industry must be examined specifically, having regard to its maturity, evolution and requirements. Accordingly, it is acknowledged that pecuniary penalties for breaches of the Code may to some extent change the nature of the industry codes framework.

The government may take the decision that franchising is no longer appropriately regulated by way of an industry code if it wishes to preserve the non-punitive nature of the industry codes framework. That is not a question for this review, which has not been focussed on industry codes generally, but has specifically looked at whether further enforcement measures are necessary in the franchising context.

⁴⁹⁸ Asia-Pacific Centre for Excellence in Franchising, *Franchising Australia 2012*, p 10.

⁴⁹⁹ Vicky Comino, 'Effective Regulation by the Australian Securities and Investments Commission: The Civil Penalty Problem' (2009) 33 *Melbourne University Law Review* 802.

⁵⁰⁰ *Schneider Electric (Australia) Pty Ltd v ACCC* [2003] FCAFC 2.

⁵⁰¹ Australian Law Reform Commission, *Securing Compliance: Civil and Administrative Penalties in Federal Jurisdictions*, [ALRC Report, Securing Compliance](#), DP 65 p 53, May 2002.

⁵⁰² See Commonwealth Treasury, *Policy Guidelines on Prescribing Industry codes under Part IVB of the Competition and Consumer Act 2010*, May 2011, p 9, May 2011.

The Code places many obligations on franchisors. It cannot be said that they are all of the same level of seriousness. The same pecuniary penalty is not appropriate for all breaches of the Code, any more than anyone would argue that all breaches of the Criminal Code should carry the same penalty.

It is recommended that pecuniary penalties to a maximum of \$50 000 be made available as a remedy for a breach of the Code. This is considered sufficient to act as a deterrent to breaches of the Code, as well as giving the court ample discretion to apply the penalty it thinks appropriate, having regard to all the factors that would apply ordinarily in setting a pecuniary penalty, as outlined above. It is noted that the maximum penalty for a breach of the ACL by a corporation is \$1.2 million. The policy goal of less serious cases attracting lesser penalties can still be achieved with the introduction of a maximum penalty.

In relation to infringement notices, it is clear that industry concerns about how the ACCC may use this power are genuine, given the relative lack of official regulation surrounding what is, essentially, an administrative function. The reason for granting the ACCC the power to issue infringement notices was set out in the Explanatory Memorandum for the Trade Practices Amendment (Australian Consumer Law) Bill 2009:

[Infringement notices] will remedy a significant gap in the current enforcement framework by facilitating the payment of relatively small financial penalties in relation to relatively minor contraventions that may not otherwise be pursued through the Courts... It will allow the ACCC and ASIC to take action against minor breaches of unfair practices and other conduct more efficiently and effectively than through Court action alone, and provide the potential for a speedier resolution of matters than is possible through the Courts (although this would depend on the complexity of each matter).⁵⁰³

Such a power is entirely appropriate and indeed well suited to the enforcement of the Code, given that there are many aspects to the Code that might be breached. While the ACCC has a clear policy about the issuing of infringement notices and addressed this in its supplementary submission, some safeguards are considered necessary.

Criticism of the ACCC's resourcing and approach to enforcement is not new. The 2008 Joint Committee report observed:

Notwithstanding the limitations of the ACCC's role, there appears on the face of it to be room for improvement by the regulator in taking a more active role in dealing with franchising-related complaints.⁵⁰⁴

The 2010 Expert Panel report noted the limitations of the ACCC stating '...it is not necessarily the function of the ACCC to arbitrate every commercial dispute, even where contraventions of the [CCA] are alleged.'⁵⁰⁵ On the other hand, there is some indication that the role of the ACCC is not properly understood by some parties to a franchising agreement.

⁵⁰³ See Trade Practices Amendment (Australian Consumer Law) Bill (No. 1) 2010, Explanatory Memorandum.

⁵⁰⁴ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 124.

⁵⁰⁵ Expert Panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, p 188, February 2010.

From the evidence presented to the review, both through submissions and in meetings, it appears there is a perception in the franchising industry that the ACCC does not investigate as many complaints as it is believed it should. A number of possible reasons for this have been put forward, including:

- limited funding;
- limited powers of the ACCC; and
- lack of education of franchisees about the role of the ACCC and the protections available under the Code and the CCA.

As an independent government agency, the ACCC must remain free to determine how it will fulfil its obligations under the CCA, in accordance with the law and its own Compliance and Enforcement Policy. It would, therefore, be inappropriate to make a recommendation concerning how it should enforce the Code. Nonetheless, the evidence provided to the review supports the ACCC continuing to adopt, as its first line of enforcement of the Code, a strong information and education program in an attempt to change standards of conduct and behaviour in the industry. The evidence also indicates that its enforcement efforts would be aided by the development of a franchising specific enforcement and compliance policy to provide the industry with clear and transparent statements. This could be done in consultation with its Franchising Consultative Committee.

The franchising enforcement and compliance policy it develops might address matters such as:

- the basis on which it will seek an order from the court to impose civil pecuniary penalty for a breach of the Code;
- it not seeking an order for a civil pecuniary penalty for what it considers to be a trivial, unrepeatable, unintended or technical breach of the Code;
- the conduct of proper and thorough investigative processes;
- providing a warning prior to the issue of an infringement notice or the commencement of legal proceedings for a breach of the Code;
- not seeking pecuniary penalties or issuing infringement notices for breaches of the Code that are substantially similar;
- what it considers to be the reasonable grounds upon which it will issue an infringement notice or seek a civil pecuniary penalty from the court;
- the onus of proof it will meet before it will issue an infringement notice;
- a franchisor or franchisee's rights of objection to an infringement notice;
- what consideration it will give to the impact of a penalty on a franchisor, franchisees and the franchise system as a whole; and
- what steps it might take to negotiate with the franchisor to address concerns that lead to the alleged breach of the Code, including the sale of its franchise system.

It should be stressed that the imposition of a civil pecuniary penalty, including an infringement notice, should be utilised as a last resort after other non-pecuniary penalty remedies have been considered.

As indicated above, in keeping with its independent status, it is up to the ACCC to determine what breaches of the Code it would consider seeking a pecuniary penalty. In recommending pecuniary penalties be made available for a breach of the Code, it is anticipated that this remedy will be utilised for significant or serious breaches only and not for minor breaches. That, in turn, will depend on the particular circumstances of the case.

It is envisaged that a serious breach might relate to the management of a marketing or other cooperative fund; not providing a disclosure document; providing a disclosure document that has significant omissions or errors or preventing a prospective franchisee from contacting existing or former franchisees. It would not be expected to include conduct where no harm results or the breach is trivial, unrepeatable, unintended or technical, such as being a few days late in materially relevant facts or with advice about end of term arrangements.

While it is ultimately a matter for itself, it is considered advisable that, when seeking orders under section 86C of the CCA in relation to a breach of the Code, the ACCC should consider orders that are specifically tailored to franchising.

It is arguable that franchising specific remedies, such as the sort of orders canvassed in the submission of the NSW Small Business Commissioner and the Expert Panel report, already can be made under the section 87 of the CCA. Regardless, orders of particular relevance to franchising are more likely to be made by a court if they are included in subsection 87(2). If that were not the case, section 87 would merely state that the court could make such compensation orders as it thinks fit and there would be no need to include examples of possible orders in subsection 87(2).

Many franchise systems are closely identified with certain individuals, usually the individual who founded it. By their nature, franchise systems are invariably closely controlled by the directors of the parent company. It is appropriate, therefore, that the directors of a company be held liable for a breach of the Code for which they have been responsible. It is difficult to see why a director of a franchisor should be exempt from the same remedy as the director of any other corporation, particularly if pecuniary penalties are considered necessary to act as a deterrent from breaching the Code.

An expansion of the ACCC's audit powers would assist it to better regulate the industry. They would allow it to make simple and discrete inquiries in a timely and cost-effective manner. It would thus be able to identify and address breaches of the Code before a franchisor's problems in complying with the Code results in greater damage to the franchise system and franchisees. The result may, in fact, reduce the need for more serious enforcement activity. This may have implications for the enforcement of other industry codes, however, as noted above, the scope of this review extends only to making recommendations for the Franchising Code of Conduct. Amendments to the audit power under the CCA to apply only to the Code will have to be worded carefully to avoid unintended consequences of the recommendation.

Recommendation

15. The Competition and Consumer Act 2010 (the CCA) be amended to:
 - c. allow civil pecuniary penalties to a maximum of \$50 000 to be available as a remedy for a breach of the Code;
 - d. allow the ACCC to issue an infringement notice for a breach of the Code;
 - e. allow the ACCC to use its powers under section 51ADD of the CCA (its random audit powers) to assess a franchisor's compliance with all aspects of the Code, not just to require the production of documents created under the Code;
 - f. include a breach of the Code in the contraventions for which the court may make an order under section 86E (Order disqualifying a person from managing corporations); and
 - g. specify that the court can make franchising specific orders under section 87, including orders requiring a franchisor to:
 - i. give a royalty free period to a franchisee affected by a breach of the Code; and
 - ii. pay a sum of money specified by the court into any marketing or cooperative fund applicable to that franchise system.

Part Nine – Particular issues for franchisees in the motor vehicle industry

Introduction

The Joint Committee review and the Expert Panel inquiry were told that many franchisees in the retail motor trades invest significant amounts of capital in their franchised businesses and they, therefore, require a reasonable period of tenure to recoup that investment.⁵⁰⁶ Ibisworld Car Retailing in Australia 2012 reported that it can cost up to six million dollars to establish a new vehicle franchise. This consists of up-front costs, site development and stock purchases. Motor vehicle manufacturers also require a substantial percentage of the annual working capital requirements as the standard initial contribution by prospective dealers.⁵⁰⁷

The Joint Committee was also told that ‘...previously in the motor vehicle dealership sector franchise agreements were often evergreen; they had no fixed terms. ...a trend over time such that these agreements have now been replaced with fixed term agreements, some of which are as short as 12 months in duration.’⁵⁰⁸

The Joint Committee did not support an automatic right to renewal.⁵⁰⁹ The Expert Panel noted the Joint Committee’s view and was of the opinion that the end-of-term arrangements announced in the government’s response to the Joint Committee report:

‘...may assist prospective franchisees in assessing the commercial viability of the agreement they are considering. Under the changes, prospective franchisees should be given a clearer understanding of what will happen at the end of the term before they enter the agreement. This will be further assisted by the requirement for franchisors to advise franchisees whether or not the agreement will be renewed at least six months before the end of the term. A clear understanding of the parties’ positions at the end of the franchise term will allow franchisees to analyse more comprehensively the consequences of any unforeseen capital expenditure, and to the extent that they are aware of the risk of such expenditure, this will also feed into their decisions about entering a franchise, bearing in mind their possible return on investment.’⁵¹⁰

The amendments to the Code in 2010 – Annexure 1, item 17C – relate to arrangements to apply at the end of the franchise agreement, including providing information on whether the prospective franchisee will have any options to renew, or extend the scope of the franchise agreement or enter into a new franchise agreement. This disclosure was designed to provide information and certainty about agreement renewal.

⁵⁰⁶ MTAA (now AMIF), submission to the Joint Parliamentary Inquiry into Franchising and the Code of Conduct, 2008, p 13.

⁵⁰⁷ Ibisworld, Car Retailing in Australia August 2012, p 23.

⁵⁰⁸ R Gardini, submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising, 2008, pp 6-7.

⁵⁰⁹ Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008, p 81.

⁵¹⁰ Expert Panel, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, 2010, p 59.

The 2010 amendments also required disclosure of whether the franchisor has considered any significant capital expenditure undertaken by franchisees in determining the arrangements to apply at the end of franchise agreements between the franchisor and those franchisees.

Evidence considered during the review

A number of submissions commented on issues relating to the motor vehicle dealership industry in Australia. The main issues raised were:

- the length of the term of the franchise agreement;
- termination, where there has been no breach by franchisee;
- end of term arrangements, including goodwill payments; and
- the inclusion of motor vehicle industry specific provisions in the Code or an industry sector specific code.

The consideration of good faith and unconscionable conduct is relevant to a number of the submissions relating to motor vehicle dealerships. The subject of good faith is left to the coverage in Part Five – Good Faith.

The goodwill issues relating to motor vehicle dealerships are largely discussed in the report in Part Six – Transfer, renewal and end of term arrangements for a franchise agreement. However, there is some discussion of goodwill in this part, associated with the end of term of motor vehicle agreements.

Length of the term of the franchise agreement

Concern was expressed in submissions that the term of the motor vehicle dealership agreement is often too short to enable a motor vehicle dealer to recoup its large capital investment before the end of the agreement term.

A confidential letter from a person experienced in the automotive sector stated that the short duration of dealership agreements was not of concern to dealers for many years, but that more recently circumstances have changed:

The term of motor vehicle dealership agreements is of relatively short duration being in most cases 1 to 5 years. While motor car dealers do not pay any franchise fee, they make significant investments in dealership facilities costing millions of dollars. Such investments take many years to achieve profits and to recoup a reasonable return on the investment.

... The Code provides no assistance or remedy for dealers of a dealer agreement. Dealers are under threat more than ever as a result of:

1. A lack of ability to negotiate terms having regard to the fact that most dealerships are of long standing duration.
2. The general resistance exhibited by most distributors to proposals for extended terms by dealer councils when agreements are to be renewed. There are few exceptions where one or two distributors have in recent years provided terms of 5 years with a renewal of a further 5 years subject to certain conditions being met.

The confidential letter proposed that the Code be amended to specify a minimum term of five years for a motor vehicle dealership agreement, provided a franchisee had invested a requisite amount over the past 10 years, or intends to invest a requisite amount in relation to the dealership business.

Another confidential submission argued for a minimum term of the franchise agreement with an option to renew:

Automotive franchise agreements should be a minimum of ten years with options of the same. For example, some manufacturers provide a franchise agreement for ten years with options of five, while others have three year agreements with options of 1 year.⁵¹¹

A motor vehicle distributor believed the amendments in 2010 provide franchisees with adequate disclosure and information about the end of term arrangements that will apply and adequate notice of non-renewal:

The nature of motor vehicle sales and distribution, and presumably other franchised businesses with similar significant capital investment requirements, is such that motor vehicle dealers are not, in the absence of cause, quickly terminated and replaced without long term planning. In [our] case this is always accompanied by consultation with the outgoing dealer. We consider the amendments codify this approach for all franchises and address any concerns that franchisees might have in this regard.⁵¹²

Termination, no breach by franchisee

During consultations it was pointed out that, apart from non renewal at the end of the term of the agreement, agreements can be terminated at will where there is no default. This was contrasted with a view that an amendment to the Code in this respect had the potential to alter established principles of the freedom of contract, that the termination or non-renewal terms are well known to both parties entering into the agreement.

