

Industry consultation: *Review of the Franchising Code of Conduct* recommendations, options for implementation and their impact on the franchising industry

Introduction

Franchising

The franchising sector is an important component of Australia's small business sector, with approximately 73 000 franchises and approximately 1180 franchisors in Australia, and an annual turnover in the order of \$131 billion.¹

The interdependent nature of a franchise arrangement makes it a unique business relationship. The success of a franchisor relies on that of a franchisee and vice versa.

A number of laws support participants in the franchising sector. In particular, the *Competition and Consumer Act 2010* (CCA) includes a number of requirements aimed at promoting competition and fair dealing, and protecting consumers. Part IVB of the CCA provides an additional framework to promote fair dealing where there may be a need for additional measures to improve the functioning of an industry, for example, due to the unequal bargaining. This framework aims to involve an industry in a co-regulatory way to address particular industry concerns. To address particular concerns in the franchising industry, the government prescribed the *Trade Practices (Industry Codes – Franchising) Regulations 1998* (the Code) under Part IVB of the Code.

Franchising Code of Conduct

As discussed above, the Code is a mandatory industry code under the CCA that regulates the conduct of franchisors and franchisees. It was introduced, in part, in recognition of the imbalance in bargaining power between franchisors and franchisees.

The purpose of the Code is 'to regulate the conduct of participants in franchising towards other participants in franchising.'² In particular, the objective of the Code is to:

- 'address the imbalance of power between franchisors and franchisees;
- raise the standards of conduct in the franchising sector without endangering the vitality and growth of franchising;
- reduce the cost of resolving disputes in the sector; and

¹ Griffith University, Asia-Pacific Centre for Franchising Excellence, *Franchising Australia 2012* pages 9-12.

² *Trade Practices (Industry Codes – Franchising) Regulation 1998*, clause 2.

- reduce the risk and generate growth in the sector by increasing the level of certainty for all participants.³

Broadly, it seeks to achieve this by requiring franchisors to disclose specific information to franchisees and to follow set procedures in their dealings with franchisees.

The Code provides minimum standards of disclosure and conduct to assist both franchisors and franchisees in undertaking the due diligence process.

The Australian Competition and Consumer Commission (ACCC) enforces compliance with the Code. The Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education (the department) has responsibility for the policy underpinning the Code.

The Australian Government (the government) funded Office of the Franchising Mediation Adviser (OFMA) assists franchisors and franchisees resolve their problems and disputes through an early intervention service and mediation, which is often less costly than going to court.

2013 Wein Review

On 4 January 2013, the former Minister for Small Business, the Hon Brendan O'Connor MP, announced the commencement of an independent review of the Code, to be conducted by Mr Alan Wein.

The terms of reference for the review focused on 2008 and 2010 amendments to 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.

Mr Wein presented his report, *Review of the Franchising Code of Conduct* (the report), to the Minister for Small Business, the Hon Gary Gray AO MP, and the Parliamentary Secretary for Small Business, the Hon Bernie Ripoll MP, on 30 April 2013. The report was made publicly available on 17 May 2013 and can be accessed at www.innovation.gov.au/SmallBusiness/CodesofConduct/Pages/2013-Review-of-the-Franchising-Code-Of-Conduct.aspx.

Request for comment

This consultation paper (paper) has been released by the government to seek stakeholder input on possible amendments to the Code in response to the review.

The paper is intended to be read in conjunction with the review report. The structure of the paper is similar to that of the report and is divided into the same eight, broad topic headings, with the review's 18 recommendations grouped under their relevant part. The discussion of each recommendation includes a short introduction; options (the number of options vary according to the complexity of the recommendation); and discussion questions.

³ Explanatory Statement, *Trade Practices (Industry Codes – Franchising) Regulation 1998*.

This paper continues the consultation process undertaken by Mr Wein and will further inform the government's response to the recommendations made in the report. As such, the government is seeking additional information to that already provided, particularly in relation to the options and questions outlined in this paper. The questions and options are aimed at clarifying the business compliance activities and implementation costs associated with the recommendations and the other options identified in this paper. This paper does not reflect a settled position on the issues by the government.

In your response to this paper, please identify the option you consider the best approach to the problem and why. When considering your response, you should take into account the following factors:

- whether the problem identified in the report would best be addressed by a change to the Code or further education;
- what costs and/or savings (for example, time, legal, accounting or administrative) to franchisors and franchisees there may be if that option is implemented, including initially and ongoing;
- whether there are any benefits or disadvantages of implementing that option; and
- if there are any unintended consequences from the implementation of that option.

This paper is available through the Business Consultation Portal at www.consultation.business.gov.au. Appendix 1 provides a template that may be used to provide comment on the recommendations and options discussed in this paper.

Any written comments may be emailed to the department at franchisingcodereview@innovation.gov.au or may be marked to the attention of:

The General Manager
Business Conditions Branch
Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education
GPO Box 9839
CANBERRA ACT 2601

The closing date for written comments is Tuesday, 9 July 2013. Responses will not be accepted after this date.

It should be noted that while the department will treat correspondence responding to this paper in-confidence, requests may be made for release of information relating to franchising under the *Freedom of Information Act 1982*. A request made under the Freedom of Information Act for a response to this paper to be made available will be determined in accordance with that Act.

Main areas of suggested regulatory reforms

Mr Wein noted that Australia has ‘a good franchise model’ and that the Code generally ‘operates effectively within a very dynamic and difficult economic environment.’ Mr Wein’s recommendations seek ‘to improve upon that model’, as ‘like most industries, there are changes that could be made to improve upon what is already a robust model.’

Mr Wein made 18 recommendations to improve the operation of the Code, including the introduction of civil penalties and an explicit obligation to act in good faith. A number of recommendations are also aimed at addressing specific areas identified as being problematic, such as franchisor failure.

Key areas of regulatory reform proposed by Mr Wein are:

- Recommendation 5 – summary of key risks;
- Recommendation 6 – franchisor failure;
- Recommendation 7 – unreasonable, significant and unforeseen capital expenditure;
- Recommendation 8 – marketing funds;
- Recommendation 9 – express obligation to act in good faith;
- Recommendation 12 – restraint of trade clauses;
- Recommendation 14 – dispute resolution; and
- Recommendation 15 – enforcement.

This paper sets out the problem to be addressed in each of these areas and identifies a range of options that may address the problem. To ascertain the effectiveness and desirability of these options, a series of specific questions have been asked. These key areas of regulatory reform have been explored in some detail.

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Part 1 Disclosure

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.

Introduction

The intention of disclosure is to provide prospective franchisees and franchisees looking to renew their agreement with the information they need to make an informed decision on whether or not to enter into a franchise agreement.

Under the Code, a franchisor must provide a current disclosure document to a prospective franchisee or a franchisee who is considering renewing or extending the scope of their franchise agreement (see clauses 6B and 10). Clause 20A of the Code requires a franchisor to notify a franchisee before the end of the term of the franchise agreement, whether it intends 'to renew or not to renew the franchise agreement [or] enter into a new franchise agreement'. It does not, however, oblige a franchisor to provide a franchisee with a current disclosure document at this time. Mr Wein found that this prevents a franchisee from being able to make a reasonably informed decision when considering the franchisor's notice of intention to renew. Therefore, he recommends that a current disclosure document should be provided at the time a clause 20A notice is provided.