An experienced franchising lawyer, Derek Sutherland, when discussing clause 22 of the Code, termination – no breach by franchisee, said:

The automotive sector has argued for many years that agreements that allow for termination by notice (without cause) leads to a significant imbalance in the relationship and there should be a minimum term or a significant period of minimum notice to ensure the other party can mitigate or reduce its loss. A unilateral right to terminate without cause or even because of an inability to meet KPI's that are unilaterally determined and imposed during a term is most often found in motor vehicle dealership agreements and agreements in the automotive industry rather than in your typical quick service restaurant agreement even though both may be tied to tenure under a long term lease.⁵¹³

The Federal Chamber of Automotive Industries (FCAI) stated that any amendment to the Code to address concerns that some franchisors allegedly terminate or refuse to renew franchise agreements, when they do not have 'good cause' for doing so, could compel franchisors to renew their franchise agreements at the end of term, contrary to the franchisor's wishes. They argue that

⁵¹¹ Confidential submission to the review.

⁵¹² Confidential submission to the review.

⁵¹³ Derek Sutherland, submission to the review, page 30.

this could also lead to a perpetual franchise agreement which would then become an assignment rather than a licence:⁵¹⁴

The FCAI referred to their submission to the Joint Committee:

As noted in our 2008 submissions, a franchise agreement is a 'relational contract', which depends for its success on a mutually trusting relationship between the parties.

A franchisee, with the protection of the Code and the remedies under the [*Competition and Consumer Act*] enters into a franchise agreement fully aware of these rights and it would not be fair or reasonable for a statutory provision to distort established principles of freedom of contract, to facilitate a contractual relationship on a perpetual basis or to create a mechanism that may frustrate or compromise the legitimate rights and interests of the franchisor. A contract is consensual and a franchise agreement is based on mutual trust and confidence. Any obligation in relation to renewal imposed on a franchisor would be contrary to these fundamental principles.⁵¹⁵

The termination or non-renewal provisions are known to both parties prior to entering into the contract and form an important part of the bargain the parties have chosen to accept.⁵¹⁶

The FCAI submitted that the real complaint is more likely to be around disclosure, which is adequately dealt with in the Code or if it is misleading or deceptive conduct and estoppel, there is a large body of law to refer to.⁵¹⁷

The review considered regulation relating to car retailing in the United States of America. Car retailing in the USA is highly regulated, with each state having a law governing the car manufacturer and dealer relationships and at the federal level, there is the Automobile Dealers' Franchise Act. The state laws have evolved over many decades and contain significant protection for motor dealers.

An article in the *Journal of Economic Perspectives* stated:

States' auto dealership laws also constrain the circumstances under which a franchise relationship can be terminated, cancelled, or transferred. As of 2009, all states had a prohibition against termination except for "good cause". "Good cause" reasons for termination are often enumerated in the law and typically do not include efficiency or increased manufacturer profit (for an example, see the text of the Maine vehicle franchise law in the online appendix at (<http://www.e-jep.org>). As a result, the manufacturer cannot adjust its network to declining demand without paying a penalty, which is often the present discounted value of expected future profits from the dealership in the regulated world, which can be large.⁵¹⁸

⁵¹⁴ Federal Chamber of Automotive Industries, submission to the review, p 6

⁵¹⁵ Federal Chamber of Automotive Industries, submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising, 2008, p 9.

⁵¹⁶ Federal Chamber of Automotive Industries, submission to the review, page 7.

⁵¹⁷ Ibid.

⁵¹⁸ F Lafontaine, F Scott Morton, 'State Franchise Laws, Dealer Terminations, and the Auto Crisis', *Journal of Economic Perspectives*, vol. 24, 2010, p 239.

It is suggested that one consequence of state car retailing laws in the USA is dynamic inefficiencies and that the laws do not ultimately benefit consumers:

... Furthermore, the lack of flexibility in dealer network disadvantages incumbent manufacturers relative to entrants. Toyota and Hyundai, relatively late entrants into U.S. automotive retailing, arrived after the passage of most state laws protecting dealers. They could therefore design a network in response to state laws, one that has fewer but larger dealers, located where the U.S. car-buying population lives today.⁵¹⁹

End of Term Arrangements

The issues raised in consultation regarding end of term arrangements in the motor vehicle sector relate to claims of inappropriate behaviour toward the franchisee at the end of term and whether compensation is due where agreements are not renewed.

The FCAI believed the amendments to the Code regarding end of term arrangements and renewal notices have been effective in addressing 'inappropriate conduct' and is strongly opposed to any moves to amend the current code provisions where agreements are not renewed:

The underlying commercial arrangement, when considered with the extensive disclosure requirements under the Code even apart from the normal due diligence applied in any major commercial transaction, quickly and clearly indicate the arrangements that will apply. Neither the market nor the competition are static features of the automotive industry and end of term arrangements are essential elements of dynamic operations, allowing franchisors to respond to changes in trends and deliver the most appropriate brand response to the environment with full disclosure of that possibility.⁵²⁰

M+K Lawyers, specialists in franchising in the automotive sector, acknowledged that amendments to the Code regarding end of term arrangements have gone some way in setting more realistic expectations. They suggested, however, that the amendments to the Code go further to address inappropriate conduct at the end of term of franchise agreements:

... simply requiring disclosure as to end of term arrangements does not in itself lead to appropriate conduct. Franchisees, especially those under very large or powerful franchise groups, such as motor dealerships, have very little scope to negotiate changes. Therefore, the debate remains whether in some circumstances franchisors should provide payments to franchisees at the end of term.⁵²¹

M+K Lawyers stated that a franchisee invests millions of dollars over the term and that success is largely dependent on the franchisee's contributions, and that the goodwill built up in their territory is mainly created by the individual motor dealer. They submit that where the franchisor is set to make a gain, or seeks to re-franchise the territory (even with no gain), franchisees should be given a first right of refusal to continue with the business:

Regardless of the contribution of the motor dealer, at the end of the term, the motor dealer has no rights and, where the agreement is not renewed or another entered into, receives nothing. The franchisor is not constrained in how it deals with the territory.⁵²²

⁵¹⁹ Ibid, p 244.

⁵²⁰ Federal Chamber of Automotive Industries, submission to the review, p 4.

⁵²¹ M+K Lawyers, submission to the review, p 3.

⁵²² Ibid.

A confidential letter to the review stated:

Recent experience in the automotive industry suggests that distributors have moved away from issuing notices of termination to issuing notices of non-renewal so as to avoid the need to provide reasons for terminations and thereby avoid the risk of legal proceedings.

The confidential letter recommended adding specific end of term provisions for motor vehicle dealerships after subclause 20A(2) in the Code. These suggested clauses relate to notification, allowing the franchisee to offer the business for sale as a going concern, the determination of the market value of the going concern, and certain restrictions on the franchisor if, in their notice, they state they do not want the franchised business to continue.

The FCAI stated that a requirement for the franchisor to pay the franchisee compensation for goodwill at the end of term should not be introduced into the Code.⁵²³ It submitted that where the goodwill is attached to the franchisor, the franchisee cannot acquire any proprietary interest in the franchisor's goodwill. The FCAI stated that where goodwill belongs to the franchisee, for example, where a franchisee has multiple franchises and may brand themselves in their own right, citing an example of a 'Prestige Cars' brand that doesn't reference the franchisor's brand, the goodwill vests in the franchisee's brand and belongs to the franchisee. The FCAI also noted that it is common in the automotive industry for the franchisee to own or control the site where the franchise is located. As a result, at the end of the term of the franchise agreement, the franchisee retains the goodwill attached to the location and is able to use this goodwill for any subsequent franchise or business.⁵²⁴

The ACCC was asked to provide comments on non-renewal of a franchise agreement at the end of the term and provided guidance on six scenarios. Two of the scenarios, 3 and 4, are particularly relevant to motor vehicle dealerships and are repeated here:

Scenario 3: A franchisee is in the ninth year of a ten year franchise agreement. It paid \$500 000 for the franchise and is making on average net profit of \$55 000 per year. With 18 months of the franchise agreement remaining, the franchisor decides that it will not be renewing the Agreement. However, relying on the terms of the franchise agreement the franchisor requires the franchisee to build a new showroom at a cost of \$300 000. The new showroom takes ten months to complete. With eight months remaining on the agreement, the franchisor advises the franchisee that his agreement will not be renewed.⁵²⁵

The ACCC stated that as long as the possibility of unforeseen capital expenditure is disclosed in the disclosure document, there has not been a breach of the Code. However, the conduct could amount to unconscionable conduct under the Australian Consumer Law. The franchisor has forced the franchisee to outlay \$300 000 for a new showroom, knowing that it does not intend to renew the franchisee's agreement.

Scenario 4: Because of concerns that it may not be able to recoup its investment within the five year term, a franchisee sought assurance that its agreement would be renewed. The franchisor provided a verbal guarantee that if the franchisee did not breach the agreement it would be renewed, which

⁵²³ Federal Chamber of Automotive Industries, submission to the review, p 6.

⁵²⁴ Ibid, p 5.

⁵²⁵ ACCC, supplementary submission to the review, p 2.

was repeated each year. In fact, the franchisor intended to offer the franchise to his brother, unless his brother was not interested. After four years, despite the franchisee having never breached the agreement, the franchisor advises the franchisee that he won't be renewing the agreement for personal reasons.

ACCC said this conduct is likely to raise concerns under the ACL (e. g. misleading or deceptive conduct). It is unlikely that the franchisee would have purchased the franchise had the franchisor not been willing to guarantee the renewal of the agreement.

Motor vehicle industry specific provisions in the code or an industry sector specific code

In relation to the creation of industry sector codes, the 2000 report of the Franchising Policy Council (FPC) found:

The FPC concludes that sector specific codes have an obvious practical appeal but that, on balance, there is a strong argument for retaining a single generic code such as the Franchising Code of Conduct. Although there may be minor distortions and anomalies in applying a generic code to the whole of the franchising industry, it has the advantage of avoiding a proliferation of industry codes that may set different standards of compliance, or that would allow debateable measures such as "contracting out".⁵²⁶

The FPC recommended the retention of a single generic Franchising Code.

In his submission to the current review, Mr Sutherland stated:

It is apparent that industry specific issues confronting the automotive sector remain of concern and they continue in their desire to either have a separate automotive code apply to them or to have specific provisions to protect participants inserted into the Franchising Code of Conduct. It would be useful for government to examine this in more detail, remembering that they are the ONLY form of agreement that is deemed to be a franchise agreement without applying the tests in clause 4(1) of the code. They therefore cannot restructure themselves to fall outside and in essence are captured by this Code because of the nature of the good or service they sell being a "motor vehicle".

There is no doubt that many dealers and their representative organisations would argue that the current framework to protect them is inadequate given the size and nature of their investment and the significant imbalance in the relationship caused by an ability to unilateral change significant rights and obligations at any time during the term, a lack of security of tenure by virtue of short term agreements or a unilateral right to terminate without cause on notice.

This arguably may explain why that sector raises issues of exit payments for goodwill and recovery of loss on termination of a motor vehicle dealer agreement arising from that notice period. The losses caused on termination simply by notice can be extensive.

A framework where there is an obligation to act in good faith may assist but on its own may not necessarily be the sole or appropriate remedy.

This should require further consideration and review of the nature and extent of disputes that arise in that sector and whether a separate code is now required whether by inclusion

⁵²⁶ Review of the Franchising Code of Conduct, 2000, Report of the Franchising Policy Council, page 34

of a new Part to the Code to apply to them or for additional relief. The main areas of concern in that sector appear to relate to good faith, unilateral variations and terminations and they appear to be in some cases quite legitimate concerns.⁵²⁷

As noted in the discussion of the length of the term of the franchise agreement, there were two suggestions that a clause be added to the Code that is specific to the term of a 'motor vehicle dealership'. There has also been a suggestion for a motor vehicle dealership specific inclusion regarding end of term arrangements after clause 20A(2) of the Code.

Law firm DLA Piper stated:

...the breadth of the definition of "motor vehicle" is extremely wide and should either: (i) be narrowed or clarified as to its application to "motor vehicles" that are not cars, such as boats and agricultural machinery; or (ii) appropriate exemptions need to be included to ensure the Code does not apply to persons who are not participants in the franchising industry.⁵²⁸

Other issues raised in motor vehicle submissions:

Other issues raised included problems with automatic bailment systems,⁵²⁹ artificial inflated pricing; warranty repair rates and interpretation; and with freight monopoly.

Observations

The evidence presented to the review was from an experienced and established cross-section of those involved in the motor vehicle industry. The issues were also evident in the Parliamentary Joint Committee Review and in the Expert Panel's report.

Observations in previous parts of this report are also relevant to the motor vehicle industry, in particular Part Five – Good faith and Part Six – Transfer, renewal and end of term arrangements.

An important concern for motor vehicle dealerships is that the length of the term of the franchise agreement should be sufficient to recoup capital investment. There were proposals that the Code specify a minimum term for motor vehicle dealership agreements, with submissions quoting examples of short agreement periods, particular inappropriate behaviours at the end of the term of an agreement, and a tendency to simply not renew. Given the strong representations and arguments, there is some attraction and possible merit in a recommendation in considering a minimum term for motor vehicle dealership agreements. It would be prudent, however, to first examine the quantum of the issue, given there are 4403 motor vehicle retail outlets in Australia,⁵³⁰ and to consider the consequences for both the industry and for the consumer before taking the step of introducing regulation for one particular sector.

The Expert Panel's view when commenting on the issue of return on investment was that a clear understanding of the parties' positions at the end of the franchise term would allow franchisees to analyse more comprehensively the consequences of any unforeseen capital expenditure, and to the

⁵²⁷ Derek Sutherland, submission to the review, pp 33 – 34.

⁵²⁸ DLA Piper, submission to the review, p 4.

⁵²⁹ A system of payment for new vehicles when invoiced by franchisors to franchisees. The franchisee has in place a facility with a financier (bailment plan) whereby the franchisor can send an invoice to the financier and the funds are automatically transferred to the franchisor.

⁵³⁰ Asia-Pacific Centre for Franchising Excellence, *Franchising Australia 2012*, p 10.

extent that they are aware of the risk of such expenditure, this was intended to feed into a prospective franchisee's decision about entering a franchise, bearing in mind their possible return on investment.⁵³¹

The current disclosure provisions, in particular, amendments made to the Code in 2010 (Annexure 1, item 17C) should assist motor vehicle franchisees. The Annexure 1, item 17C amendment relates to arrangements to apply at the end of the franchise agreement, including providing information on whether the prospective franchisee will have any options to renew, or extend the scope of the franchise agreement or enter into a new franchise agreement. This disclosure was designed to provide information and certainty about agreement renewal.

Annexure 1, items 17C.2 and 17C.3 prospectively requires the franchisor to disclose whether it has considered any significant capital expenditure undertaken by franchisees in determining the arrangements to apply at the end of franchise agreements was prospective and phased in from 1 July 2011.

It is noted that a number of submissions thought the 2010 amendments in regard to disclosure and information about end of term arrangements have been effective. Agreements made after the 2010 amendments came into effect (1 July 2010) may have only just reached, or are nearing, the end of their term. Therefore, it is too premature to fully assess the impact of these provisions. These agreements have benefited from the 2010 amendments regarding disclosure of the arrangements to apply at the end of the franchise agreement.

There are sound reasons for the FPC's recommendations that a single generic franchising code should be retained.

Recommendation

16. An analysis of the impact of a minimum term and standard contractual terms for motor vehicle agreements should be undertaken prior to a future review of the Code.

⁵³¹ Expert Panel, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, 2010, p 59.