Mr Wein felt that this clarification was needed to ensure the policy intention underlying clause 20A of the Code was implemented.

Options

Option 1: Retain existing arrangements

The requirements of clause 20A will remain unchanged and a franchisor will continue to be required to provide a current disclosure document 14 days before the franchisee is required to enter into the franchise agreement, in accordance with clause 10 of the Code.

Option 2: Amend the Code to implement Recommendation 1

A franchisor notifying a franchisee under clause 20A of the Code of an intention to renew or extend the scope of their franchise agreement would be required to provide a current disclosure document to the franchisee. Though not stated in the recommendation, it is apparent that Mr Wein's intention is for disclosure to take place at the same time as the notice under clause 20A is provided. Any amendment to the Code can make this clear.

Discussion questions

1. Does not receiving a current disclosure document when a franchisor indicates an intention to renew a franchise agreement disadvantage a franchisee? How and why?
2. Which of the proposed options best addresses the problem identified in the review?
3. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
4. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
5. What are the benefits and/or disadvantages from implementing your preferred option?

6. Do you see any unintended consequences arising from the implementation of your preferred option?
7. In what circumstances should there be subsequent disclosure if a current disclosure document is provided at the time a clause 20A notification is given and why? For example, how should the requirements in clause 10 operate if Recommendation 1 is implemented?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

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 information 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.

Introduction

A foreign and/or master franchisor is required to provide a full disclosure document to prospective franchisees and franchises seeking to renew the franchise agreement. Evidence presented to Mr Wein indicated that the level of detail included in the disclosure document is not relevant to a subfranchisee and simply adds compliance costs. He concluded that a full disclosure document should only be required from the master franchisee, with whom the subfranchisee deals directly.

Options

Option 1: Retain existing arrangements

A foreign or master franchisor would continue to be required to provide a full disclosure document to subfranchisors and subfranchisees.

Option 2: Amend the Code to implement Recommendation 2

This option would result in a prospective franchisee, the party that needs disclosure most, receiving all of the information they need, whilst ensuring that only the key information is provided to a master franchisee. It is envisaged that this will reduce duplication and administrative costs for franchisors, whilst simplifying and reducing the volume of material provided to franchisees.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. If implemented, will a master franchisee have all the information it requires to comply with its disclosure requirement under Annexure 1 of the Code?
7. What information should be included in a reduced disclosure document and why?
8. Will a franchisee be adversely impacted by not having access to the full disclosure document that is available under the existing requirements of the Code? Why or why not?
9. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

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 an ability of the franchisor to conduct online sales.

Introduction

Mr Wein received evidence that industry practice on disclosure relating to e-commerce (namely, online sales) has not kept pace with technological and market developments and changes in consumer behaviour. This has become an area of dispute between franchisors and franchisees. In its submission to the review, the ACCC stated that there have been 17 complaints over the last five years from franchisees concerned about online competition from their franchisor. The ACCC considered that this issue will become more prevalent over time. Therefore, Mr Wein concluded that as e-commerce has become more common and an area of contention, it is important that the Code is amended to take account of these developments.

Options

Option 1: Retain existing arrangements

The disclosure of information about online sales in the franchise system will continue to be a matter for the franchisor. However, a prospective franchisee or franchisee could of its own initiative seek information about the rights and benefits of online sales from the franchisor before entering into or renewing the agreement, as part of its due diligence.

Option 2: Amend the Code to implement Recommendation 3

The Code would be amended to require the disclosure of the rights of the parties to a franchise agreement as they relate to online sales.

Technical note: Annexure 1 of the Code could be amended with the insertion of an additional item. The item could be titled '11A Online Sales'. Potential wording of this may be: 'The rights of the franchisor and franchisee respectively to conduct and benefit from online sales, including any ability of the franchisor to conduct online sales. In this context, online sales includes sales made to customers, regardless of whether they are located within the territory in which the franchised business operates or not.'

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Are you aware of instances where a prospective franchisee or a franchisee's request for information about online sales was refused or inadequate information was provided?
7. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Recommendation 4: The Code be amended to remove Annexure 2 (Short form disclosure document for franchisee or prospective franchisee).

Introduction

Under subclause 6(2)(a)(ii) of the Code, a franchisor can provide a prospective franchisee or franchisee with either a long form disclosure document, in accordance with Annexure 1 to the Code, or a short form disclosure document, in accordance with Annexure 2, 'if the franchised business has an expected annual turnover of less than \$50 000'.

Short form disclosure was introduced to cater for low-investment franchise systems. Mr Wein received evidence that the short form disclosure document is no longer used.

Options

Option 1: Retain existing arrangements

Under this option, franchisors would still be required to provide disclosure with either Annexure 1 or 2, if the franchise business is expected to have an annual turnover of less than \$50 000. If a franchisee is provided with disclosure in accordance with Annexure 2, it can request any of the information contained in Annexure 1, the long form disclosure document.

Option 2: Amend the Code to implement Recommendation 4

Annexure 2 would be deleted from the Code and there would no longer be a short form disclosure document available to prospective franchisees or franchisees.

Option 3: Amend the Code to increase the threshold for use of short form disclosure

The Code would be amended to increase the threshold value for the use of the short form disclosure document.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?

4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Do you use the short form disclosure document? If the threshold to which Annexure 2 applies was increased, would this increase the use of disclosure in accordance with Annexure 2? What should this threshold be increased to?
7. Are those franchisors that have provided short form disclosure under Annexure 2 subsequently asked to provide additional information that is required under Annexure 1?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Recommendation 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).

Introduction

Mr Wein received evidence that the increasing complexity and length of disclosure documents is leading to a decline in their scrutiny by prospective franchisees. This recommendation is intended to provide prospective franchisees and franchisees with an additional tool to encourage them to conduct due diligence.

It should be noted that the implementation of any option relating to disclosure does not affect the need for a prospective franchisee or existing franchisee to obtain independent advice before entering into, renewing or extending the scope of an existing franchise agreement.

Options

Option 1: Retain existing arrangements

A franchisor will continue to include the generic risk statement on the first page of a disclosure document pursuant to item 1 of Annexure 1. Clause 11 of the Code, which effectively requires a franchisee to obtain advice about the proposed franchise agreement from an independent legal adviser, business adviser or accountant before a franchise agreement is entered into, unless a conscious decision is made not to seek this advice despite it being recommended, will also continue to apply.

Option 2: Amend the Code to implement Recommendation 5

In addition to the inclusion of a generic risk statement required by item 1 of Annexure 1, a franchisor will be required to provide a prospective franchisee with a short summary of the key risks and matters they should be aware of when going into franchising. To ensure a consistent approach, the government could produce a template, after consultation with stakeholders. As with Option 1,

clause 11 will also continue to apply, requiring a franchisor to receive from a franchisee a statement that they have obtained independent advice or chosen not to do so.

Option 3: Improved education of prospective franchisees about undertaking due diligence

The ACCC would be asked to develop a factsheet on the risks and benefits of franchising and the importance of seeking independent advice that can be provided to a prospective franchisee or franchisee through a variety of means including the franchisor, the ACCC or government agencies. This document would incorporate the principles of the recommendation and/or a list of behaviours of successful franchisees.

Option 4: Mandatory education for franchisees

All new prospective franchisees would be required to undertake a franchising course, which would include training on the risks.

Option 5: Amend the Code to require signed statutory declarations

This option would amend clause 11 to replace references to 'written statement' with 'signed statutory declaration'.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. How should this statement be different from the generic risk statement already provided under item 1 of Annexure 1?
7. What are the key risks and matters that should be included in the statement?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Part 2 Franchisor failure

Recommendation 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.

Introduction

Clause 23 of the Code does not give a franchisor a right to terminate a franchise agreement. Whether a right to terminate exists depends upon the terms of a franchise agreement and the application of the general law. Clause 23 allows a franchisor who wishes to terminate a franchise agreement, in the event a franchisee becomes bankrupt, insolvent under administration or an externally-administered body corporate, to provide relief from procedural requirements set out in the Code.

Concerns were raised with Mr Wein during the review that the problem of franchisor failure is a serious and ongoing one and that amendments to item 1 of Annexure 1, the inclusion of a warning statement that a franchise is like any other business and that it may fail, did not go far enough.

Two of the specific problems identified by Mr Wein were:

- the inability of a franchisee to terminate its relationship with a franchisor in the event of the franchisor's insolvency (even though franchisors usually have a right to terminate in the event of the franchisee's insolvency); and
- the fact that a franchisee is not usually treated as a creditor when a franchisor becomes insolvent, meaning it cannot participate in creditor meetings and other mechanisms designed to protect parties who had dealings with that franchisor.

Options

Option 1: Retain existing arrangements

Franchisees and franchisors will not have a right under the Code to terminate a franchise agreement after the appointment of an administrator. Clause 23 of the Code will still apply.

Option 2: Amend the Code to implement Recommendation 6

The Code would be amended to provide that a franchisee and franchisor have the right to terminate the franchise agreement in the event the franchisor goes into administration, provided certain conditions are met. Additionally, a franchisee will be made an unsecured creditor of the franchisor by notionally apportioning the franchise fee across the life of the franchise agreement.

Mr Wein's intention with recommendation 6(a) is to 'provide franchisees with more certainty regarding the procedure and timing of the options they will be faced with if the franchisor fails', if the franchise agreement does not already contain a clause addressing possible franchisor failure.

Recommendation 6(b) is aimed at providing franchisees with rights in the event of franchisor failure, similar to the rights of creditors, noting that at present creditors may enjoy greater rights than a franchisee, whose business is intimately linked with that of the franchisor.

Option 3: Amend the Code so that the disclosure document includes examples of possible consequences of franchisor failure

The warning statement in item 1 of Annexure 1 would be amended to include examples of problems a franchisee may face in the event of franchisor failure.

Option 4: Increased education

The ACCC would be asked to develop specific educational material about the consequences that may apply to a franchisee in the event of insolvency of a head franchisor, franchisor or master franchisor.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Is it common for a franchise agreement to include provisions relating to what is to happen in the event of franchisor failure? Why or why not?
7. What is the purpose of a franchise fee and how is it typically used by a franchisor? Does this impact on how Recommendation 6(b) could apply?
8. It is believed that the majority of franchise arrangements include a franchise fee. What franchise arrangements do not involve a franchise fee? How could Recommendation 6(b) apply to these arrangements, if at all? Should Recommendation 6(b) apply where there is no upfront fee paid?
9. Would the implementation of Recommendation 6(b) change a franchisor's operations, for example, how it structures its fee arrangements? If so, how?
10. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Part 3 **Transparency of financial information in a franchise agreement**

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.

Introduction

The 2010 amendments to the Code attempted to address one aspect of the possible imbalance in power between franchisors and franchisees by requiring greater disclosure from franchisors of ‘unforeseen capital expenditure that was not disclosed by the franchisor before the franchisee entered into the franchise agreement’. Mr Wein indicated that the act of disclosing ‘unforeseen capital expenditure’ may not have provided the benefits intended when the amendment was introduced. Some submitters indicated that franchisors provide franchisees with a list of every possible expense which could arise, however unlikely some of these may be. Others submitted that franchisors indicated there would be unforeseen capital expenditure but gave no indication of what this might be.

Recommendation 7 seeks to augment the 2010 amendments by prohibiting such expenditure, where it is ‘unreasonable’ and ‘significant’. Those terms are to be defined so as to require the franchisor to demonstrate a business case for the expenditure. Mr Wein noted that a demand that a franchisee engage in significant capital expenditure has no direct costs for a franchisor, only benefits. On the other hand, the costs may outweigh any benefits for franchisees.

Options

Option 1: Retain existing arrangements

There would be no specific prohibition on the imposition of ‘unreasonable significant unforeseen capital expenditure’. However, potential changes to other parts of the Code may address behaviours which may fall under this description.

Currently item 13A in Annexure 1 of the Code (also reflected in item 7A in Annexure 2 of the Code) requires franchisors to disclose if they ‘will require the franchisee ... to undertake unforeseen significant capital expenditure that was not disclosed by the franchisor before the franchisee entered into the franchise agreement.’

Option 2: Amend the Code to implement Recommendation 7

The Code would be amended to ‘prohibit franchisors from imposing unreasonable significant capital expenditure’. The terms ‘unreasonable’ and ‘significant’ would be defined in the Code, with a view to a franchisor being able to demonstrate a business case for significant capital investment by the franchisee.

Option 3: Increase disclosure and adopt minor/technical amendment recommended

Item 13A of Annexure 1 of the Code would be amended through the minor amendment suggested by Mr Wein in Part 11 of his report. This proposed amendment seeks to produce a consistent approach in the franchising industry to disclosing unforeseen capital expenditure, so that this disclosure is most useful to a prospective franchisee or franchisee.

This option would also see item 13A amended to increase the disclosure requirements in the area of financial information, providing a prospective franchisee with the information necessary to make an informed decision before entering into a franchise agreement.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Have the 2010 changes to the Code been in place long enough for the increased disclosure requirements regarding unforeseen capital expenditure to take full effect?
7. How should 'unreasonable' and 'significant' be defined for the purposes of the Code?
8. What are the practical implications of requiring a franchisor to prepare a business case in relation to proposed capital expenditure? What compliance costs (if any) may this impose?
9. What effect would the proposed recommendation and options have on the number of disputes between franchisors and franchisees? Why?
10. If an obligation to act in good faith was implemented, would this address any issues in relation to 'unreasonable significant unforeseen capital expenditure'?
11. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

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.

Introduction

The use of marketing funds by franchisors was highlighted in submissions to Mr Wein as an area of concern for franchisees and source of tension between franchisors and franchisees. Two consistent themes raised were the management of marketing funds lacking transparency and that these funds were prone to questionable use by the franchisor. There was also the comment that some franchisors are avoiding obligations with respect to marketing funds by structuring the fund and

payments to the marketing and advertising fund so that the definition of a fund as set out in the Code is not met.