Part Ten – Future review of the Code

Introduction

The Code has been subject to a significant number of reviews over the past decade. Although it is important that legislation and supporting regulations are subject to scrutiny, it is also important that any changes are given time to take effect.

Evidence considered during the review

It has been a clear and consistent message during consultations that, following the outcome of this review process, there should be a moratorium of a specific time period for further reviews of the Code.

The Code has certainly improved the sector but after this review and resulting adjustment I plead that the Code and the sector is left alone for a considerable time.⁵³²

Following the numerous inquiries that have been conducted in recent years, at both the state and federal level, there is likely to be little value in a further review within a short period of time.

Stakeholders also commented that, for some of the amendments – particularly those made in 2010 – there may have been too little time to evaluate their effectiveness. This point was made in the context that amendments only apply to franchise agreement entered into after the amendments take effect⁵³³, and given the average franchise agreement is five years⁵³⁴, a number of existing franchise relationships would not have had the benefit of the 2010 amendments.

The Guidelines on Prescribing Codes under Part IVB of the Competition and Consumer Act 2010 (Cth) provide that: ‘Codes of conduct that are prescribed under the CCA will be reviewed at least every five years in consultation with industry, consumers and business.’⁵³⁵

Observations

The amendments to the Code in 2008 and 2010 (see sections 5(1A) & 5(1B) of the Code) were implemented prospectively. This means they only apply to agreements going forward rather than agreements already in place.

The Franchising Council of Australia commented:

Any change in the area of good faith, end of term arrangements or compensation would directly impact existing agreements. The commercial terms of those arrangements, including initial fees paid, royalty rates and length of the term, have been negotiated and agreed based on the current state of the law. The integrity of those agreements must be respected.⁵³⁶

⁵³² Phil Blain, submission to the review, p 3.

⁵³³ Franchising Code of Conduct, clause 5.

⁵³⁴ Asia-Pacific Centre for Franchising Excellence, *Franchising Australia 2012*, p 46.

⁵³⁵ Treasury, *Policy guidelines for prescribing industry codes under Part IVB of the Competition and Consumer Act 2010*, p 8.

⁵³⁶ Franchising Council of Australia, submission to the review, p 9.

Following the precedent set as a result of the amendments in 2008 and 2010, it is assumed the same conditions will apply to any amendments made as a result of this review, and that other transitional arrangements may also be appropriate. It is detrimental to certainty for the industry for there to be perpetual review of regulation of the industry. It is important that further review not occur for some time.

Recommendation

17. There should not be another review of the Code for a minimum of five years after any amendments to the Code take effect in response to this report.

Part Eleven – Technical or minor changes to the drafting of provisions of the Code

Introduction

Previous reviews have, understandably, focussed on the substantive policy issues raised in franchising relationships. The great majority of this review report has done the same.

However, particularly given the recommendations with respect to enforcement made in this report (see Part Eight – Enforcement), it is necessary to repeat some of the criticisms about some of the more minor or technical flaws in the Code.

Evidence considered during the review

The following comments from submissions speak to the issue of uncertainty in the wording of provisions in the Code, and the difficulties this may create. It is also a summary of some of the concerns expressed.

Further, some of the 2010 changes are difficult to interpret, and almost by definition unachievable. For example the provisions in relation to disclosure of “unforeseen” expenditure – if it was unforeseen, by definition it could not really be disclosed!⁵³⁷

It is unfair to penalise franchisors for failing to comply with the Code where, in many respects, the application of the Code and what it requires of franchisors is uncertain.⁵³⁸

There is also an interpretational problem with the requirement for franchisors that have not been trading for the minimum 2 years as set out in clause 20 of the Disclosure document. There is no provision to permit the disclosure of financial information over a shorter period; an audited statement appears to be the only alternative to comply with the Code requirement. Clarification is needed (if this provision is to remain as is) whether an audited statement must be provided for systems of less than 2 years duration or if disclosure of the available financial records is sufficient.⁵³⁹

...we are concerned that interpretational issues such as these, where there are genuine differences of interpretation, will result in poor outcomes for parties should penalties be introduced for breaches of the Code. ... The ACCC has a less than enviable track record in dealing with commercial practicalities of the Code and introducing penalties may well result in parties having to adopt the ACCC’s interpretations regardless of how impractical, uncommercial or unique the ACCC’s position might be.⁵⁴⁰

There are a number of poorly drafted provisions of the Code that are still open to interpretation. It would be beneficial to “close the gap” and provide clarity in relation to those provisions to ensure the Code is working and to minimise the risk of unnecessary prosecutions for breaches if a penalty regime is introduced.

Unfortunately previous reviews have not focussed on the overall provisions of the Code generally but been focussed on particular areas. Accordingly whilst some mistakes and

⁵³⁷ Franchise Council of Australia, submission to the review, p 14.

⁵³⁸ Minter Ellison, submission to the review, p 12.

⁵³⁹ Dr Elizabeth Spencer and Mr Simon Young, submission to the review, p 8.

⁵⁴⁰ Ibid., p 12.

improvements have occurred over time there are some unresolved wording and application issues that could be clarified or fixed now. An example is the transfer/ novation problem with the Code outlined below which is acknowledged widely in the legal fraternity as being broken and requiring fixing.

It is already Government policy that when drafting industry codes it is important to ensure there is clarity in drafting. It is widely considered amongst the legal community that whilst the framework of the Code is sound, the language used is not precise and if the Government subsequently overlays a penalty regime to an industry code where the language is not always clear then it will create problems for the sector.⁵⁴¹

Some of the provisions in the Code are imprecise in many respects and as a consequence the application of a good faith obligation or any penalty regime would require close scrutiny of that language to identify improvements needed to that language to prevent any inappropriate application or ambiguity.⁵⁴²

There are genuine interpretational difficulties with quite a number of provisions of the Code. If broader penalties such as Infringement Notices were to be introduced the Code would need to be revised to clarify interpretational uncertainties...⁵⁴³

Observations

The language and drafting of certain provisions of the Code should be improved to remove ambiguities and clarify obligations. Particularly given the recommendations with respect to enforcement made in this report (see Part Eight – Enforcement), it is important that there be a clear and unambiguous requirements so that regulators and industry participants can more easily reach consensus about the regulatory requirements.

Even if that were not the case, the efforts of industry and stakeholders in bringing these practical problems to the attention of government have been commendable and should not go without mention. It is naturally a good thing for there to be consistency among how industry is applying provisions of the Code, or approaching the disclosure requirements mandated therein.

Making a number of minor or clarifying amendments to the Code will not change the policy intention behind the provisions. Instead, it will ensure a more uniform approach to disclosure by the industry. Such changes will decrease the possibility that the ACCC and industry participants will take divergent views on ambiguous provisions of the Code, leading to the possibility of the ACCC imposing pecuniary penalties for conduct which a franchisor may have considered lawful. This could also be expected to have a positive effect on disputation where franchisors and franchisees take a different view of the obligations set out in the Code.

⁵⁴¹ Derek Sutherland, submission to the review, p 5.

⁵⁴² Queensland Law Society Franchising Law Committee, submission to the review, p 17.

⁵⁴³ Franchise Council of Australia, submission to the review, p 5.

Recommendation

18. The Code be amended to make the policy intent of the provisions clearer, remove ambiguities, and improve consistency and certainty of industry practice. A suggested list of provisions and possible changes is set out in Appendix D: Technical or minor changes to the drafting of provisions of the Franchising Code.

Glossary

ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law (Schedule 2, CCA)
ASIC	Australian Securities and Investments Commission
CCA	<i>Competition and Consumer Act 2010</i> (Cth)
Code	Franchising Code of Conduct (schedule to the <i>Trade Practices (Industry Codes—Franchising) Regulations 1998</i> (Cth))
Discussion Paper	<i>Discussion Paper: Review of the Franchising Code of Conduct</i> , published on the website of the Department of Industry, Innovation, Science, Research and Tertiary Education on 4 January 2013
Expert Panel	Expert Panel on Unconscionable Conduct and the Franchising Code of Conduct, convened to prepare the report <i>Strengthening statutory unconscionable conduct and the Franchising Code of Conduct</i> (February 2010)
FPC	Franchising Policy Council
Joint Committee	Parliamentary Joint Committee on Corporations and Financial Services report <i>Opportunity not opportunism: improving conduct in Australian franchising</i> (December 2008)
Matthews Review	Review of the Disclosure Provisions of the Franchising Code of Conduct, report to the Hon Fran Bailey MP, Minister for Small Business and Tourism (October 2006)
NSWSBC	New South Wales Small Business Commissioner
OFMA	Office of the Franchising Mediation Adviser
SASBC	South Australian Small Business Commissioner
TPA	<i>Trade Practices Act 1974</i> , now called the <i>Competition and Consumer Act 2010</i> .
VSBC	Victorian Small Business Commissioner
WASBC	Western Australian Small Business Commissioner

Appendix A: Previous reviews of franchising policy

Table 1: Key recommendations and outcomes from 2006 Matthews review

Recommendation/finding	Government response
1. Requirement to include a complete franchise agreement.	Agreed. Many franchisors already provide the complete franchise agreement. This ‘best practice’ should be the norm.
2. Requirement to include copies of all associated agreements and contracts. Amend the Code to require all documents to be provided at least 14 days before the franchise agreement is expected to be signed.	Agreed in principle. The government acknowledges that not all documents required by the franchise agreement are available 14 days before the franchise agreement is expected to be signed. Franchisors will be required to provide copies of all available documents, within the 14 day period and all other documents when they become available.
3. Requirement to include a Risk Statement.	Not agreed. Decisions relating to the viability and associated risks of any business venture are ultimately the decision of the businesses themselves.
4. Disclosure of section 87B TPA (Trade Practices Act 1974) undertakings.	Agreed. Timely knowledge of the existence and content of section 87B undertakings would be likely to be material to the ability of franchisees to make informed decisions.
5. Rebates and other financial benefits.	Agreed. The disclosure of information about financial arrangements provides greater transparency in the relationships between the participants of franchising.
6. Auditing of marketing and other co-operative funds.	Agreed. The Code will be amended so franchisees are provided with a full account of the marketing and other co-operative funds, and with the auditor’s reports.
7. Provision of audited financial information for the franchisor and the consolidated entity.	Not agreed. The government does not support the proposed registration process (recommendation 23) on the grounds that it could create an expectation that the franchise has received the endorsement of the regulator. Decisions relating to the viability and associated risks of any business venture are ultimately the decision of the businesses themselves. In addition, the government is concerned that the regulatory burden of this proposal outweighs the potential benefit to franchisees.
8. More information about past franchises.	Agreed in principle. The Code will be amended to allow franchisors to provide details of names, location and contact details where consent has been obtained and where that information is available to the franchisor.
9. Qualifications of advisors.	Agreed. Prospective franchisees need to be informed by skilled and experienced advisors, with an understanding of franchising.

Recommendation/finding	Government response
<p>10. Disclosure of the business experience of all who have or may have management responsibilities.</p>	<p>Agreed in principle. The government is of the view that the recommendation may inadvertently capture a range of persons whose business experience is of no relevance to the operation of the franchise. The government notes recent amendments to the Corporations Law in this area, and will consult further with stakeholders to determine whether an appropriate definition can be formulated.</p>
<p>11. Opt out clause from providing information requested from Annexure 1.</p>	<p>Agreed. All disclosure information in Annexure 1 can be of importance to franchisees and if requested by them should be provided.</p>
<p>12. Disclosure of materially relevant facts.</p>	<p>Agreed. Franchisees require timely disclosure of information that is materially relevant to the operation of their franchise.</p>
<p>13. Exemption from application of the Code (the exemption to the application of the Code referred to in Part 1, clause 5(3)(a)(i) and (ii) be removed from the Code).</p>	<p>Agreed. All franchisee systems operating in Australia should be subject to the same rules.</p>
<p>14. Franchisees currently excluded from the Code (delete clause 5(3)(c)).</p>	<p>Agreed in principle subject to consultation with industry.</p>
<p>15. Directors to disclose their convictions.</p>	<p>Agreed. Such information may be material to existing and prospective franchisees.</p>
<p>16. The right of unilateral termination to a franchise agreement.</p>	<p>This will be addressed through reform to section 51AC of the TPA in relation to unconscionable conduct where unilateral variation clauses will be a factor that may indicate a corporation has engaged in unconscionable conduct.</p> <p>The government will ask the Australian Competition and Consumer Commission (ACCC) to consider including this issue in their educational material.</p>
<p>17. The right of unilateral change to a Franchise Agreement.</p>	<p>As above, this will be addressed through reform to section 51AC of the TPA in relation to unconscionable conduct where unilateral variation clauses will be a factor that may indicate a corporation has engaged in unconscionable conduct.</p> <p>The government will ask the ACCC to consider including this issue in their educational material.</p>

Recommendation/finding	Government response
<p>18. Prospective franchisees communication with existing franchisees. Part 3 clause 15 of the Code be amended to include a reference to prospective franchisees after the references to franchisees.</p>	<p>Agreed. This protection to current franchisees should be extended to include prospective franchisees to better enable them to conduct their due diligence.</p>
<p>19. General waivers of written representations. Consideration be given as to whether or not franchise agreements and disclosure documents should be prohibited by the Code from including any general waivers of written representations made to potential franchisees or franchisees seeking to extend their franchise agreements.</p>	<p>Agreed. Further consideration will be undertaken on this issue.</p>
<p>20. Clarity at the termination, expiry or non-renewal of an agreement. The Risk Statement should, if significant, refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement.</p>	<p>Agreed in principle. Although the government does not agree to the recommendation for a Risk Statement, the government will ask the ACCC to refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement in its educational material.</p>
<p>21. Clarity in the event of franchisor failure. The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with franchisor failure.</p>	<p>Agreed in principle. Although the government does not agree to the recommendation for a Risk Statement, the government will ask the ACCC to address the importance of considering the consequences of franchisor failure in its educational material.</p>
<p>22. Financial Details. The requirement under item 20 of Annexure 1, to disclose financial details be extended, where applicable, to include the consolidated entity to which the franchisor belongs.</p>	<p>Agreed. The requirement under item 20 of Annexure 1 will be extended to include the financial reports for the consolidated entity.</p>

Recommendation/finding	Government response
<p>23. Registration and Review of Disclosure Documents. The government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate enforcement of the Code. The process would be administered by the ACCC.</p>	<p>Not Agreed. Registration of the franchisors and their disclosure documents could be seen as providing credibility to their claims and ACCC endorsement. The ACCC would not be in a position to ensure the quality nor the substance of the documents. The cumulative paperwork and compliance burden upon franchisors is likely to be significant and would be at odds with the government's policy of reducing the regulatory burden on business, where possible.</p> <p>The government notes that the Franchising Council of Australia has implemented a national franchise-accreditation scheme. The government will request the Franchise Council of Australia to publish a report regarding the details of the scheme, its implementation progress and take-up.</p>
<p>24. The current level of ACCC action relating to franchising. The government appraise the ACCC of concerns expressed to the Committee about the level and extent of action by the ACCC in dealing with claims of breaches of the Code by franchisors.</p>	<p>Agreed. It is appropriate that the ACCC be briefed on the concerns that have been brought to the attention of the Committee. The ACCC worked cooperatively with the review.</p>
<p>25. Implementation of the principle of good faith and fair dealing.</p>	<p>The government agrees with the intention that franchisors, franchisees and prospective franchisees act towards each other fairly and in good faith. Section 51AC of the TPA includes 'good faith' as a factor that can be taken into account when determining unconscionable conduct.</p>
<p>26. Standardisation of the audit period.</p>	<p>Agreed. Consistency with other statutory requirements, such as the <i>Corporations Act 2001</i>, is appropriate.</p>
<p>27. Avoidance of providing the details and history of the territory of site to be franchised together with the disclosure documents.</p>	<p>Agreed. Details and history of the site to be franchised is potentially of critical importance to prospective franchisees.</p>
<p>28. Clarification of 'other payments'.</p>	<p>Agreed. 'Other payments' should 'real property', which are often a major expense to franchisees.</p>
<p>29. Consistency with regard to attaching a copy of the Code to the disclosure document.</p>	<p>Agreed. A copy of the Code should be attached to the disclosure document as required by clause 10.</p>

Recommendation/finding	Government response
<p>30. Clarification of 'extend'. Part 2 clause 6B(1) be amended to read: '(1) A franchisor must give a current disclosure document to: (a) a prospective franchisee; or (b) a franchisee proposing to renew a franchise agreement or extend the scope or term of a franchise agreement'.</p>	<p>Agreed. It is appropriate that a current disclosure document be provided whenever there is any extension of either the scope or term of a franchise agreement.</p>
<p>31. Clarification of the time frame for the measure used to determine the use of the Annexure 1 or Annexure 2 disclosure documents. That in Part 2 clause 6(2) of the Code 'at any time during the term of the franchise agreement' be added after "turnover" to clarify the time frame.</p>	<p>Agreed. This amendment will be made to Part 2 clause 6(2)(a)(i).</p>
<p>32. Definitions of "executive officer" and "officer". That, in view of the repeal of the definition of "executive officer" under the <i>Corporations Law</i>: (a) clause 6(2)(c) of the Code be amended to replace the term "executive officer" with the term "officer"; (b) item 2.6 of Annexure 1 be amended in accordance with Recommendation 10; and (c) clause 3(2) of the Code be amended to delete the term "executive officer", and the usage of that term in the rest of the Code and the Annexures be reviewed.</p>	<p>Agreed in principle. The government notes recent amendments to the Corporations Law in this area, and will consult further with stakeholders to determine whether an appropriate definition can be formulated.</p>
<p>33. Termination of the agreement and costs within the 'cooling off' period.</p>	<p>Agreed.</p>

Recommendation/finding	Government response
<p>34. Relevance of “site” and “premises”. Add a reference to “and premises” after “site” in Annexure 1 item 16.1(a), so that it reads: “site and premises selection and acquisition” Add a reference to “site and” before “premises” in Annexure 1 item 16.1(j), so that it reads: “maintenance and appearance of site and premises, vehicles and equipment”.</p>	<p>Agreed.</p>

Table 2: Key recommendations and outcomes from 2008 Joint Committee inquiry

Recommendation/finding	Government response
<p>1. Amend the Franchising Code to require disclosure documents to include a clear statement by franchisors of the liabilities and consequences applying to franchisees in the event of franchisor failure.</p>	<p>Not supported. The disclosure requirements under the Franchising Code are intended to assist, not replace, standard due diligence processes. The obligation remains on a prospective franchisee, and their advisers, to adequately assess the business opportunity they are considering.</p>
<p>2. Investigate the benefits of developing a simple online registration system for Australian franchisors, requiring them on an annual basis to lodge a statement confirming the nature and extent of their franchising network and providing a guarantee that they are meeting their obligations under the Franchising Code and the TPA.</p>	<p>Not supported. The information that would be available through a registration system is unlikely to provide greater benefit than existing broad statistical information available to the industry through private industry surveys. Therefore the benefit is unlikely to outweigh the costs to business. As the government would not be involved in verifying the accuracy of franchisors’ statements of guarantee, a system of registration of guarantees is unlikely to provide franchisees with any extra benefit, as they would still need to undertake their own due diligence to confirm the accuracy of the information on the register.</p>
<p>3. Review the efficacy of the 1 March 2008 amendments to the disclosure provisions of the Franchising Code within two years of them taking effect.</p>	<p>Agreed in principle. The government agrees to review the efficacy of the 1 March 2008 amendments, and any amendments to the Franchise Code proposed as part of this response to the Joint Committee report, in 2013.</p>

Recommendation/finding	Government response
<p>4. Explore avenues to better balance the rights and liabilities of franchisees and franchisors in the event of franchisor failure.</p>	<p>Supported. The government supports the development, by the ACCC, of additional educational information on the potential consequences and liabilities franchisees could be exposed to in the event of franchisor failure.</p>
<p>5. Amend the Franchising Code to require franchisors to disclose to franchisees, before a franchising agreement is entered into, what process will apply in determining end of term arrangements.</p>	<p>The government will amend the Franchising Code to require franchisors to disclose to franchisees the processes that will apply in determining end-of-term arrangements, including whether or not there is some right of renewal beyond the term of the agreement. Franchisors will also be required to inform franchisees at least six months before the end of the franchise agreement of their decision either to review or to end a franchise agreement.</p>
<p>6. Change the name of Office of the Mediation Adviser to the Office of the Franchising Mediation Adviser and amend the Franchising Code to reflect this change.</p>	<p>Agreed.</p>
<p>7. The Australian Bureau of Statistics develop mechanisms for collecting and publishing relevant statistics on the franchising sector.</p>	<p>Not agreed. To limit the compliance burden on business, the government supports exploring existing mechanisms of data collection. The ACCC currently collates a summary of the statistics it collects in relation to small business disputes and enquiries, and franchising related disputes and enquiries. The government will work with industry, academics and the ACCC to gain a better understanding of the stability of the sector and will continue to investigate future opportunities to collect and publish statistics on the franchising sector, including ABS survey options.</p>
<p>8. Insert a 'good faith' clause into the Franchising Code.</p>	<p>Not Agreed. The government has concluded that a well-defined good-faith obligation is not achievable. The law on good faith is evolving and there is not a single definition or an agreed, standard set of behaviours that constitute good faith. Instead the government will amend the Franchising Code to provide that nothing in the Code limits any common law requirement of good faith in relation to a franchise agreement to which the Code applies.</p>

Recommendation/finding	Government response
<p>9. Amend the TPA to include pecuniary penalties for breaches of the Franchising Code.</p>	<p>Agreed in principle. The government will introduce:</p> <ul style="list-style-type: none"> • pecuniary penalties for blatant abuse of a stronger bargaining position; • targeted enforcement measures for problems in the franchising sector; and • improved enforcement and investigative powers for the ACCC.
<p>10. Consider amending the TPA to provide for pecuniary penalties in relation to breaches of section 51AC, section 52, and other mandatory industry codes under section 51AD.</p>	<p>Agreed in part. The government will introduce civil penalties for breaches of the unconscionable conduct provisions in Part IVA of the TPA, including section 51AC. The government will also introduce civil pecuniary penalties for many of the unfair practices provisions of the TPA, such as section 53.</p> <p>With these changes to the Code, the ACCC will be able to apply for civil pecuniary penalties in response to unconscionable conduct and false or misleading representations. Maximum penalties for this conduct will be \$1.1 million for corporations and \$220 000 for individuals.</p>
<p>11. The ACCC be given the power to investigate when it receives credible information indicating that a party to a franchising agreement, or agreements, may be engaging in conduct contrary to their obligations under the Franchising Code.</p>	<p>The government will amend the TPA to allow the ACCC to conduct random audits under the Franchising Code. The public warning power available under the ACL will be extended to include breaches of the Franchising Code.</p>

Table 3: Key recommendations and outcomes from 2010 Expert Panel review

Finding	Government response
<p>1. Unconscionable conduct</p>	<p>The government adopted the recommendations of the Expert Panel that a set of principles be added to the then TPA. The principles are:</p> <ul style="list-style-type: none"> • Confirmation that the courts may examine both the terms of a contract and behaviour during the life of a contract. • Confirmation that the courts may look at systemic conduct or patterns of behaviour in order to determine whether unconscionable conduct has occurred. • There is no requirement to establish a special disadvantage between the parties, for unconscionable conduct to occur. • That unconscionable conduct under the then TPA can be interpreted more broadly than under existing case law.
<p>2. Unilateral variation of franchise agreement.</p>	<p>The government accepts the Panel’s recommendation and will amend the Code to require franchisors to disclose the circumstances in which unilateral variation to an agreement may take place, and the circumstances in which the franchisor has unilaterally varied a franchise agreement in the past three financial years.</p>

Finding	Government response
<p>3. Unforeseen capital expenditure</p>	<p>The government supported the following Panel’s recommendations in this area:</p> <ul style="list-style-type: none"> • Disclosure of whether significant capital expenditure would be a factor to be considered in deciding to renew the franchise agreement, and whether that has been a factor in the past three financial years. • Information will be provided on whether or not the prospective franchisee would be entitled to an exit payment at the end of the term and, if so, how the exit payment would be determined. • Details will need to be provided on what arrangements would apply at the end of the agreement to unsold stock or to equipment purchased at the beginning of the term. • Details will be provided on whether or not the prospective franchisee would have the right to see the business at the end of the term, whether the franchisor would have the right of first refusal, and on how market value would be determined. • The disclosure statement will also need to state whether a franchise agreement may be amended, even when the franchisee is seeking to sell the franchise, and whether the franchisor will attribute their legal costs to a franchisee in the event of dispute resolution.
<p>4. Sale of business by franchisee</p>	<p>The government will:</p> <ul style="list-style-type: none"> • Require that the potential for any changes at the time when the franchisee is selling a business will be disclosed upfront, before the agreement is signed. • Amend the Franchising Code so that the transfer of an existing franchise agreement will also include the novation of the current franchisee’s agreement, where the prospective franchisee signs a new franchise agreement.
<p>5. Confidentiality agreements</p>	<p>The government agrees with the Panel’s recommendation that prospective franchisees need to be alerted to the categories of information that cannot be discussed with existing and former franchisees, such as outcomes of mediation, settlements, intellectual property and trade secrets.</p>

Finding	Government response
<p>6. Short 'plain English' document, which would be additional to the existing disclosure requirements under the Franchising Code.</p>	<p>The Expert Panel recommended the development of a short, simple, plain English document which would emphasise the key costs, benefits and risks of the franchise system.</p> <p>The government sought the support of the franchising community to voluntarily produce this document; and accepted the recommendation to monitor the evidence of whether franchisees remain unaware of the costs, benefits and risks of franchising in case the short form document should be made mandatory.</p>
<p>7. Good faith</p>	<p>With the law on good faith still evolving, there is not a single definition or an agreed, standard set of behaviours that constitute good faith. The government has therefore concluded that a well-defined good faith obligation is not achievable.</p> <p>The government will amend the Franchising Code to provide that nothing in the Code limits any common law requirement of good faith in relation to a franchise agreement to which the Code applies.</p>

Table 4: Key recommendations and outcomes from 2008 and 2011 Western Australian reviews

April 2008

There was no specific government response to each of the recommendations of the 2008 inquiry.⁵⁴⁴

Recommendation
<p>1.1 The Commonwealth Government work with State and Territory Governments and the franchising sector to develop a coordinated approach to delivering targeted pre-entry education to prospective franchisees.</p>

⁵⁴⁴ The then WA Minister for Small Business, Ms Margaret Quirk, MLA gave the Government's response to this inquiry in the WA Legislative Assembly on 6 May 2008. She stated the 'report makes 20 recommendations, with a strong focus on suggested action to the federal government'. The WA Minister was expected to present the report to the May 2008 Small Business Ministerial Council (SBMC) meeting. A copy of the Minister's speech can be found at:

[http://www.parliament.wa.gov.au/Hansard/hansard.nsf/0/44d70a3628d91ceac8257570000f81df/\\$FILE/A37%20S1%2020080506%20p2403b-2403b.pdf](http://www.parliament.wa.gov.au/Hansard/hansard.nsf/0/44d70a3628d91ceac8257570000f81df/$FILE/A37%20S1%2020080506%20p2403b-2403b.pdf).

The Communique of the May 2008 SMBC meeting states that the Council 'noted that the Australian Government will, consistent with its pre-election commitment, consider the introduction of a well-defined obligation for parties to bargain and negotiate in "good faith" as part of the Franchising Code' (A copy of the communique is available at:

<http://www.innovation.gov.au/SmallBusiness/Support/Documents/2008Communique.pdf>).

Recommendation

- | | |
|-----|---|
| 1.2 | The Commonwealth Government provide funding to State and Territory Governments to cooperatively develop an effective marketing strategy to facilitate the promotion of the information and advisory services available to both franchisees and franchisors. |
| 1.3 | The Commonwealth Government regularly inform the sector about current issues, trends and key areas of concern in relation to franchising via a periodical publication. A component of this publication should provide information that is specifically focussed on education and informing new and existing franchisees. |
| 2.1 | The Commonwealth Government amend the Franchising Code to make it mandatory for franchisors to include, as part of its disclosure document, a statement that highlights the rights and responsibilities of, and risks to, the franchisee. |
| 2.2 | The Commonwealth Government, through the ACCC, develop a standard checklist of known potential risks for prospective franchisees to investigate. The checklist is to be attached to all disclosure documents. |
| 2.3 | The Commonwealth Government immediately amend the Franchising Code to specifically require franchisors to disclose: <ul style="list-style-type: none">• the amount of rebates received from any business for the supply of goods or services to franchisees;• what services they will provide to franchisees in explicit terms;• their financial position to franchisees; and• their relevant franchising experience, qualifications and training. |
| 2.4 | The Commonwealth Government review the Franchising Code by 2010 in order to evaluate the effectiveness of changes to the disclosure provisions and any other amendments. |
| 2.5 | The Commonwealth Government amend the Franchising Code to require all franchisors to register their franchise system with the ACCC. |
| 2.6 | The Commonwealth Government amend the Franchising Code to require all franchise systems to lodge a copy of its current disclosure document annually with the ACCC. |
| 2.7 | The Commonwealth Government, through the ACCC, undertake a regular review of a random sample of disclosure documents to monitor compliance with the Franchising Code and publish the results of their findings annually. |
| 3.1 | The Commonwealth Government amend the Franchising Code to require franchisors to explicitly specify, in the disclosure document, what end of agreement arrangements are in place under the franchise agreement. |
| 3.2 | The Commonwealth Government amend the Franchising Code to require franchisors to explicitly specify, in the disclosure document, what the position is in relation to the franchisee's entitlement or lack of entitlement to goodwill or other compensation if the agreement is not renewed. |
| 3.3 | The Commonwealth Government amend the Franchising Code to require franchisors to conduct a pre-expiry review with the franchisee at least one year prior to the expiry of the franchise agreement. The purpose of the review is to inform the franchisee of any variations between the existing and new agreement and any conditions that need to be met in order for agreement renewal. |

Recommendation	
3.4	The Commonwealth Government amend the Franchising Code to require franchisors to specify, in the disclosure document, a reasonable period of notification in which to inform the franchisee of their intention not to renew the agreement.
4.1	The Commonwealth Government, through the ACCC, review the current mediation processes mandated under the Franchising Code with a view to implementing an earlier, more cost-effective and accessible dispute resolution system.
4.2	The Commonwealth Government amend the Franchising Code in relation to mediation to: <ul style="list-style-type: none"> • require parties in dispute to attend mediation compulsorily; • make mediated agreements enforceable to ensure both parties adhere to the agreed resolutions; and • include prescribed penalties for refusing to attend mediation or refusing to make a genuine attempt to resolve a dispute.
5.1	The Commonwealth Government review its current level of funding to the ACCC in order to ensure adequate resourcing for the monitoring, enforcement and education of franchising participants under the Franchising Code.
5.2	The Commonwealth Government establish a dedicated franchising enforcement unit with the ACCC to proactively monitor and enforce compliance with the Franchising Code and the TPA.
5.3	The Commonwealth Government amend the TPA to prescribe penalties for breaches of the Franchising Code.
5.4	The Commonwealth Government work with the judicial system and the franchising sector to introduce a more streamlined approach to accessing compensation and recovery of costs where a particular court decision impacts on a group of franchisees.