Options

Option 1: Retain existing arrangements

The administration of marketing funds would continue to be undertaken according to existing requirements in clause 17 of the Code. Under item 12 of Annexure 1 of the Code, there are extensive disclosure requirements relating to marketing funds. These disclosure requirements include who contributes to the fund, how much they contribute, details of audits and what the funds will be used on.

Currently subclause 17(2) of the Code states that a franchisor does not have to comply with the requirement to prepare an annual financial statement detailing the fund's receipts and expenses or have the statement audited if 75 per cent of the franchisees who contribute to the fund vote to agree that the franchisor does not have to comply with this requirement. This approval remains in force for three years.

Existing provisions of the CCA may provide a remedy for the misuse of marketing funds.

Option 2: Amend the Code to implement Recommendation 8

The Code would be amended so that a franchisor would be required to manage marketing funds in accordance with the six principles outlined in Recommendation 8.

The objective of the recommendation is to provide transparency and accountability about the extent and use of the franchise business marketing funds. It is noted that if implemented the recommendation could potentially improve administrative practice and would ensure that company-owned units contributed equally to the marketing and advertising fund.

Option 3: Amend the Code to require an annual audit

Amend the Code to remove subclauses 17(2) and 17(3), which would have the effect of requiring the franchisor to have the annual financial statement audited by a registered company auditor within 4 months of the end of the financial year. It would remove the ability of franchisees to vote against a yearly audit. It would essentially be adopting parts (e) and (f) of Recommendation 8.

Option 4: Amend the Code to adopt Recommendation 8(c) and concurrently increase the level of education

This option is to adopt part (c) of Recommendation 8 to require company-owned units to contribute to the marketing and advertising fund on the same basis as franchised units. This option would be implemented with increased education to franchisors and franchisees on common reasons why disputation occurs in relation to marketing funds and how to avoid this.

Option 5: Increase education

The ACCC would be asked to prepare educational material on common reasons why disputation occurs in relation to marketing funds and how to avoid this.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?

3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Would the introduction of an obligation to act in good faith address the concerns raised in relation to the franchisor's use of marketing funds?
7. Would the implementation of this recommendation reduce disputes between franchisees and franchisors? Why?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Part 4 Good faith (and confidentiality of contact details for ex-franchisees)

Recommendation 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 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.

Introduction

The interdependent nature of a franchise relationship and the inherent imbalance of power between franchisors and franchisees can leave parties vulnerable to opportunistic behaviour by the other party. This opportunistic behaviour can be demonstrated by either party to a franchise agreement.

Good faith in franchising was included in the terms of reference of the review and was widely discussed in submissions. Good faith was also considered in previous reviews of the Code, at both state and federal levels. Mr Wein stated that consultation during the review ‘presented consistent anecdotal evidence of questionable behaviours in franchising’ and that ‘these behaviours may be addressed by a sensible obligation to act in good faith being incorporated into the Code’. His report also indicates that there is still uncertainty within the industry as to whether the parties to the franchise agreement have an obligation to act in good faith towards each other.

Options

Option 1: Retain existing arrangements

Under this option there would be no change to the current position. The Code does not limit any obligation imposed by the common law on parties to franchising agreements to act in good faith by virtue of clause 23A. However, the parties to a franchise agreement may contract out of this obligation.

It is understood that the common law obligation to act in good faith only relates to the performance of the franchise agreement itself, not to its negotiation or dispute resolution.

Existing laws would continue to apply to the franchising industry, including:

- provisions in the Australian Consumer Law (ACL) relating to:

- misleading or deceptive conduct (section 18);
 - unconscionable conduct (sections 20-22);
 - false or misleading representations about the supply of goods or services (section 29);
 - wrongly accepting payment without an intention to supply goods or services (section 36) or
 - making false or misleading representations about the profitability or risk or other material aspect of any business activity (section 37);
- the common law relating to misrepresentation; and
 - the legal doctrines of equitable estoppel and undue influence.

Option 2: Amend the Code to implement Recommendation 9

This option is to accept and implement the recommendation made in the report in full. This would require the Code to be amended to include an express obligation for the parties to a franchise agreement to act in good faith towards each other in all aspects of the franchising relationship, including the negotiation of the agreement, its performance and the resolution of any disputes between the parties, regardless of whether a valid agreement is still in place at that time. The obligation of good faith would be defined in terms of the common law. The parties to the franchise agreement will not be able to contract out of the obligation.

Under this option, the existing laws outlined in Option 1 would continue to apply.

Option 3: Amend the Code to include a defined obligation to act in good faith

This option would implement the policy intent behind the recommendation, but provide franchisors and franchisees with more certainty on their obligations in relation to good faith.

One objection to implementing the recommendation is that there is no clear definition of good faith. This may be addressed by including some words explaining the intended meaning of good faith, while stating that the definition does not limit the operation of any common law obligation to act in good faith. A possible formulation, based on the Franchising (South Australia) Bill 2009 and the West Australian Franchising Bill 2010, would be to include words to the following effect:

Without limiting the definition of good faith, for the purposes of this clause, to act in good faith means to act fairly, honestly, reasonably and in a cooperative manner.

Alternatively, the Code would be amended to include a list of the factors a court may have regard to when deciding whether a party to an agreement has contravened the obligation to act in good faith.

If, however, it is believed that greater certainty is preferable, the amendment would include words to the following effect:

For the purposes of this clause, to act in good faith means to act fairly, honestly, reasonably and in a cooperative manner.

Under this option, the existing laws outlined in Option 1 would continue to apply.

Option 4: Improved education of parties about their existing obligations at common law

This option would complement Option 1. While maintaining the status quo, the adoption of this option would seek to improve the conduct of the parties to a franchise agreement by making them more aware of their obligations to comply with any common law obligation to act in good faith.

Given its expertise in this area, the lead on such education would likely fall to the ACCC. However, there would also be a strong onus on franchisor and franchisee representative groups, such as the Franchising Council of Australia and the Franchisees Association of Australia; small business commissioners; and government agencies generally, to undertake this work.

Under this option, the existing laws outlined in Option 1 would continue to apply.

Option 5: Every franchise agreement to include an obligation to act in good faith

Under this option, every franchise agreement would be required by law to include an obligation that the parties comply with the common law duty of good faith. If such an obligation was not included in an agreement, it would be a breach of the Code. Parties who failed to act in good faith would not breach the Code. However, it would be a breach of the franchise agreement if parties failed to act in good faith, and this may give rise to legal action for breach of contract. A possible amendment to the Code would be to replace clause 23A with words to the following effect: 'a franchise agreement must include a requirement that the parties to the agreement will act in accordance with the requirements of good faith in carrying out the terms of such an agreement'. Good faith could then be defined in the Code.

As contractual disputes are not a matter for the ACCC, it would not have any role in enforcing a contractual obligation to act in good faith. However, the ACCC could take action to enforce the Code if a good faith provision was not included in a franchise agreement as required by the Code.