2010

Recommendation/finding	Government response
1. That the Franchising Bill 2010 (the WA 2010 Bill) be opposed.	Supported
2. That, if the WA 2010 Bill is to proceed, clause 4(1) should be amended to explicitly remove any ambiguity as to whether, and to what extent, the Bill is intended to have extra-territorial application.	Supported
3. That if the WA 2010 Bill is to proceed, clause 4 should be amended to stipulate that the Bill does not apply to agreements that are excluded under sections 5(3)(a) and (b) of the Franchising Code.	Supported
4. That if the WA 2010 Bill is to proceed, any statutory obligation to act in good faith should be left undefined.	Supported

Recommendation/finding	Government response
5. The Minister for Small Business ensure that the effectiveness of the amendments to the <i>Competition and Consumer Act 2010</i> and the Franchising Code is reviewed in 2013 by the federal government, with particular emphasis given to considering the need to introduce: <ul style="list-style-type: none"> • civil monetary penalties for breaches of the Franchising Code; and • a general statutory obligation to act in good faith into the Code. 	The government supports the intent of this recommendation.
6. If the Bill is enacted, the Minister for Commerce make sure that administrative arrangements are made between the ACCC and the Commissioner for Consumer Protection to ensure that the risk of a multiplicity of actions under clause 12 is negated.	The government supports the intent of this recommendation.
7. If the WA 2010 Bill is to proceed, clause 13(2) should be amended to apply only to the Commissioner for Consumer Protection.	Supported in principle.
8. If the WA 2010 Bill is to proceed, clause 14(1)(b) “a renewal order” should be removed.	Supported.
9. If the WA 2010 Bill is to proceed, clause 15(1) should be deleted and clause 15(2) should be amended to read: <i>A person who suffers loss or damage by an act or omission of another person that contravenes this Act has a cause of action against that person for damages for the loss or damage.</i>	Supported.

Table 5: Key recommendations and outcomes from 2008 and 2011 South Australian reviews

The 2011 *Franchises* supplementary report of the Economic and Finance Committee of the South Australian Parliament (SA Committee) reviewed how the Commonwealth government’s 2010 changes to the Code addressed the recommendations of the SA Committee’s 2008 inquiry. The ‘Government response’ information, included in the table below, is taken from the 2011 SA Committee report. The majority of the recommendations in the 2008 report relate to issues which fall into the responsibility of the Commonwealth Government. The following responses therefore refer to action by the SA Government and/or the Commonwealth Government, whichever is relevant.

Recommendation/finding	Government response
7.1.1 That the definition of “lessee” in section 3 of the <i>Retail and Commercial Leases Act 1995 (SA)</i> (the RCL Act) be amended to include “licensee” in order to recognise the interests of franchisees as stakeholders under head leases entered into by their franchisors.	Not acted on by the SA government. The SA Minister for Consumer Affairs stated that there is sufficient existing state legislation.
7.1.2 That the RCL Act be amended to prohibit unconscionable conduct in retail leasing, including enforcement and dispute resolution processes to facilitate that prohibition.	Not acted on by the SA government. The SA Minister for Consumer Affairs stated that both the RCL Act and the Commonwealth TPA provide sufficient coverage and protection of this area.
7.1.3 That the Minister for Consumer Affairs require prospective franchisees and franchisors to identify their proposed business as a franchise when they register their business name with the Office of Consumer and Business Affairs.	Not acted on by the SA government. The Commonwealth Government has responsibility for business name registration.
7.1.4 That the Minister provide educational information (including access to seminars) relating to franchising to all businesses registered as franchises (both franchisees and franchisors). This information should be provided both at the initial registration phase and regularly during the life of the business.	Not acted on by the SA government. This is a Commonwealth Government responsibility.
7.1.5 The use of these records as a franchise database for both regulators and researchers.	Not acted on by the SA government. This is a Commonwealth Government responsibility.
7.2 Given jurisdictional limitations, the Committee made recommendations so that they may be taken by the Ministers to the relevant national Ministerial Councils for presentation to the relevant Commonwealth authorities.	-----
7.2.1 The introduction of a mandatory federal registration scheme for franchise disclosure documents.	Not acted on by the SA or Commonwealth governments. This is a Commonwealth Government responsibility and it does not believe that the cost is outweighed by the perceived benefit.
7.2.2 That such a register be maintained by the ACCC which would ensure that all documents lodged with the register comply with Code requirements.	Not acted on by the SA or Commonwealth governments. This is a Commonwealth Government responsibility and it does not believe that the cost is outweighed by the perceived benefit.

Recommendation/finding	Government response
7.2.3 The Franchising Code be amended to require the franchisor to provide continuous and freely accessible disclosure to current and prospective franchisees.	Not acted on by the SA or Commonwealth governments. Existing regulations are considered sufficient.
7.2.4 That item 11 of Annexures 1 and 2 of the Franchising Code be amended to require the franchisor to disclose a summary of its particular experience operating a franchise business.	Not acted on by the SA or Commonwealth governments. Existing regulations are considered sufficient.
7.2.5 The Franchising Code be amended to prohibit any conduct that has the effect of preventing or obstructing communication between prospective and existing franchisees.	Not acted on by the SA or Commonwealth governments. Existing regulations are considered sufficient.
7.2.6 The Committee endorses Recommendation 21 of the Matthews Inquiry and encourages its timely implementation by the Commonwealth.	Acted on in part by the Commonwealth government. 2010 changes to the Code added a new paragraph to the disclosure document that raises risks and consequences of entering into a franchise agreement. The FCA has amended its own franchise guide to include information on franchise failure. The Code changes are sufficient to address this recommendation.
7.2.7 The Franchising Code be amended to remove the exception in item 20.3.	Not acted on by the SA or Commonwealth governments. This is a Commonwealth Government responsibility and was not considered by the Joint Committee or Expert Panel reports.
7.2.8 The Franchising Code be amended to include a requirement to disclose the amount or the methods of calculation of any rebates and/or other financial or commercial benefits received by franchisors or master franchisees in relation to goods or services supplied to franchisees.	Not acted on by the SA or Commonwealth governments. The Commonwealth government advised that existing regulations are sufficient.
7.2.9 The Franchising Code be amended to introduce specific penalties for breaches of the disclosure requirements under the Code.	Acted on in part by the Commonwealth government. The CCA was amended to include financial penalties for breaches of the unconscionable conduct and false or misleading representations provisions.

Recommendation/finding	Government response
7.2.10 Section 51AC of the TPA be amended to include a statutory definition of unconscionability or alternatively by the insertion in the Act of a prescribed list of examples of the types of conduct that would ordinarily be considered to be unconscionable.	Acted on in part by the Commonwealth government. The CCA was amended to include a list of principles to assist with interpretation.
7.2.11 Amending the alternative dispute resolution measures available under the Franchising Code by: (a) mandating more effective mediation of disputes; (b) providing for additional alternative dispute resolution mechanisms allowing the timely and cost effective resolution that would not disadvantage franchisees.	Acted on in part by the Commonwealth government. Changes were made to the Code and new services introduced in July 2011 to assist with resolution of disputes.
7.2.12 Consideration of the establishment of a Franchise Ombudsman, or a Franchise Tribunal, or a specific Franchise Arbitration Unit within the ACCC or other relevant entity to administer the enhanced dispute resolution system.	Not acted on by the SA or Commonwealth governments. Existing regulations are considered sufficient.
7.2.13 Amending the Franchising Code by inserting a provision imposing a duty to act in accordance with good faith and fair dealing by each part of the franchise relationship.	Acted on in part by the Commonwealth Government. Section 23A was inserted into the Code, making reference to good faith and the application of common law.
7.2.14 The Franchising Code be amended to insert a provision imposing a duty to conduct renewal negotiations in accordance with good faith and fair dealing with each party.	Not acted on by the SA or Commonwealth governments. Existing regulations are considered sufficient.
7.2.15 The Franchising Code be amended to include a provision mandating that franchise agreements must include the basis on which termination payments or goodwill or other such exit payments will be paid at the end of the agreement.	Acted on in part by the Commonwealth government. The Code was amended to include disclosure items with regard to end of term arrangements.
7.2.16 The exclusion of inadequate determination of goodwill or other such exit payments of a franchisor during negotiations with a franchisee regarding a franchise agreement constitute “unconscionable conduct” and should be included in any discussions regarding an amendment to section 51AC of the TPA.	Not acted on by the SA or Commonwealth governments. The Code amendments referred to in 7.2.15 above cover off on this issue.

Recommendation/finding	Government response
7.2.17 The ACCC publish the outcomes of any investigations in which franchisors are found to be acting unlawfully or persistently in breach of the Franchising Code. Such findings should further be kept on a publicly accessible register.	Acted on by the Commonwealth government. This is something that the ACCC is doing.
7.2.18 The Franchising Code be amended to include a requirement to disclose: (1) a copy of the franchisor's, or associate's, head lease over a premises; and (2) any sub-leases over the premises occupied by the franchisee for the purpose of conducting the franchise business.	Not acted on by the SA or Commonwealth governments. The existing clause 14 of the Code is considered sufficient.
7.2.19 The ACCC considers providing further resources for the explicit purpose of providing education support to the franchise industry. Such support should take the form not only of printed and electronic materials, but seminars and information lines through which franchise participants might seek help.	Not acted on by the SA or Commonwealth governments. Existing ACCC activities are in place to address this recommendation.
7.2.20 The ACCC strengthen its involvement in the development of case law in the area of unconscionable conduct by supporting actions brought under section 51AC of the TPA and its enforcement and funding strategies to support such an aim.	Acted on in part by the Commonwealth government. The ACCC can and does take decisive action where serious breaches of the Code and/or the CCA are indicated.
7.2.21 The ACCC's jurisdiction with regard to franchising should be amended to accommodate and complement the operation of additional dispute resolution measures and nay body – such as an Ombudsman or tribunal – established to administer such measures.	Not acted on or considered by the SA or Commonwealth governments. The ACCC is a regulatory and enforcement body and therefore the alternative dispute resolution options within the franchise sector should operate outside the ACCC.

Appendix B: Part IVB of the *Competition and Consumer Act 2010*

Part IVB—Industry codes

Division 1—Preliminary

51ACA Definitions

(1) In this Part:

applicable industry code, in relation to a corporation that is a participant in an industry, means:

- (a) the prescribed provisions of any mandatory industry code relating to the industry; and
- (b) the prescribed provisions of any voluntary industry code that binds the corporation.

consumer, in relation to an industry, means a person to whom goods or services are or may be supplied by participants in the industry.

industry code means a code regulating the conduct of participants in an industry towards other participants in the industry or towards consumers in the industry.

mandatory industry code means an industry code that is declared by regulations under section 51AE to be mandatory.

related contravention: a person engages in conduct that constitutes a **related contravention** of an applicable industry code, if the person:

- (a) aids, abets, counsels or procures a corporation to contravene the applicable industry code; or
- (b) induces, whether by threats or promises or otherwise, a corporation to contravene the applicable industry code; or
- (c) is in any way, directly or indirectly, knowingly concerned in, or party to, a contravention by a corporation of the applicable industry code; or
- (d) conspires with others to effect a contravention by a corporation of the applicable industry code.

voluntary industry code means an industry code that is declared by regulations under section 51AE to be voluntary.

(2) For the purposes of this Part, a voluntary industry code binds a person who has agreed, as prescribed, to be bound by the code and who has not subsequently ceased, as prescribed, to be bound by it.

(3) To avoid doubt, it is declared that:

- (a) franchising is an industry for the purposes of this Part; and
- (b) franchisors and franchisees are participants in the industry of franchising, whether or not they are also participants in another industry.

Division 2—Contravention of industry codes

51AD Contravention of industry codes

A corporation must not, in trade or commerce, contravene an applicable industry code.

Division 3—Public warning notices

51ADA Commission may issue a public warning notice

Commission may issue a public warning notice

(1) The Commission may issue to the public a written notice containing a warning about the conduct of a person if:

- (a) the Commission has reasonable grounds to suspect that the conduct may constitute:
 - (i) if the person is a corporation—a contravention of an applicable industry code by the corporation; or
 - (ii) in any case—a related contravention of an applicable industry code by the person; and
- (b) the Commission is satisfied that one or more persons has suffered, or is likely to suffer, detriment as a result of the conduct; and
- (c) the Commission is satisfied that it is in the public interest to issue the notice.

Notice is not a legislative instrument

(2) A notice issued under subsection (1) is not a legislative instrument.

Division 4—Orders to redress loss or damage suffered by non-parties etc.

51ADB Orders to redress loss or damage suffered by non-parties etc.

Orders

(1) If:

- (a) a person engaged in conduct (the **contravening conduct**) that:
 - (i) if the person was a corporation—constituted a contravention of an applicable industry code; or
 - (ii) in any case—constituted a related contravention of an applicable industry code; and
 - (b) the contravening conduct caused, or is likely to cause, a class of persons to suffer loss or damage; and
 - (c) the class includes persons (**non-parties**) who are not, or have not been, parties to a proceeding (an **enforcement proceeding**) instituted under Part VI in relation to the contravening conduct;
- any court having jurisdiction in the matter may, on the application of the Commission, make such order or orders (other than an award of damages) as the court thinks appropriate against a person referred to in subsection (2) of this section.

Note: The orders that the court may make include all or any of the orders set out in section 51ADC.

(2) An order under subsection (1) may be made against:

- (a) the person mentioned in paragraph (1)(a); or
- (b) a person involved in the contravening conduct.

(3) A court must not make an order under subsection (1) unless the court considers that the order will:

- (a) redress, in whole or in part, the loss or damage suffered by the non-parties in relation to the contravening conduct; or
- (b) prevent or reduce the loss or damage suffered, or likely to be suffered, by the non-parties in relation to the contravening conduct.

Application for orders

(4) An application may be made under subsection (1) even if an enforcement proceeding in relation to the contravening conduct has not been instituted.

(5) An application under subsection (1) may be made at any time within 6 years after the day on which the cause of action that relates to the contravening conduct accrues.

Determining whether to make an order

(6) In determining whether to make an order under subsection (1) against a person referred to in subsection (2), a court may have regard to the conduct of:

- (a) the person; and
- (b) the non-parties;

in relation to the contravening conduct, since the contravention occurred.

(7) In determining whether to make an order under subsection (1), a court need not make a finding about either of the following matters:

- (a) which persons are non-parties in relation to the contravening conduct;
- (b) the nature of the loss or damage suffered, or likely to be suffered, by such persons.

When a non-party is bound by an order etc.

(8) If:

- (a) an order is made under subsection (1) against a person; and
- (b) the loss or damage suffered, or likely to be suffered, by a non-party in relation to the contravening conduct to which the order relates has been redressed, prevented or reduced in accordance with the order; and
- (c) the non-party has accepted the redress, prevention or reduction;

then:

- (d) the non-party is bound by the order; and
- (e) any other order made under subsection (1) that relates to that loss or damage has no effect in relation to the non-party; and
- (f) despite any other provision of this Act or any other law of the Commonwealth, or a State or Territory, no claim, action or demand may be made or taken against the person by the non-party in relation to that loss or damage.

51ADC Kinds of orders that may be made to redress loss or damage suffered by non-parties etc.

Without limiting subsection 51ADB(1), the orders that a court may make under that subsection against a person (the **respondent**) include all or any of the following:

- (a) an order declaring the whole or any part of a contract made between the respondent and a non-party referred to in that subsection, or a collateral arrangement relating to such a contract:
 - (i) to be void; and
 - (ii) if the court thinks fit—to have been void ab initio or void at all times on and after such date as is specified in the order (which may be a date that is before the date on which the order is made);
- (b) an order:
 - (i) varying such a contract or arrangement in such manner as is specified in the order; and
 - (ii) if the court thinks fit—declaring the contract or arrangement to have had effect as so varied on and after such date as is specified in the order (which may be a date that is before the date on which the order is made);
- (c) an order refusing to enforce any or all of the provisions of such a contract or arrangement;
- (d) an order directing the respondent to refund money or return property to a non-party referred to in that subsection;
- (e) an order directing the respondent, at his or her own expense, to repair, or provide parts for, goods that have been supplied under the contract or arrangement to a non-party referred to in that subsection;
- (f) an order directing the respondent, at his or her own expense, to supply specified services to a non-party referred to in that subsection;
- (g) an order, in relation to an instrument creating or transferring an interest in land (within the meaning of section 53A), directing the respondent to execute an instrument that:
 - (i) varies, or has the effect of varying, the first-mentioned instrument; or
 - (ii) terminates or otherwise affects, or has the effect of terminating or otherwise affecting, the operation or effect of the first-mentioned instrument.

Division 5—Investigation power

51ADD Commission may require corporation to provide information

(1) This section applies if a corporation is required to keep, to generate or to publish information or a document under an applicable industry code.

(2) The Commission may give the corporation a written notice that requires the corporation to give the information, or to produce the document, to the Commission within 21 days after the notice is given to the corporation.

(3) The notice must:

- (a) name the corporation to which it is given; and
- (b) specify:
 - (i) the information or document to which it relates; and
 - (ii) the provisions of the applicable industry code which require the corporation to keep, to generate or to publish the information or document; and
- (c) explain the effect of sections 51ADE, 51ADF and 51ADG.

(4) The notice may relate to more than one piece of information or more than one document.

51ADE Extending periods for complying with notices

(1) A corporation that has been given a notice under section 51ADD may, at any time within 21 days after the notice was given to the corporation, apply in writing to the Commission for an extension of the period for complying with the notice.

(2) The Commission may, by written notice given to the corporation, extend the period within which the corporation must comply with the notice.

51ADF Compliance with notices

A corporation that is given a notice under section 51ADD must comply with it within:

- (a) the period of 21 days specified in the notice; or
- (b) if the period for complying with the notice has been extended under section 51ADE—the period as so extended.

51ADG False or misleading information etc.

(1) A corporation must not, in compliance or purported compliance with a notice given under section 51ADD:

- (a) give to the Commission false or misleading information; or
- (b) produce to the Commission documents that contain false or misleading information.

(2) This section does not apply to:

- (a) information that the corporation could not have known was false or misleading; or
- (b) the production to the Commission of a document containing false or misleading information if the document is accompanied by a statement of the corporation that the information is false or misleading.

Division 6—Miscellaneous

51AE Regulations relating to industry codes

The regulations may:

- (a) prescribe an industry code, or specified provisions of an industry code, for the purposes of this Part; and
- (b) declare the industry code to be a mandatory industry code or a voluntary industry code; and
- (c) for a voluntary industry code, specify the method by which a corporation agrees to be bound by the code and the method by which it ceases to be so bound (by reference to provisions of the code or otherwise).

51AEA Concurrent operation of State and Territory laws

It is the Parliament's intention that a law of a State or Territory should be able to operate concurrently with this Part unless the law is directly inconsistent with this Part.

Appendix C: Differences between the Long Form and Short Form Disclosure Documents

Long Form	Short Form
1. First Page	1. First Page
2. Franchisor's Details	2. Franchisor's Details
3. Business Experience	NA
4. Litigation	3. Litigation
5. Payment to agents	NA
6. Existing franchises	NA
7. Intellectual property	4. Intellectual property
8. Franchise site or territory	5. Franchise site or territory
9. Supply of goods or services to a franchisee	NA
10. Supply of goods or services by a franchisee	NA
11. Sites or Territories	NA
12. Marketing or other cooperative funds	6. Marketing or other cooperative funds
13. Payments	7. Payments
13A. Unforeseen significant capital expenditure	7A. Unforeseen significant capital expenditure
13B. Costs of dispute resolution	7B. Costs of dispute resolution
14. Financing	NA
15. Franchisor's obligations	8. Franchisor's obligations
16. Franchisee's obligations	9. Franchisee's obligations
17. Other conditions of agreement	NA
17A. Unilateral variation of the franchise agreement	9A. Unilateral variation of franchise agreement
17B. Confidentiality obligations	9B. Confidentiality obligations

Long Form	Short Form
17C. Arrangements to apply at the end of the franchise agreement	9C. Arrangements to apply at the end of the franchise agreement
17D. Amendment of franchise agreement on transfer or novation of franchise	9D. Amendment of franchise agreement on transfer or novation
18. Obligation to sign related agreements	NA
19. Earnings information	NA
20. Financial details	10. Financial details
21. Updates	NA
22. Other relevant disclosure information	11. Other relevant disclosure information
23. Receipt	12. Receipt

A prospective franchisee may ask the franchisor for any of the information in the long form disclosure document that is not in the short form version (i.e. items 3, 5, 6, 9, 10, 11, 14, 17, 18, 19 and 21).

Appendix D: Technical or minor changes to the drafting of provisions of the Franchising Code

In the course of consultations for the review, a number of changes to the Code were recommended or discussed which would not necessarily change the policy intent underlying the Code. These recommended changes clarify the drafting or wording of provisions of the Code. This will assist industry participants and their advisers to understand the obligations set out in the Code, and improve uniformity of approach within the sector by removing some ambiguities.

This Appendix D provides a summary of suggested changes and clarifications to the wording of provisions of the Code. The changes are primarily taken from submissions, and Recommendation 18 of my report is that government consider making these changes next time amendments to the Code are progressed. These amendments are outlined in the table below.

For further discussion, see Part Eleven – Technical or minor changes to the drafting of provisions of the Code.

Suggested amendments to the Franchising Code

Reference	Problem	Recommended change
Clauses of the Franchising Code		
Part 1 – Preliminary		
Clause 3 Definitions	<p>Many clauses in the Code reference ‘financial year’. This is not defined in the Code, triggering the definition in the <i>Acts Interpretation Act 1901</i> which defines ‘financial year’ as ‘a period of 12 months starting on 1 July’.⁵⁴⁵</p> <p>This poses a problem for some foreign franchisors, such as those from the United States, that have a financial year that ends on 31 December. It is not practical for these foreign franchisors to be subject to disclosure requirements halfway through their financial year.</p> <p>This may have been an unintended consequence of removing former clause 9 of the Code in 2001 which referred to ‘the financial year of the franchisor’. There does not appear to have been any intention to change the policy with respect to the relevant financial year when removing clause 9 of the Code in 2001.</p>	<p>Define ‘financial year’ to mean the ‘financial year of the franchisor’.</p>
	<p>It is unclear what is meant by ‘extend or extend the scope of a franchise</p>	<p>Define the phrase ‘extend or extend the scope of a franchise agreement’.</p>

⁵⁴⁵ *Acts Interpretation Act 1901* (Cth), section 2B, ‘definitions’.

Reference	Problem	Recommended change
	<p>agreement'. This phrase appears a number of times throughout the Code.</p> <p>The meaning of this phrase being unclear has implications regarding the issue of unilateral contract variation and when such an amendment may amount to extending of the scope of a franchise agreement. The policy intent of the requirement appears to be that where there is a significant change imposing or providing additional obligations or rights to one or both of the parties this should be an extension of the scope of the agreement.</p> <p>This should also clarify whether a holding over after the end of a term (for example, on a month-by-month basis) is intended to be caught by the phrase 'extend or extend the scope' – this would not appear to be the policy intention of the provision however it has been pointed out that this is unclear.</p>	
	<p>Submissions have highlighted a difference between the general legal understanding of novation and the practice of novation in the franchising industry.</p> <p>According to submissions, common practice within the franchising sector is for new franchise agreements to be entered into, granting a full term to the incoming franchisee. This is unlike the general legal understanding of novation where a party to an agreement is simply replaced.</p> <p>Submissions raised concerns that the effect of the definition of novation in clause 3 of the Code is that it does not make it clear whether an incoming franchisee can enter into a new agreement or must take up the remainder of the outgoing franchisees' agreement term. This definition does not make it clear whether it is the general legal practice of novation or the</p>	<p>Clause 3 should be amended to state:</p> <p>'novation in relation to a franchise agreement, means the termination of the franchise agreement and entry into a new franchise agreement with a proposed transferee on substantially the same terms as the terminated franchise agreement'.</p>

Reference	Problem	Recommended change
	<p>practice that has operated in the franchising industry that the Code refers to for the purposes of novation.</p> <p>Novation was introduced into the Code with the intention of finding a balance between the rights of the franchisor and the interests of the franchisee when it is selling the franchise. The definition has also been criticised because it applies to 'a franchise' rather than 'a franchise agreement'.</p>	
Part 2 – Disclosure		
<p>Clause 10 Franchisor obligations</p>	<p>Many submissions raised concerns about the impracticability of a requirement to include a copy of a franchise agreement 'in the form it is to be executed' with the disclosure document, as required by subclause 10(c).</p> <p>The provision presents practical difficulties and delays at the time franchise agreements are being negotiated and disclosure is being provided by franchisors, since it may require a franchisor to provide multiple instances of disclosure (including restarting the 14 day period) if any changes are made or negotiated to the franchise agreement. This may be the case even if the relevant changes were requested or initiated by the franchisee, or are only minor, such as the insertion of the franchisee's details into the agreement.</p> <p>The government agreed to an earlier recommendation to insert the word 'intended' into the subclause, however when changes were introduced to the code this amendment was missed.</p>	<p>The word 'intended' should be inserted into subclause 10(c) so that it reads:</p> <p><i>...a copy of the franchise agreement, in the form in which it is intended to be executed...</i></p> <p>A guidance note may also be added to note that immaterial changes to the franchise agreement, such as the insertion of the franchisee's details into the agreement, or changes at the request of a franchisee, do not trigger a further 14 day disclosure period.</p>
Part 3 – Conditions of a franchise agreement		
<p>Clause 13 Cooling off period</p>	<p>Subclause 13(2) of the Code states that the seven day cooling off period set out in subclause 13(1) 'does not apply to the renewal, extension, extension of the scope or transfer of an existing</p>	<p>Amend subclause 13(2) of the Code so that it reads:</p> <p>Subclause (1) does not apply to the renewal, extension, extension of the</p>

Reference	Problem	Recommended change
	<p>franchise agreement.’</p> <p>It is argued that this is a drafting error that means the cooling off period applies only to novation, not to the transfer of a franchise agreement. The consequence of this is that, in relation to novation by a franchisor, a franchisee could argue that it has seven days from the novation of the agreement to exit the agreement.⁵⁴⁶</p> <p>It is arguable that the government did not intend to have the seven day cooling off period apply to a novation when it did not apply to a transfer, given that they are treated in similar terms in clause 20 and elsewhere in the Code.</p>	<p>scope, novation or transfer of an existing franchise agreement...</p>
<p>Clause 14 Copy of lease</p>	<p>Clause 14 of the Code requires a copy of a lease or agreement relating to the occupation of premises by the franchisee from the franchisor to be provided within one month. The new clause 18.2 in the standard long form disclosure document introduced in the 2010 amendments requires a franchisor to provide to the franchisee documents that the franchisee will be required to enter into in addition to the franchise agreement, including any lease or other agreement under which the franchisee will occupy premises, at least 14 days before the franchise agreement is signed or as soon as they become available after this time.</p> <p>...insofar as clause 18.2 of the disclosure document deals with premises documents, it overlaps with clause 14 of the Code proper. Clause 14 of the Code effectively provides that where the franchisor or its associate is involved in arrangements concerning premises, the franchisor or its associate must provide to the franchisee the documents</p>	<p>Amend clause 14 to make reference to obligations of the kind referred to in clause 18.2 of the disclosure document to ensure all obligations are consistent and that the two sets of obligations do not conflict. Consideration might also be given to reproducing in the Code, the provisions of clause 18.2 with regard to other types of documents.</p>

⁵⁴⁶ Derek Sutherland, submission to the review, pp 22 - 23.

Reference	Problem	Recommended change
	<p>evidencing the arrangement within 1 month after the documents are signed or the occupation of the premises commences.</p> <p>The provisions of clause 14 are not necessarily inconsistent with clause 18.2 of the disclosure document, insofar as the latter relates to lease documents, although on some interpretations the provisions could conflict.⁵⁴⁷</p>	
Clause 15 Association of franchisees or prospective franchisees	Clause 15 contains double negatives. The clause would be easier to read and be more readily understood if it was written in plain English without double negatives.	Reword clause 15 to remove double negatives.
Clause 18 Disclosure of materially relevant facts	Legislation cited in subclause 18(2)(c) may be referenced incorrectly or has since become inapplicable. Is the purpose of disclosure in this subclause to provide a franchisee with information if a franchisor has had a contract with a franchisee deemed unfair?	Review references to cited legislation and update if necessary.
	Some submissions commented that there is nothing in the Code that requires a franchisor to disclose as a materially relevant fact when there is a change in ownership of the franchise system. Although it seems such a change may fit within a number of the requirements in clause 18(2) such as (a) or (h), apparently in at least one case a franchisor sold its business and claimed that clause 18 was not relevant, so no disclosure was necessary.	Clarify clause 18(2)(a) of the Code to make it clear that a change in the ownership of a franchise system must be disclosed to franchisees by including the following words (in bold) in that provision: <i>...change in majority ownership or control of the franchisor or the franchise system...</i>
Clause 20A End of term arrangements – notification by franchisor	Some submissions claimed that it is not clear from the language of the provision that the relevant notice should be provided in writing, notwithstanding that this appears to be the clear policy intent of the provision. This may also prevent the ACCC from being able to seek a copy of the 20A notice using its audit powers.	Clause 20A should be clarified to include a requirement that a franchisor must provide the relevant notice in writing.

⁵⁴⁷ The Franchise Lawyer, submission to the review, p 7.

Reference	Problem	Recommended change
<p>Clause 23 Termination – special circumstances</p>	<p>During consultation, some parties commented that clause 23 of the Code contains an inequity by giving a franchisor a right to terminate in specific circumstances but not the franchisee. The perceived inequity in clause 23 is questionable. On a strict reading of the provisions of the Code, clause 23 does not provide the franchisor with a right to terminate the franchise agreement, including in the event of the franchisee's bankruptcy or insolvency. Rather, such a right would have to be provided for in the franchise agreement. Clause 23 of the Code merely exempts a franchisor from a <i>procedure</i> which the franchisor must otherwise follow to validly terminate a franchise agreement in accordance with its terms. In all cases of termination, any rights to terminate must be conferred by the franchise agreement.</p> <p>It is also understood that there is a divergence of opinion among practitioners about the effect of subclause 23(g) and whether the parties can agree to the termination of a franchise agreement at the time the franchise agreement is entered into, or whether the agreement has to be reached at the time of termination.</p>	<p>Insert a guidance note into clause 23 to clarify that it does not provide a franchisor with the right to terminate in the circumstances specified in that clause.</p> <p>Clarify 23(g) to include words to the following effect (in bold):</p> <p><i>...agrees to termination of the franchise agreement otherwise than at the time of entering into the franchise agreement. ...</i></p> <p>(It is noted that a substantive change is recommended to the rights of franchisors and franchisees in the Code in the event or one or the other parties insolvency. See Part Three – Franchisor Failure.)</p>
Part 4 – Resolving disputes		
<p>Clause 29 Procedure</p>	<p>Clause 29 contains double negatives. The clause would be easier to read and be more readily understood if it was written in plain English without double negatives.</p>	<p>Reword to remove double negatives.</p>
Annexure 1 – Disclosure document for franchisee or prospective franchisee		
<p>Item 4 Litigation</p>	<p>Legislation cited in item 4, like subclause 18(2)(c) discussed above, may be referenced incorrectly or has since become inapplicable. Is the purpose of disclosure in this subclause to provide a franchisee with information if a franchisor has had a contract with a franchisee deemed unfair?</p>	<p>Review references to cited legislation and update if necessary.</p>

Reference	Problem	Recommended change
Item 9 Supply of goods or services to a franchisee	It is unclear what is intended by the phrase 'other financial benefit'. For example, does it include volume incentives and license fees?	Insert a guidance note or definition for 'other financial benefit'.
Item 13A Unforeseen significant capital expenditure	<p>Submissions raised the impracticality of the franchisor disclosing unforeseen capital expenditure, a requirement added into the Code following a recommendation for further disclosure made by the Expert Panel. The Expert Panel did not favour the imposition of a conditional prohibition on unforeseen capital expenditure or a requirement to obtain a franchisee's agreement. It noted that unconscionable conduct provisions in the ACL may provide recourse where franchisees have been exposed to unilateral contract variations resulting in unforeseen capital expenditure.</p> <p>Many submissions raised concerns that the provision was not achieving its objective of ensuring that prospective franchisees, before committing to the franchise, gain access to essential and meaningful information without unduly burdening both franchisees and franchisors. Some franchisors were said to be merely stating 'yes' in their disclosure documents without providing any further information, whilst others were disclosing a long list of expenses which provided little valuable information to a franchisee.</p>	<p>Amend the Code to clarify the requirements to disclose unforeseen capital expenditure to improve consistency of the industry's approach to disclosure of significant capital expenditure.</p> <p>(It is noted that a substantive change is recommended regarding unforeseen capital expenditure. See Part Four – Transparency of financial information in a franchise.)</p>
Item 17A Unilateral variation of franchise agreement	Many parties raised concerns that there was uncertainty around whether unilateral contract variations may, in some cases, amount to an extension of the scope of a franchise agreement (see discussion at clause 3 above).	The recommendation above in relation to clause 3 will also provide some clarity regarding when a unilateral contract variation may be an extension of the scope of a franchise agreement.
	It was said to be unclear whether the disclosure requirements relate to immaterial amendments to operations manuals and other documents which may, technically speaking, form part of the franchise agreement.	Clarify whether immaterial variations of operations manuals and other documents require disclosure under item 17A.
Item 18 Obligation to sign related	This item conflicts with clause 14 of the Franchising Code. See the discussion above for clause 14 of the Code.	As stated above where clause 14 is discussed, amend clause 14 to make reference to obligations of the kind

Reference	Problem	Recommended change
agreements		referred to in clause 18.2 of the disclosure document to ensure all obligations are consistent and that the two sets of obligations do not conflict. Consideration might also be given to reproducing in the Code, the provisions of clause 18.2 with regard to other types of documents.
Item 19 Earnings information	Some parties suggested that it would be helpful if the terms 'projection' and 'forecast' were defined.	Consider defining the terms 'projection' and 'forecast' in item 19.
Item 20 Financial details	<p>This clause requires franchisors to provide with their disclosure documents a solvency statement signed, as at the end of the last financial year, and financial reports for each of the last two completed financial years (unless an independent auditors report accompanies the solvency statement). This apparently creates a difficulty for franchisors who cannot provide two completed financial years of financial reports or who were not able to sign a solvency declaration as at the end of the previous financial year because they were not incorporated at that time.</p> <p>This may also be a problem for entities newly entering into franchising, noting that the Code does not take into account commercial practice and recommended structuring advice that a separate new entity operates as the franchisor and often intellectual property and corporate stores or supply arrangements are through associated entities.</p> <p>The solvency declaration also does not contemplate the appointment of an administrator or controller to the franchisor or what sort of solvency (or insolvency) declaration an administrator or liquidator would be required to give if it has to provide a disclosure document to a franchisee or prospective franchisee or master franchisee.</p>	<p>Item 20 should be amended to:</p> <ul style="list-style-type: none"> • make it clear that if a franchisor cannot give the two years financial reports, then it must complete a solvency declaration and independent audit report as at the date of the declaration; • clarify the disclosure required if the franchisor was not solvent at the relevant time; and • explicitly require the information mentioned in item 20 to be attached to the disclosure document.

Reference	Problem	Recommended change
	<p>The Queensland Law Society also noted that clause 20 should expressly require franchisors to attach either the accounts or the audit report to the disclosure document. Apparently, while most franchise systems do acknowledge that there is a requirement to do so, there are some who refuse to provide the documents because the obligation is not sufficiently clear.</p>	
<p>Item 22 Other relevant disclosure information</p>	<p>See comments in relation to clause 10(c). This item also contains the phrase 'in the form it is to be executed'.</p>	<p>Similar to clause 10(c), insert the word 'intended' to make the phrase '...in the form in which it is intended to be executed...'</p>
<p>Annexure 2 – Short form disclosure document for franchisee or prospective franchisee</p>		
	<p>It is recommended that Annexure 2 be removed from the Code (see Part Two - Disclosure).</p> <p>Annexure 2 contains similar requirements to those required in Annexure 1. If Annexure 2 remains as part of the Code and amendments are made to Annexure 1 and not to Annexure 2, the two annexures will be inconsistent.</p>	<p>If Annexure 2 is not deleted as recommended, amendments proposed for Annexure 1 should be implemented as they apply to Annexure 2.</p>
<p>Other</p>		
	<p>Some submissions raised concerns that the provisions in the Oilcode and Franchising Code have not remained aligned as reviews have occurred so that changes have not been made to both codes where the provisions are the same.</p>	<p>It is advisable that when the Oilcode is next reviewed, the government consider aligning the wording of provisions which appear in both codes to reflect improvements to the Franchising Code in the context of the current and previous reviews. There should be some reluctance to amend the Oilcode in the absence of a consultation process which has provided parties with an opportunity to make submissions, such as the process underpinning the current review of the Franchising Code.</p>

Appendix E: Consultation

Submissions

From 4 January 2013 to 15 February 2013, stakeholders (including members of the public) could make a written submission to the review. Some late submissions were accepted by prior arrangement with the review secretariat.

A total of 73 submissions were received, including 2 supplementary submissions and 13 confidential submissions. Submissions were received from current and former franchisees, franchisee associations, franchisors, franchisor associations, Members of Parliament, government agencies, lawyers and consultants working in the industry, law societies, business organisations and academics.

1	Mr Trevor Banks
2	Franchisees Association of Australia Incorporated
3	Confidential Submission
4	Bakers Delight Holdings Ltd
5	Mr Phil Blain
6	Mr Peter Abetz MLA, Member for Southern River (WA State Parliament)
7	International Franchise Association
8	Mr Scott Cooper
9	Mr Philip Colman
10	Think DONE Management Consultancy
11	Confidential Submission
12	Competitive Foods Australia Pty Ltd
13	Confidential Submission
14	The Franchise Lawyer (Mr Peter Sanfilippo)
15	Confidential Submission
16	Victorian Small Business Commissioner
17	Confidential Submission
18	Dr Jenny Buchan, Australian School of Business, University of NSW

19	Lottery Agents Association of Victoria
20	Confidential Submission
21	Australian Small Business Commissioner
22	Mr Derek Sutherland (supplementary submission received)
23	Mr Ray Borradale
24	Mr Don Randall MP, Federal Member for Canning (WA)
25	Dr Elizabeth Spencer and Mr Simon Young
26	Mr Aleksandar Trajceski
27	Confidential Submission
28	Australian National Retailers Association
29	Mr Colin Dorrian
30	Mr Tim Hantke (Franchising Solutions)
31	Shopping Centre Council of Australia
32	Franchise Council of Australia
33	Yum! Restaurants Australia Pty Limited
34	KFC Independent and Corporate Franchisee Association of Australia
35	Confidential Submission
36	Real Estate Institute of Australia
37	Post Office Agents Association Ltd
38	Confidential Submission
39	M + K Lawyers (Mr Paul Kirton)
40	Australian Competition and Consumer Commission (supplementary submission received)
41	Confidential Submission
42	Confidential Submission
43	DLA Piper

44	The Hon Judi Moylan MP, Federal Member for Pearce (WA)
45	Avis Budget Group
46	Ms Narelle Walter
47	Quick Service Restaurants Holdings Pty Ltd
48	Confidential Submission
49	Franchise Relationships Institute (Mr Greg Nathan)
50	Queensland Law Society
51	Minter Ellison (National Franchising Group, Ms Rebecca Bedford)
52	Lottery Agents Association of Tasmania and the Australian Newsagents Federation, SA
53	Solomon Bampton (Mr Richard Solomon)
54	Australian Franchising Systems
55	Law Society of South Australia
56	Law Council of Australia, Competition and Consumer Committee, Business Law Section
57	Mr Peter Hayes and Ms Trudi Martin
58	Bedshed Franchising Pty Ltd
59	Jani-King (Australia) Pty Ltd
60	McDonald's Australia Limited
61	Law Institute of Victoria
62	Confidential Submission
63	Law Council of Australia, SME Business Law Committee, Business Law Section
64	Federal Council of Automotive Industries
65	The Franchise Advisory Centre and the Asia-Pacific Centre for Franchising Excellence, Griffith University (Joint submission)
66	Terceiro Legal Consulting (Mr Michael Terceiro)
67	Western Australian Small Business Commissioner
68	Office of the Franchising Mediation Adviser

69	LPO Group
70	South Australian Small Business Commissioner
71	The Hon Adam Searle MLC, the NSW Shadow Minister for Small Business
72	New South Wales Small Business Commissioner
73	7-11 Incorporated

The review also received correspondence from stakeholders that was not in the form of a submission and not intended for publication.

Meetings

In addition to a period for the public to make submissions, meetings were held with the following stakeholders throughout February and March 2013 to discuss key issues arising out of the terms of reference.⁵⁴⁸

1	Mr Aleksandar Trajceski (former franchisee)
2	Australian Competition and Consumer Commission, Deputy Chair, Dr Michael Schaper
3	Australian Competition and Consumer Commission Franchising Consultative Committee
4	Australian Small Business Commissioner, Mr Mark Brennan
5	The Hon Brendan O'Connor MP, Minister for Immigration and Citizenship (former Minister for Small Business)
6	The Hon Bruce Billson MP, Shadow Minister for Small Business, Competition Policy and Consumer Affairs
7	Commonwealth Attorney-General's Department
8	Commonwealth Treasury
9	Derek Sutherland (franchising lawyer)
10	Franchise Council of Australia
11	Franchisees Association of Australia Incorporated
12	The Hon Gary Gray AO MP, Minister for Small Business
13	Mark Maumill (Franchisee, Member of the ACCC Franchising Consultative Committee)
14	New South Wales Small Business Commissioner, Ms Yasmin King
15	Office of the Franchising Mediation Adviser

⁵⁴⁸ Note, this list is not complete as some meetings were confidential in nature.

16	Philip Colman (franchising lawyer)
17	Professor Lorelle Frazer, Asia-Pacific Centre for Franchising Excellence, Griffith University
18	Queensland Law Society Franchising Committee
19	The Hon Bernie Ripoll MP, Parliamentary Secretary for Small Business
20	Robert Toth (franchising lawyer)
21	South Australian Small Business Commissioner, Mr Mike Sinkunas, and Deputy South Australian Small Business Commissioner, Associate Professor Frank Zumbo
22	Western Australian Small Business Development Corporation, Mr David Eaton (Western Australian Small Business Commissioner)
23	Western Australian Minister for Finance, Commerce and Small Business, the Hon Simon O'Brien MLC, together with representatives from Western Australian Department of Commerce
24	Western Australian Shadow Minister for Small Business, the Hon Kate Doust MLC
25	Victorian Small Business Commissioner, Mr Geoff Browne

Appendix F: Summary of publicity relating to the review

It was seen as crucial to the success of the review that stakeholders were adequately informed about the review and knew of the opportunity to provide submissions.

The following is a summary of publicity relating to the review.

Media release and editorial

A media release was issued on 4 January 2013 by the then Minister for Small Business, the Hon Brendan O'Connor MP.

An editorial piece was circulated to over 80 media outlets. A large proportion of these were targeted at ethnic and cultural groups to ensure that franchisees from a non-English speaking background were more likely to hear of the review.

Interviews were conducted with the Australian Financial Review, the Business Review Weekly and smartcompany.com.au. Throughout the period of the review different news outlets published articles about the review drawing on these sources.⁵⁴⁹

The review was also mentioned in articles and newsletters by numerous parties. Examples include the Australian Competition and Consumer Commission (see below), Thompsons Lawyers, Minter Ellison, the Australian Taxpayers Association and the Asia-Pacific Centre for Franchising Excellence.⁵⁵⁰

Letters to stakeholders

Letters were sent to 61 key stakeholders, alerting them to the review and encouraging them to provide a submission.

Notice

A notice was provided to the Franchise Council of Australia and the Franchisees Association of Australia Incorporated. The notice alerted readers to the fact of the review, that submissions were being called for, and provided details of where to find further information.