Under this option, the existing laws outlined in Option 1 would continue to apply.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Do you understand what acting in good faith, as defined by the common law, means?
7. Is there conduct that would be addressed by an explicit obligation to act in good faith but not by existing law, in particular the ACL or the Code?
8. What do you consider to be acting in bad faith within a franchise agreement?
9. Is it practical, from the point of view of time and cost, to allow the law of good faith in franchising to develop under the common law? Would this process be accelerated by including a definition or a non-limiting definition in the Code?
10. What effect do you believe inclusion of an obligation to act in good faith would have on the cooperative working relationship between the parties to a franchise agreement and why?

11. If good faith is included in the Code as a defined obligation, how should it be defined?
Should the definition be exhaustive?
12. At what points during the franchising relationship should there be an obligation of good faith and why?
13. What effect would the proposed recommendation and options have on the number of disputes between franchisors and franchisees? Why?
14. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Recommendation 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.

Introduction

Due diligence conducted by a prospective franchisee prior to entering into a franchise agreement may include a discussion with current and former franchisees. Evidence presented to Mr Wein suggested that some franchisors may be circumventing the requirement to provide prospective franchisees with the contact details of ex-franchisees or existing franchisees. Franchisors were said to achieve this by soliciting requests from ex-franchisees or existing franchisees that their details not be disclosed to incoming franchisees. Mr Wein described this as a 'serious' issue that 'should be directly addressed by an amendment to the Code'.

Options

Option 1: Retain existing arrangements

A franchisor will continue to be required to provide the contact details of current and former franchisee, unless 'the franchisee has requested in writing that the details not be disclosed' in accordance with item 6 of Annexure 1. A franchisor is not prevented from seeking such a written request from a franchisee.

Option 2: Amend the Code to implement Recommendation 10

Annexure 1 of the Code would be amended to ensure that a franchisee's contact details will only be kept confidential if that franchisee initiates the non-disclosure. Such a request must be made in writing and not be procured in any way by the franchisor.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Are there legitimate reasons why a franchisor might initiate, procure or encourage a franchisee to sign a document that prevents it from disclosing a franchisee's details?

7. What impact will the implementation of Recommendation 10 have on a prospective franchisee, franchisee or franchisor? What impact will this have on the franchising industry?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Part 5 The transfer, renewal or end of a franchise agreement

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]

Introduction

Mr Wein identified a need for a franchisor to be provided with the information it requires to be able to assess a proposed transfer or novation of a franchise agreement put forward by a franchisee, before it is deemed to have consented to the transfer or novation.

Options

Option 1: Retain existing arrangements

Under this option there would be no change to the current arrangements for a franchisee seeking the franchisor's consent for a transfer or novation of their franchise. A franchisor will continue to have 42 days, from receiving notification from the franchisee, to provide consent. The 42 day decision period would continue to run despite any subsequent requests from the franchisor for further information about the proposed transfer and prospective new franchisee.

Option 2: Amend the Code to implement Recommendation 11

The intent of the recommendation and, therefore, this option, is to ensure that a franchisor has the information reasonably required to make a decision about the transfer or novation of a franchise agreement. Under this option, the 42 day period for the decision process will only commence when the franchisee has provided all the information the franchisor reasonably requires under the franchise agreement to make an informed decision.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Is any amendment necessary to existing arrangements if an explicit obligation to act in good faith is included in the Code? Why?

7. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

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.

Introduction

In his report, Mr Wein referred to instances where franchise agreements were not renewed in all situations where a franchisee was not in breach and wished to continue in the franchising relationship. He did not, however, believe that an automatic right of renewal was appropriate, nor that franchisees should be entitled to a fixed or minimum term. In keeping with basic principles of contract law, the Code is silent on the arrangements that apply at the end of the agreement. It therefore does not impose contract conditions on parties or force parties to engage in contractual arrangements against their will.

Options

Option 1: Retain existing arrangements

Under this option there would be no restriction on franchisors exercising a restraint of trade clause in their franchise agreements. Under the current clause 20A and item 17C of Annexure 1 (and item 9C of Annexure 2) of the Code, a franchisor would still be required to disclose information about the end of term arrangements that apply to the franchise agreement, including any restraint of trade clause that may apply.

The common law relating to restraint of trade clauses will continue to apply to a franchise agreement. The aim of these laws is to read down or make void restraint of trade clauses which are anti-competitive and do not protect the legitimate business interests of the party that is seeking to benefit from the clause.

Option 2: Amend the Code to implement Recommendation 12

Under this option, the Code will be amended to prevent a franchisor from enforcing a restraint of trade clause against a compliant franchisee, when the franchisor has decided not to renew the franchise agreement, provided all conditions in the recommendation are satisfied.

Option 3: Increase education

Under this option, the government will ask the ACCC to produce educational material to make it clearer about the arrangements that will apply at the end of the franchise agreement and educate potential franchisees about the possibility of a restraint of trade clause in their franchise agreement.

It is envisaged that this educative material will assist franchisees to make a more informed choice about any proposed restraint of trade clause in their franchise agreement.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. What legitimate reasons, if any, might a franchisor have for enforcing a restraint of trade clause in the circumstances noted in the recommendation?
7. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Part 6 **Dispute resolution**

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.

Introduction

The government provides funding for the Office of the Franchising Mediation Adviser (OFMA) to assist parties to a franchising agreement who are in dispute. OFMA arranges mediation for franchising parties who are in dispute at an average cost of \$1200 for each party, and can also offer parties assistance through a free early intervention service.

In addition to the services offered by OFMA, there are a number of other bodies who may be able to assist franchising parties in dispute. Examples include the dispute resolution services offered by the state small business commissioners. In his report, Mr Wein noted benefits from the availability of a range of mediation and alternative dispute resolution services offered by government and non-government providers.

Mediation and other forms of alternative dispute resolution services for franchising parties are beneficial, as they:

- lower the cost of resolving disputes;
- make the dispute resolution system more flexible and responsive to the needs of the industry; and
- help to reduce litigation between parties, which is often counter-productive to the symbiotic nature of the franchising relationship or outside the reach of the parties.

Mr Wein noted that success rates for OFMA and other alternative dispute resolution services available to franchising parties are in the range of 70-90 per cent.

Some submissions made to Mr Wein called for the government to introduce additional mechanisms for dispute resolution, such as arbitration, for franchising disputes which fail to settle at mediation. Mr Wein considered that instead of recommending a tribunal or ombudsman system, and the associated additional layer of complexity this would involve, there was merit in making recommendations to improve current processes for dispute resolution. In addition to the above recommendation, Mr Wein recommended that a franchisee should not be required to pay a franchisor's legal costs of dispute resolution, and a franchisor should not require a franchisee to travel interstate to litigate (this is the effect of Recommendation 14, discussed further below). Mr Wein's recommendation relating to good faith may, if accepted by the government, also have a beneficial effect in the context of dispute resolution.

Regarding Recommendation 13, Mr Wein considered it important that 'the intention of the 2010 amendments to the Code to introduce reconciliatory behaviours for parties involved in alternative dispute resolution, are maintained' and 'applied to all dispute resolution processes regardless of the setting'. Evidence to the review indicated that it is unclear whether subclause 29(8) applies to all mediation involving parties to a franchise agreement.

Option 1: Retain existing arrangements

Under this option, clause 26 will continue to require that franchise agreements must provide for a complaint handling procedure that compiles with clause 29 and clause 30 of the Code, including subclause 29(8) which requires certain behaviours to be demonstrated by parties engaging in mediation. These behaviours include: attending meetings at reasonable times; making the goals of the mediation clear at outset; maintain confidentiality; and not taking action or refusing to take action that would damage the franchise system.

Option 2: Amend the Code to implement Recommendation 13

This option would clarify that all parties who choose to mediate with a provider that is not appointed by the mediation adviser would still have to abide by the behaviours summarised above and stated in clause 29(8) of the Code.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. If an obligation to act in good faith that extended to dispute resolution was inserted into the Code, would this address the concerns raised by parties in relation to conduct in dispute resolution?
7. In your experience, is there is a misunderstanding within the industry whether the behaviours under 29(8) apply to all dispute resolution processes involving the parties to a franchise agreement?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

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.

Introduction

Currently, a franchise agreement may include a clause which attributes legal costs of dispute resolution incurred by the franchisor to the franchisee. In 2010, the Expert Panel found that there could be legitimate business reasons for franchisors to have this ability, for example the franchisor could then reduce the franchise fee as a trade-off. The Expert Panel did not recommend removing this ability from franchisors.

Evidence provided to Mr Wein argued that the 2010 amendments to the Code concerning dispute resolution needed reinforcement and, indeed, may have had a negative effect on the position of franchisees. For example, in his submission to the review, the Victorian Small Business Commissioner argued '(s)uch an inequality may encourage the indemnified party to over utilise legal resources, as

there is no or lowered cost disincentive to do so'. Another submitter also argued that litigation should occur in the state in which the franchisee operates as it is required to abide by the laws of that state in the operation of its business.

On the basis of this evidence, Mr Wein concluded that restricting a franchisor's capacity to attribute the costs of dispute resolution to a franchisee and requiring legal proceedings to be conducted in the jurisdiction where a franchise operates is 'a more direct means of reducing the costs 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'.

Options

Option 1: Retain existing arrangements

Under this option, franchisors would continue to be allowed to attribute their legal costs associated with dispute resolution to the franchisee. Item 13B in Annexure 1 (item 7(B) of Annexure 2) of the Code requires the franchisor to disclose whether legal costs will be attributed to the franchisee. Franchisors would still be able to continue to attribute their legal costs to the franchisee in dispute resolution and to litigate in their home jurisdiction, as opposed to the jurisdiction in which the franchisee primarily operates.

A court can deploy safeguards to address power imbalances, including staying proceedings in favour of a more appropriate court. Courts also have existing rules and tests concerning where proceedings should be conducted.

Option 2: Amend the Code to implement Recommendation 14

If this option is adopted the Code would need to be amended to remove the ability of a franchisor to attribute legal costs and require it to litigate in the state where the franchisee primarily conducts its business. This would mean that a franchisor may have to litigate in an unfamiliar jurisdiction. This option would also mean that each party in a dispute would bear its own costs for dispute resolution.

Option 3: Amend the Code to implement Recommendation 14(a) only

Under this option, the Code would be amended to incorporate part (a) of Recommendation 14, but not part (b). This would mean that a franchisor would not be able to attribute legal costs to a franchisee.

Option 4: Amend the Code to implement Recommendation 14(b) only

Under this option, the Code would be amended to incorporate part (b) of Recommendation 14, but not part (a). This would mean that a franchisor could not require a franchisee to litigate outside the jurisdiction in which the franchisee's business primarily operates.

Option 5: Amend the Code to implement Recommendation 14(a) and strengthen the court's forum tests

Under this option, Recommendation 14(a) would be implemented. Further, instead of implementing Recommendation 14(b), the court's forum tests should be strengthened to ensure that power imbalances between the parties are adequately addressed by the courts, including by staying proceedings before them in favour of a more appropriate court.

This ability of courts could be strengthened, including by crafting a list of discretionary factors that can be taken into consideration, such as costs, the effect of exclusive choice of court clauses and other matters that can contribute to power imbalances.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. In your experience, has the attribution of legal costs acted as a disincentive for parties to enter into dispute resolution? Does it encourage parties to be less efficient with the use of legal services? Would removing the ability of a franchisor to attribute legal costs to a franchisee improve a franchisee's access to justice?
7. In your experience, is litigation being conducted in a jurisdiction other than where the franchised business operates?
8. Are there already laws that adequately deal with the issue of which jurisdiction is the most appropriate for litigation between two parties in different jurisdictions?
9. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Part 7 Enforcement

Recommendation 15: The Competition and Consumer Act 2010 (CCA) be amended to:

- b. allow civil pecuniary penalties to a maximum of \$50 000 to be available as a remedy for a breach of the Code;
- c. allow the ACCC to issue an infringement notice for a breach of the Code;
- d. 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;
- e. 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
- f. 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 specific by the court into any marketing or cooperative fund applicable to that franchise system.

Introduction

The government is committed to ensuring that proportionate and appropriate tools are available to the ACCC and the courts to allow for the effective regulation of the franchising industry. An effective Code requires an effective enforcement regime.

Recommendation 15 of Mr Wein's report recommends increasing the enforcement tools available to the ACCC in the event that the Code is breached. The aim is to deter and reprimand conduct in breach of the Code, rather than to only compensate the party who suffered as a result of the breach. At present, the enforcement regime for the Code is contained in the CCA and is the same for all industry codes prescribed under the CCA. If changes to the enforcement of the Code are made to the CCA, this may impact upon other industry codes.

Some aspects of Recommendation 15, if implemented, may also require the government to revisit the *Policy Guidelines on Prescribing Industry Codes under Part IVB of the Competition and Consumer Act 2010* (Cth) (May 2011, Commonwealth Treasury).

Options – Penalties and infringement notices (Recommendation 15(a) and (b))

Option 1: Retain existing arrangements

Under this option, there would be no changes to the CCA or the Code to implement Recommendation 15(a) and (b). The ACCC will be unable to issue infringement notices or ask a court to impose civil pecuniary penalties on a party for breaching the Code.

The ACCC will, however, continue to be able to issue infringement notices or seek civil pecuniary penalties in cases where a party has breached the provisions of the CCA, including those relating to unconscionable conduct and false or misleading representations.

Option 2: Amend the CCA to implement Recommendation 15(a) and (b)

Under this option, if a party breached *any* provision of the Code, the ACCC would issue an infringement notice or ask a court to impose civil pecuniary penalty of up to \$50 000 per breach.

Technical note: One way this option could be implemented would be to amend s 76 of Part VI of the CCA (Enforcement and remedies) to provide that a court may impose a pecuniary penalty up to \$50 000 in respect of breaches of 'pecuniary penalty provisions' of an industry code. Section 51AE of Part IVB of the CCA could then be amended to declare that the provisions of the Franchising Code are all pecuniary penalty provisions.

Option 3: Amend the CCA to allow the ACCC to seek pecuniary penalties or issue infringement notices for some, but not all, breaches of the Code

Under this option, if a party breached *certain* provisions of the Code, the ACCC could issue an infringement notice or ask a court to impose civil pecuniary penalty of up to \$50 000 per breach.