⁵⁴⁹ See, for example, Brea Carter, 'Franchising Code of Conduct under review', franchise.net.au, 8 January 2013; Jason Murphy, 'Franchisers may face penalties', *Australian Financial Review*, 9 January 2013, p.11; Patrick Stafford, 'Franchise code review head tells SmartCompany what he plans to target', smartcompany.com.au, 9 January 2013; Ben Hurley, 'Franchise "good faith" provisions under review', *Business Review Weekly*, 10 January 2013; 'Review of the Franchising Code of Conduct', *Sydney Morning Herald*, 14 January 2013; Shanna Crispin, 'Federal review to scrutinise franchising code', *Business News Perth*, 16 January 2013, p. 5; 'Submissions sought for franchise code review', *Bendigo Advertiser*, 19 January 2013, p. 37; Michelle Hammond, 'Franchisees call for action on "churning" and "good faith" in government's franchise review', smartcompany.com.au, 11 February 2013; Brea Carter, 'Submissions for code review coming to a close', franchise.net.au, 12 February, 2013.

⁵⁵⁰ See Thomsons Lawyers 'Franchising Alert: 2013 Review of the Franchising Code', [Thompsons Lawyers website](http://ThompsonsLawyerswebsite), 8 January 2013; Minter Ellison 'Federal Government releases terms of reference and appoints experienced franchise mediator Mr Alan Wein to review the Franchising Code of Conduct', [Minter Ellison website](http://MinterEllisonwebsite), 11 January 2013; Taxpayers Association, 'Have your say on review of franchising code of conduct', 16 January 2013, [Taxpayers Association website](http://TaxpayersAssociationwebsite); Griffith University, 'Australian Federal Franchise Inquiry launched', [Griffith University website](http://GriffithUniversitywebsite), 10 January 2013.

These industry associations were asked to distribute the notice to their members, who were in turn asked to forward it, as appropriate (in particular to franchisees).

The notice was also sent to a number of chambers of commerce and business organisations representing ethnic communities, for circulation to their members.

Social media

The review was publicised by Minister O'Connor on 3 January 2013 using Twitter. This tweet has since been deleted from Minister O'Connor's stream.

The Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education also maintains Facebook pages for its [AusIndustry](#) program and [business.gov.au](#) website. These Facebook pages were used to post information about the review.

Business Consultation Website

The Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education maintains the [Business Consultation website](#). The Business Consultation website businesses and individuals more opportunities to be consulted about government policies and regulations that may affect them. The website also allows users to register to receive notifications of new public consultations that are posted to the site by government agencies.

Details about the review of the Franchising Code were posted on the Business Consultation website, with alerts being emailed to users who have subscribed.

ACCC Franchising Information Network

An email was sent to members of the ACCC Franchising Information Network. This is a free information service keeping subscribers informed of recent updates to the Franchising Code of Conduct. Any person can subscribe to this Network via the [ACCC website](#).

Appendix G: ACCC Compliance and Enforcement Policy⁵⁵¹

Policy purpose

This policy sets out the principles adopted by the ACCC to achieve compliance with the law, and outlines the ACCC's enforcement powers, functions, priorities, strategies and regime.

ACCC jurisdiction and available enforcement options

The ACCC is Australia's peak consumer protection and competition agency. The ACCC is an independent statutory government authority serving the public interest. Most of the ACCC's enforcement work is conducted under the provisions of the *Competition and Consumer Act 2010*.

The purpose of the Competition and Consumer Act is to enhance the welfare of Australians by:

- promoting competition among business;
- promoting fair trading by business;
- providing for the protection of consumers in their dealings with business.

The Competition and Consumer Act provides the ACCC with a range of enforcement remedies, including court-based outcomes and court enforceable undertakings. The ACCC also resolves many matters administratively. These options are discussed more fully below.

Australian Consumer Law

The Australian Consumer Law is the national consumer law and is applied at the Commonwealth level and in each state and territory.

At the Commonwealth level it is included as part of the Competition and Consumer Act. Compliance and enforcement with the law will be on a 'one law, multiple regulators' model, with existing consumer regulators enforcing the uniform law.

This policy is consistent with and expands on the principles in the ACL Compliance and Enforcement Guide and outlines the ACCC's approach to compliance and enforcement more generally.

Prioritisation of enforcement matters and the exercise of the ACCC's discretion

In enforcing compliance with provisions of the Competition and Consumer Act, the ACCC's main goals are to:

- maintain and promote competition and remedy market failure, and
- protect the interests and safety of consumers and support fair trading in markets.

⁵⁵¹ Australian Competition and Consumer Commission, *Compliance and Enforcement Policy*, 20 February 2013.

With these goals in mind the ACCC takes action to:

- stop unlawful conduct;
- deter future offending conduct;
- where possible, obtain remedies that will undo the harm caused by the contravening conduct (for example, by corrective advertising or securing redress for consumers and businesses adversely affected);
- encourage the effective use of compliance systems;
- where warranted, take action in the courts to obtain orders which punish the wrongdoer by the imposition of penalties or fines and deter others from breaching the Act.

The ACCC cannot pursue all the complaints it receives about the conduct of traders or businesses and the ACCC is unlikely to become involved in resolving individual consumer or small business disputes. While all complaints are carefully considered, the ACCC's role is to focus on those circumstances that harm the competitive process or result in widespread consumer detriment. The ACCC therefore exercises its discretion to direct resources to the investigation and resolution of matters that provide the greatest overall benefit for competition and consumers.

To assist with this determination, the ACCC gives enforcement priority to matters that demonstrate one or more of the following factors:

- conduct of significant public interest or concern;
- conduct resulting in a substantial consumer (including small business) detriment;
- unconscionable conduct, particularly involving large national companies or traders;
- conduct demonstrating a blatant disregard for the law;
- conduct involving issues of national or international significance;
- conduct detrimentally affecting disadvantaged or vulnerable consumer groups;
- conduct in concentrated markets which impacts on small business consumers or suppliers;
- conduct involving a significant new or emerging market issue;
- conduct that is industry-wide or is likely to become widespread if the ACCC does not intervene;
- where ACCC action is likely to have a worthwhile educative or deterrent effect; and/or
- where the person, business or industry has a history of previous contraventions of competition, consumer protection or fair trading laws.

Where appropriate the ACCC may also pursue matters that will assist to clarify aspects of the law, especially newer provisions of the Act.

The ACCC reviews its priorities regularly. There are some forms of conduct that are so detrimental to consumer welfare and the competitive process that the ACCC will always assess them as a priority. These include cartel conduct and anti-competitive agreements, and the misuse of market power. The ACCC will also always prioritise the assessment of product safety issues which have the potential to cause serious harm to consumers.

In addition to those matters that demonstrate the factors above, the ACCC is currently prioritising its work in the following areas:

- consumer protection in the telecommunications and energy sectors;
- online competition and consumer issues including conduct which may impede emerging competition between online traders or limit the ability of small businesses to effectively compete online;
- competition and consumer issues in highly concentrated sectors, in particular in the supermarket and fuel sectors;
- credence claims, particularly those in the food industry with the potential to have a significant impact on consumers or the competitive process;
- misleading carbon pricing representations;
- the ACL consumer guarantees regime;
- consumer protection issues impacting on Indigenous consumers.

When the ACCC decides not to pursue enforcement action in relation to complaints it receives, it may nevertheless:

- provide information to the parties to help them deal with the matter and gain a better understanding of the Competition and Consumer Act even where a possible contravention of the Act is unlikely;
- postpone or cease investigations where insufficient information is available to it, with a view to later investigation should further information become available;
- draw the possible contravention to relevant parties' attention and provide information to encourage rectification and future compliance where the possible contravention appears accidental, of limited detriment to consumers and of limited gain to the business concerned;
- place the relevant parties on notice about the ACCC's concerns and the possibility of future investigation and action should the conduct continue or re-emerge;
- deal with the matter informally where a business has promptly and effectively corrected a possible contravention and has implemented measures to prevent recurrence.

While the ACCC relies on complaints to identify issues and inform its compliance and enforcement activities, the ACCC is not a complaint handling body that seeks to resolve every approach. It is unlikely to pursue matters that:

- are one-off, isolated events, unless the conduct involves a blatant and deliberate breach of the law;
- are more appropriately resolved directly between the parties under an industry code (for example, by way of mediation);
- involve issues more effectively dealt with at the local level by state and territory agencies (for example, by way of individual dispute resolution of a complaint);
- are primarily contractual or private right disputes (the Competition and Consumer Act provides complainants with a private right of action in these circumstances).

Principles and approaches underlying this policy

The ACCC exercises its enforcement powers independently in the public interest with integrity and professionalism and without fear, favour or bias.

The ACCC's enforcement response is proportionate to the conduct and resulting harm, and the implementation of the ACCC's enforcement policy is governed by the following guiding principles:

Transparency—this has two aspects:

- the ACCC's decision-making takes place within rigorous corporate governance processes and is able to be reviewed by a range of agencies, including the Commonwealth Ombudsman and the courts;
- the ACCC does not do private deals—every enforcement matter that is dealt with through litigation or formal resolution is made public.

Confidentiality—in general, investigations are conducted confidentially and the ACCC does not comment on matters it may or may not be investigating.

Timeliness—the investigative process and the resolution of enforcement matters are conducted as efficiently as possible to avoid costly delays and business uncertainty.

Consistency—the ACCC does not make ad hoc decisions; it sets its focus clearly to give business certainty about its actions.

Fairness—the ACCC seeks to strike the right balance between voluntary compliance and enforcement while responding to many competing interests.

ACCC compliance and enforcement strategy

To achieve its compliance objectives the ACCC employs three flexible and integrated strategies:

- enforcement of the law, including resolution of possible contraventions both administratively and by litigation;
- encouraging compliance with the law by educating and informing consumers and businesses about their rights and responsibilities under the Competition and Consumer Act;
- working with other agencies to implement these strategies.

These strategies are discussed further below.

The ACCC has two additional enforcement strategies, the cooperation policy and the immunity policy for cartels. These are discussed briefly below.

Cooperation policy

The ACCC encourages persons and companies who might have contravened the Competition and Consumer Act to come forward and cooperate with the ACCC to address these possible contraventions.

The ACCC may recognise cooperation by:

- permitting complete or partial immunity from ACCC action;
- making submissions to the court for a reduction in penalty;
- agreeing to an administrative settlement instead of litigation.

This policy is flexible, with the ACCC determining each case on its merits. Further information regarding the ACCC cooperation policy for enforcement matters is available at the ACCC website www.accc.gov.au.

Immunity policy for cartels

The ACCC also has an immunity policy designed to encourage self-reporting of cartel involvement. The immunity policy confers immunity from ACCC action to the first eligible cartel participant to report involvement in a cartel. Immunity is provided subject to certain conditions being met, including full, frank and truthful disclosure and continued cooperation with the ACCC's investigation and any subsequent legal proceedings against other participants. Further information regarding the ACCC Immunity policy for cartels is available at the ACCC website www.accc.gov.au.

Compliance and enforcement outcomes

The ACCC uses a range of compliance and enforcement tools in order to encourage compliance with the Act. In deciding which compliance or enforcement tool (or the combination of such tools) to use, the ACCC's first priority is always to achieve the best possible outcome for the community.

Education, advice and persuasion

The ACCC makes comprehensive use of educational campaigns to provide information and advice to consumers and businesses, and to use persuasion to encourage compliance with the Competition and Consumer Act. The ACCC takes the firm view that prevention of a breach of the Competition and Consumer Act is always preferable to taking action after a breach has occurred. The Commission also seeks to ensure that consumers and small businesses are fully aware of both their rights and responsibilities under the Act.

The ACCC provides targeted and general information, tips and tools to help consumers via a wide range of channels; it liaises extensively with business, consumer and government agencies about the Competition and Consumer Act and the ACCC's role in its administration and is working to ensure that consumer education is embedded in the new National Curriculum. The ACCC aims to ensure that consumers and small businesses are sufficiently well-informed to benefit from, and stimulate, effective competition.

Communicating its enforcement role is fundamental to the effectiveness of the ACCC's information and liaison activities.

Voluntary industry self-regulation codes and schemes

The ACCC encourages and assists genuine voluntary compliance initiatives by individual businesses and industry sectors. These initiatives range from individual trader compliance programs to sector-wide initiatives, including industry charters and voluntary codes of conduct that apply the requirements of the Competition and Consumer Act to the specific circumstances of a particular industry sector.

Administrative resolution

In some cases—for example, where the ACCC assesses potential risk flowing from conduct as low—the ACCC may accept an administrative resolution. Depending on the circumstances, administrative resolutions can range from a commitment by a trader in correspondence to a signed agreement between the ACCC and a trader setting out detailed terms and conditions of the resolution. Administrative resolutions generally involve the trader agreeing to stop the conduct and compensate those who have suffered a detriment because of it, and to take other measures necessary to ensure that the conduct does not recur. The ACCC is unlikely to accept an administrative resolution for conduct that recurs after having been subject to a previous administrative resolution.

Infringement notices

The ACCC may issue an infringement notice where it believes there has been a contravention of the Competition and Consumer Act that requires a more formal sanction than an administrative resolution but where the ACCC considers that the matter may be resolved without legal proceedings.

Section 87B enforceable undertakings

The ACCC often resolves contraventions of the Competition and Consumer Act by accepting court enforceable undertakings under s. 87B of the Act. In these undertakings, which are on the public record, companies or individuals generally agree to:

- remedy the harm caused by the conduct;
- accept responsibility for their actions;
- establish or review and improve their trade practices compliance programs and culture.

Court cases

Legal action is taken where, having regard to all the circumstances, the ACCC considers litigation is the most appropriate way to achieve its enforcement and compliance objectives. The ACCC is more likely to proceed to litigation in circumstances where the conduct is particularly egregious (having regard to the factors set out on page two), where there is reason to be concerned about future behaviour or where the party involved is unwilling to provide a satisfactory resolution.

Under the Competition and Consumer Act, legal action may result in the court:

- making declarations that a company or individual has contravened the Act ;
- making injunctions restraining current or future conduct, or requiring respondents to take certain action;
- requiring respondents to publish notices about their conduct and corrective advertising, and to disclose relevant information to others (for example, to their customers);
- making findings of fact that show contraventions of the Act so that damages may be recovered by consumers and businesses affected by the conduct;
- making orders to achieve financial redress for consumers or businesses harmed by the conduct;
- making various non-punitive orders, including community service or probation orders (which may include orders for implementing a compliance or an education and training program);
- imposing significant pecuniary penalties for breaches of the consumer protection or restrictive trade practices provisions (the ACCC is more likely to seek pecuniary penalties in matters which result in significant consumer detriment, involve blatant conduct or where the traders or individuals concerned have a history of past conduct);
- convicting persons found to have contravened various offence provisions in the Act; and/or
- imposing prison sentences for serious cartel conduct.

Working with other agencies

The ACCC is not always the agency best placed to deal with particular consumer and small business issues. For example, most state and territory fair trading agencies facilitate dispute resolution between consumers and traders and have enforcement responsibilities under the Australian Consumer Law. Various Ombudsmen services may also provide a more appropriate resolution through dispute resolution schemes.

In addition, some business-to-business matters raised with the ACCC are more effectively dealt with under the various mediation services provided by different state and federal governments. Where this is the case, the ACCC will refer the complainant to an appropriate agency or mediation service.