One example of a requirement of the Code which may attract a penalty if breached is the requirement to give a franchisee a current disclosure document prior to the franchisee entering into a franchise agreement.

Technical note: One way this option could be implemented would be to amend s 76 of Part VI of the CCA (Enforcement and remedies) to provide that a court may impose a pecuniary penalty up to \$50 000 in respect of breaches of 'pecuniary penalty provisions' of an industry code. Section 51AE of Part IVB of the CCA could then be amended to permit the making of regulations declaring that some or all of the provisions of a particular industry code are 'pecuniary penalty provisions'. The Code could then be amended declaring which provisions of the Code are 'pecuniary penalty provisions'. Alternatively, declaration of what provisions of the Code should attract a pecuniary penalty can be inserted in the CCA.

Option 4: Review of the industry codes framework with a view to strengthening the enforcement regime

Under this option, the government would conduct a review of the industry codes framework to determine whether civil pecuniary penalties and infringement notices are an appropriate enforcement tool within that framework generally.

This may allow the enforcement regime for all industry codes to remain consistent, and would likely involve asking whether franchising should be regulated within an industry code model or some other mechanism such as an Act of parliament.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. What Code breaches should civil pecuniary penalties and infringement notices apply to?
7. If the government accepts Recommendation 9 relating to good faith, should civil penalties and infringement notices apply to a breach of a requirement to act in good faith?
8. Is \$50 000 an appropriate upper limit on a court's discretion in awarding any civil pecuniary penalty?
9. What consequences, if any, may arise for other industry codes if any of these options are implemented?
10. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Options – Audit powers (Recommendation 15(c))

Option 1: Retain existing arrangements

Under this option, there would be no changes to the CCA to provide the ACCC with additional investigation powers in respect of the Code.

At present the ACCC can require a corporation to produce any document or information that it 'is required to keep, to generate or to publish' under an industry code. The ACCC would continue to have this power.

The government could keep this matter under review and consider it in any future review of the industry codes framework generally (see Option 4 above in relation to penalties and infringement notices). It would then have at its disposal more information from the ACCC on the results of its use of its audit powers.

Option 2: Amend the CCA to implement Recommendation 15(c) (Audit Powers)

Under this option, the ACCC would investigate a corporation's compliance with all aspects of the Code using its audit powers under section 51ADD. It would be able to request any information to demonstrate compliance with the Code.

Although the recommendation mentions investigating a franchisor's compliance with the Code, if implementing this recommendation, the government would be likely to ensure the ACCC could investigate the compliance of all corporations regulated by the Code (in so far as possible, this would include both franchisees and franchisors).

Option 3: Amend the CCA to broaden the ACCC's powers under section 51ADD (Audit Powers)

Under this option, the government would implement Recommendation 15(c), as set out in Option 2 above, and also amend section 51ADD of the CCA to state that the ACCC can require a corporation to provide it with information and/or documents to substantiate or support a representation contained in a document it supplies to the ACCC under section 51ADD. The amendment could be modelled on the substantiation notice provisions of the ACL, so that, as with a substantiation notice:

- a corporation 'may refuse or fail to give particular information or produce a particular document...on the ground that the information or production of the document might tend to incriminate the individual or to expose the individual to a penalty'; and
- the ACCC would not need to form a belief that there has been a breach of the Code before demanding this information.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?

6. What consequences, if any, may arise for other industry codes if any of these options are implemented?
7. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Options – Disqualification of directors (Recommendation 15(d))

Option 1: Retain existing arrangements

Under this option, there would be no changes to the CCA. The ACCC would not be able to seek an order from a court disqualifying a person from managing a corporation due to its breach of the Code.

The government could keep this matter under review and consider it in any future review of the industry codes framework generally (see Option 4 above in relation to penalties and infringement notices).

Option 2: Amend the CCA to implement Recommendation 15(d)

Under this option, the CCA would be amended to allow the ACCC to seek an order from a court to disqualify a person from managing a corporation due to a breach of the Code.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Should the ACCC have the capacity to seek an order from a court to disqualify a person from managing a corporation due to a) any breach of the code or b) certain breaches of the code?
7. What consequences, if any, may arise for other industry codes if any of these options are implemented?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Options – Other orders (Recommendation 15(e))

Option 1: Retain existing arrangements

Under this option, there would be no changes to the CCA to specify that the court can make orders tailored to the franchisor-franchisee relationship.

Section 87 of the CCA is a very wide provision. Broadly, it allows a court to make any orders it considers appropriate to compensate for loss or damage suffered, or prevent or reduce loss or damage. If the court was satisfied that an order requiring a franchisor to:

- i. give a royalty free period to a franchisee affected by a breach of the Code; or
- ii. pay a sum of money specific by the court into any marketing or cooperative fund applicable to that franchise system,

would compensate a party for a breach engaged in by a franchisor then the court could already impose such an order under the existing arrangements.

Option 2: Amend the CCA to implement Recommendation 15(e)

Under this option, the CCA would be amended to specify that the court could make franchising specific orders under section 87. This does not give the Court any additional powers, however inserting franchising specific orders into section 87(2) may draw the parties' and the court's attention to the ability to seek specific types of orders under the CCA, which could more directly address franchising breaches.

Discussion question

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. What consequences, if any, may arise for other industry codes if any of these options are implemented?
7. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

Part 8 Other matters

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.

Introduction

Motor vehicle dealership agreements stand in a unique place in franchising, as they are deemed to be franchise agreements by the Code.

In his report, Mr Wein noted recurring issues were raised in regard to motor vehicle dealerships. A common issue was that the length of the term of the franchise agreement is often too short to enable a motor vehicle dealer to recoup its large capital investment before the end of the franchise agreement term. The review received submissions proposing a minimum term for motor vehicle dealership agreements. Other issues raised included claims of inappropriate behaviour exhibited by the franchisor toward the franchisee regarding end of term arrangements, renewal notices and the termination of an agreement at will where there is no default by the franchisee.

Options

Option 1: Reject Recommendation 16

An analysis of the impact of a minimum term and standard contractual terms for motor vehicle agreements will not be undertaken prior to a future review of the Code. This option does not preclude such an analysis being undertaken concurrently with a future review of the Code.

Option 2: Accept Recommendation 16

An analysis of the impact of a minimum term and standard contractual terms for motor vehicles will be undertaken prior to a future review of the Code.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. What is the prevalence of the alleged problem where the term of a franchise agreement is insufficient to allow a franchisee to recoup its capital investment before the agreement with the franchisor is not renewed? What are the impacts of this on franchisees, franchisors and the sector?
7. Is the need for a separate review dependent on the government response to other recommendations made by Mr Wein? For example, if an express obligation to act in good faith is inserted into the Code (Recommendation 9), could that improve the situation for franchisees in the automotive industry and reduce the need for an analysis to be undertaken before a future review of the Code and any amendments have had time to take affect?
8. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

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.

Introduction

To assist in providing certainty to the industry and to facilitate a better review in the future, Mr Wein recommended that the industry would benefit from having time for any amendments to take effect before the operation of the Code is reviewed again.

It is important to note that under the *Legislative Instruments Act 2003*, all regulations and other legislative instruments sunset (automatically cease) after 10 years, unless action is taken to preserve them. The sunset date for the Code is currently 1 April 2019.

The Government's *Policy Guidelines on Prescribing Industry Codes under Part IVB of the Competition and Consumer Act 2010* state 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'.

Options

Option 1: Reject Recommendation 17

The Code may be reviewed within the next five years.

Option 2: Accept Recommendation 17

Accepting Recommendation 17 is undertaking not to review the Code again for a minimum of five years.

As the Code has been subject to a number of reviews, including this recent review by Mr Wein, the department could remake all provisions of the Code, in addition to any amendments made in response to the recommendations in the report, and reset the 10 year period under the *Legislative Instruments Act*. This would provide increased flexibility in the timing of the next review.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Is five years enough time for the impacts of any amendments to be realised and industry practice to become settled? Why or why not? If not, what is an appropriate timeframe?
7. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

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.

Introduction

During his review, Mr Wein identified minor and technical amendments that could be made to the Code to assist industry participants understand their rights and obligations under the Code better and foster the efficient operation of the franchising industry and assist its development.

Options

Option 1: Retain existing arrangements

Minor and/or technical amendments are not made to the Code.

Option 2: Amend the Code to implement Recommendation 18

The Code is amended to make minor and technical amendments to the Code. Mr Wein suggested some possible amendments, but this list is not authoritative or exhaustive.

Discussion questions

1. Which of the proposed options best addresses the problem identified in the review?
2. What would be the costs and/or savings (such as, time, legal, accounting or administrative) to franchisors and franchisees of implementing that option?
3. If your preferred option is not the status quo, what will be the impact of retaining the status quo?
4. What are the benefits and/or disadvantages from implementing your preferred option?
5. Do you see any unintended consequences arising from the implementation of your preferred option?
6. Are the minor and technical amendments proposed Mr Wein necessary? Do any of these change the policy intent of the Code? Are there any other amendments that are necessary to achieve the policy intent of Recommendation 18?
7. Is there another option to achieve the policy intent behind the recommendation? If yes, please outline this option and any impacts that may arise if that option was implemented.

APPENDIX 1: RESPONSE TEMPLATE

This appendix provides a template that may be used to provide comment on the recommendations and options discussed in this paper. You are not required to use this form.

Respondent details

Name (optional)	
Organisation (optional)	
Address (optional)	
Contact details (optional)	
Which group you consider yourself part of	<input type="checkbox"/> Franchisee <input type="checkbox"/> Franchisor <input type="checkbox"/> Industry group <input type="checkbox"/> Lawyer/law firm <input type="checkbox"/> Academic <input type="checkbox"/> Other, please specify:

Instructions

Please select your preferred option. Please include any comments, including details of alternative options, in the appropriate comment field.

Disclosure

Recommendation 1

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 1
- Not applicable/other option (please specify below)

Comment:

Recommendation 2

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 2
- Not applicable/other option (please specify below)

Comment:

Recommendation 3

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 3
- Not applicable/other option (please specify below)

Comment:

Recommendation 4

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 4
- Option 3: Amend the Code to increase the threshold for use of short form disclosure
- Not applicable/other option (please specify below)

Comment:

Recommendation 5

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 5
- Option 3: Improved education of prospective franchisees about undertaking due diligence
- Option 4: Mandatory education for franchisees
- Option 5: Amend the Code to require signed statutory declarations
- Not applicable/other option (please specify below)

Comment:

Franchisor failure

Recommendation 6

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 6
- Option 3: Amend the Code so that the disclosure document includes examples of possible consequences of franchisor failure
- Option 4: Increased education
- Not applicable/other option (please specify below)

Comment:

Transparency of financial information in a franchise

Recommendation 7

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 7
- Option 3: Increase disclosure and adopt minor/technical amendment recommended

Not applicable/other option (please specify below)

Comment:

Recommendation 8

Option 1: Retain existing arrangements

Option 2: Amend the Code to implement Recommendation 8

Option 3: Amend the Code to require an annual audit

Option 4: Amend the Code to adopt Recommendation 8(c) and concurrently increase the level of education

Option 5: Increase education

Not applicable/other option (please specify below)

Comment:

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

Recommendation 9

Option 1: Retain existing arrangements

Option 2: Amend the Code to implement Recommendation 9

Option 3: Amend the Code to include a defined obligation to act in good faith

Option 4: Improved education of parties about their existing obligations at common law

Option 5: Every franchise agreement to include an obligation to act in good faith

Not applicable/other option (please specify below)

Comment:

Recommendation 10

Option 1: Retain existing arrangements

Option 2: Amend the Code to implement Recommendation 10

Not applicable/other option (please specify below)

Comment:

The transfer, renewal or end of a franchise agreement

Recommendation 11

Option 1: Retain existing arrangements

Option 2: Amend the Code to implement Recommendation 11

Not applicable/other option (please specify below)

Comment:

Recommendation 12

Option 1: Retain existing arrangements

Option 2: Amend the Code to implement Recommendation 12

Option 3: Increase education

Not applicable/other option (please specify below)

Comment:

Dispute resolution

Recommendation 13

Option 1: Retain existing arrangements

Option 2: Amend the Code to implement Recommendation 13

Not applicable/other option (please specify below)

Comment:

Recommendation 14

Option 1: Retain existing arrangements

Option 2: Amend the Code to implement Recommendation 14

Option 3: Amend the Code to implement Recommendation 14(a) only

Option 4: Amend the Code to implement Recommendation 14(b) only

Option 5: Amend the Code to implement Recommendation 14(a) and strengthen the court's forum tests

Not applicable/other option (please specify below)

Comment:

Enforcement

Recommendation 15(a) and (b)

Option 1: Retain existing arrangements

Option 2: Amend the CCA to implement Recommendation 15(a) and (b)

Option 3: Amend the CCA to allow the ACCC to seek pecuniary penalties or issue infringement notices for some, but not all, breaches of the Code

Option 4: Review of the industry codes framework with a view to strengthening the enforcement regime

Not applicable/other option (please specify below)

Comment:

Recommendation 15(c)

Option 1: Retain existing arrangements

Option 2: Amend the CCA to implement Recommendation 15(c) (Audit Powers)

Option 3: Amend the CCA to broaden the ACCC's powers under section 51ADD (Audit Powers)

Not applicable/other option (please specify below)

Comment:

Recommendation 15(d)

Option 1: Retain existing arrangements

Option 2: Amend the CCA to implement Recommendation 15(d)

Not applicable/other option (please specify below)

Comment:

Recommendation 15(e)

Option 1: Retain existing arrangements

Option 2: Amend the CCA to implement Recommendation 15(e)

Not applicable/other option (please specify below)

Comment:

Other matters

Recommendation 16

Option 1: Reject Recommendation 16

Option 2: Accept Recommendation 16

Not applicable/other option (please specify below)

Comment:

Recommendation 17

- Option 1: Reject Recommendation 17
- Option 2: Accept Recommendation 17
- Not applicable/other option (please specify below)

Comment:

Recommendation 18

- Option 1: Retain existing arrangements
- Option 2: Amend the Code to implement Recommendation 18
- Not applicable/other option (please specify below)

Comment: