

AUSTRALIAN GOVERNMENT RESPONSE TO THE REVIEW OF THE DISCLOSURE PROVISIONS OF THE FRANCHISING CODE OF CONDUCT

February 2007

Recommendations directly pertinent to Part 2 and Annexure 1

1. Requirement to include a complete franchise agreement

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

Government's response: Agreed. It is understood that many franchisors already provide the complete franchise agreement. This "best practice" should be the norm.

2. Requirement to include copies of all associated agreements and contracts

Item 18 of Annexure 1 of the Code be modified to require the franchisor to provide copies of all related documents required by the franchise agreement to be signed by the franchisee, in the form they are intended to be signed with the disclosure document, or earlier, which would be at least 14 days before the franchise agreement is expected to be signed.

Government's response: Agreed in principle. The Government acknowledges that in some cases, not all documents required by the franchise agreement are available 14 days before the franchise agreement is expected to be signed. Franchisors will be required to provide copies of all documents, where available, at least 14 days before the franchise agreement is expected to be signed, and where the documents are not available at that time, for the documents to be provided to the prospective franchisee or franchisee when they become available.

3. Requirement to include a Risk Statement

The Code be amended to include a requirement for the franchisor to include a Risk Statement with the disclosure document.

The ACCC be tasked with developing a prescribed Risk Statement document with disclosure requirements.

Government's response: Not agreed. Decisions relating to the viability and associated risks of any business venture are ultimately the decision of the businesses themselves. The Government will ask the ACCC to continue their efforts in educating the industry as to the importance of risk analysis and for prospective franchisees to be encouraged by their business advisors to conduct risk analysis.

4. Disclosure of section 87B TPA undertakings

Part 3 clause 18(2) of the Code and item 4 of Annexure 1 to the Code be amended to include the requirement to disclose details of section 87B TPA undertakings within a reasonable time (but not more than 14 days) after the undertaking is given.

Government's response: Agreed. Timely knowledge of the existence and content of section 87B undertakings would be likely to be material to the ability of the franchisees to make informed decisions.

5. Rebates and other financial benefits

That item 9.1(j) of Annexure 1 to the Code be extended to include disclosure of the amounts or method of calculation of rebates or other financial benefits to the franchisor or an associate of the franchisor from the supply of goods or services to franchisees.

Government's response: Agreed. The disclosure of information about financial arrangements provides greater transparency in the relationships between the participants in franchising.

6. Auditing of marketing and other co-operative funds

The annual financial statement of marketing or other co-operative funds, receipts and expenses prepared pursuant to clause 17 of the Code be subject to compulsory annual audit by a registered company auditor.

Government's response: Agreed. The Government will go further than the recommendation and require that the Code be amended

so that the franchisees are provided with a full account of these funds and with the auditor's reports.

7. Provision of audited financial information for the franchisor and the consolidated entity

The ACCC, as part of the registration process (Recommendation 23), collect information on the extent to which franchisors' financial statements are currently audited and provided pursuant to item 20.3 of Annexure 1 of the Code.

The ACCC determine the extent to which any lack of audited financial statements is causing unsatisfactory outcomes for the industry particularly in respect of franchisor solvency disclosures.

The ACCC report to the Government on its findings and provide recommendations by 30 April 2007.

Government's response: Not agreed. The Government does not support the proposed registration process (recommendation 23) on the grounds that it could create an expectation that the franchise has received the endorsement of the regulator. Decisions relating to the viability and associated risks of any business venture are ultimately the decision of the businesses themselves. In addition, the Government is concerned that the regulatory burden of this proposal outweighs the potential benefit to franchisees.

8. More information about past franchises

Subject to compliance by the franchisor with Privacy Laws and the obtaining of relevant consents to disclosure, the Code be amended to require not just the numbers but also names, location and contact details relating to the franchisees corresponding to events listed in item 6.4 of Annexure 1. This could be included as an addendum to the disclosure document.

Government's response: Agreed in principle. The Code will be amended to allow franchisors to provide details of names, location and contact details where consent has been obtained and where that information is available to the franchisor. For reasons of enforcement and administration, this provision will operate prospectively.

9. Qualifications of advisors

The Government ask relevant peak industry bodies to raise the level of understanding of their members of the particular requirements connected with advising potential franchisees prior to them entering into franchisee agreements.

Government's response: Agreed. Prospective franchisees need to be informed by skilled and experienced advisors.

10. Disclosure of the business experience of all who have or may have management responsibilities.

That item 3.1 of Annexure 1 be amended to remove the executive officer exemption from the class of persons about which a summary of relevant business experience in the last 10 years must be provided.

That Item 2.6 of Annexure 1 be amended to substitute for the term “executive officer” (which is not defined in the *Corporations Act 2001*), the concept of a person who is concerned in, or takes part in, the management of the franchisor (regardless of the person’s designation and whether or not the person is a director of the franchisor).”

Government's response: Agreed in principle. While knowledge about the business experience of officers of corporate entities is relevant to prospective and existing franchisees, the Government is of the view that the recommendation may inadvertently capture a range of persons whose business experience is of no relevance to the operation of the franchise. The Government notes recent amendments to the Corporations Law in this area, and will consult further with stakeholders to determine whether an appropriate definition can be formulated.

11. Opt out clause from providing information requested from Annexure 1

The opt out provision in Part 2 clause 6C be deleted.

Government's response: Agreed. All disclosure information in Annexure 1 can be of importance to franchisees and if requested by them should be provided.

Recommendations directly pertinent to Parts 1 and 3

12. Disclosure of materially relevant facts

Part 3 clause 18(1) of the Code be amended to require franchisors to disclose materially relevant facts within 14 days after the franchisor becomes aware of the facts rather than the present 60 days.

Government's response: Agreed. Franchisees require timely disclosure of information that is materially relevant to the operation of their franchise.

13. Exemption from application of the Code

The exemption to the application of the Code referred to in Part 1 clause 5(3)(a)(i) and (ii) be removed from the Code.

Government's response: Agreed. All franchisee systems operating in Australia should be subject to the same rules.

14. Franchises currently excluded from the Code

Delete clause 5(3)(c).

Government's response: Agreed in principle subject to consultation with industry.

15. Directors to disclose their convictions

Part 3 clause 18(2)(b) and (2)(d) and *Annexure 1 item 4* of the Code be amended to include franchisor directors in the class of persons about which materially relevant facts must be disclosed and the scope of disclosure be extended to criminal convictions for non serious offences.

Government's response: Agreed. Such information may be material to existing and prospective franchisees.

16. The right of unilateral termination to a franchise agreement

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor termination rights contained in Part 3 clause 22 of the Code.

Consideration also be given to removing or modifying the right of a franchisor to include in a franchise agreement the right to unilaterally terminate a franchise agreement. In the event that the right to unilaterally terminate the agreement is maintained, adequate franchisee compensation should be provided for in the franchise agreement and referred to in the disclosure document.

Government's response: This will be addressed through reform to section 51AC of the Trade Practices Act 1974 in relation to unconscionable conduct where unilateral variation clauses will be a factor that may indicate a corporation has engaged in unconscionable conduct.

The Government will ask the ACCC to consider including this issue in their educational material.

17. The right of unilateral change to a Franchise Agreement

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor changes to franchise arrangements.

Consideration also be given to prohibiting unilateral changes by franchisors to arrangements with franchisees which have materially adverse effects on the franchisee without franchisee consent. In the event that the right to unilaterally amend financial arrangements with franchisees is maintained, adequate franchisee compensation should be provided for in franchise agreements and referred to in the disclosure document.

Government's response: As above, this will be addressed through reform to section 51AC of the Trade Practices Act 1974 in relation to unconscionable conduct where unilateral variation clauses will be a factor that may indicate a corporation has engaged in unconscionable conduct.

The Government will ask the ACCC to consider including this issue in their educational material.

18. Prospective franchisees communication with existing franchisees

Part 3 clause 15 of the Code be amended to include a reference to prospective franchisees after the references to franchisees.

Government's response: Agreed. This protection to current franchisees should be extended to include prospective franchisees to better enable them to conduct their due diligence.

Other recommendations and observations relevant to disclosure

19. General waivers of written representations

Consideration be given as to whether or not franchise agreements and disclosure documents should be prohibited by the Code from including any general waivers of written representations made to potential franchisees or franchisees seeking to extend their franchise agreements.

Government's response: Agreed. Further consideration will be undertaken on this issue.

20. Clarity at the termination, expiry or non-renewal of an agreement

The Risk Statement should, if significant, refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement.

Government's response: Agreed in principle. Although the Government does not agree to the recommendation for a Risk Statement, the Government will ask the ACCC to refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement in its educational material.

21. Clarity in the event of franchisor failure

The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with franchisor failure.

Government's response: Agreed in principle. Although the Government does not agree to the recommendation for a Risk

Statement, the Government will ask the ACCC to address the importance of considering the consequences of franchisor failure in its educational material.

22. Financial Details

The requirement under item 20 of Annexure 1, to disclose financial details be extended, where applicable, to include the consolidated entity to which the franchisor belongs.

Government's response: Agreed. The requirement under item 20 of Annexure 1 will be extended to include the financial reports for the consolidated entity.

23. Registration and Review of Disclosure Documents.

The Government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate enforcement of the Code. The process would be administered by the ACCC.

Government's response: Not Agreed. Registration of the franchisors and their disclosure documents could be seen as providing credibility to their claims and ACCC endorsement. The ACCC would not be in a position to ensure the quality nor the substance of the documents. The cumulative paperwork and compliance burden upon franchisors is likely to be significant and would be at odds with the Government's policy of reducing the regulatory burden on business, where possible.

The Government notes that the Franchising Council of Australia has implemented a national franchise-accreditation scheme. The Government will request the Franchise Council of Australia to publish a report regarding the details of the scheme, its implementation progress and take-up.

24. The current level of ACCC action relating to franchising

The Government appraise the ACCC of concerns expressed to the Committee about the level and extent of action by the ACCC in dealing with claims of breaches of the Code by franchisors.

Government's response: Agreed. It is appropriate that the ACCC be briefed on the concerns that have been brought to the attention of the Committee. The ACCC worked cooperatively with the review.

25. Implementation of the principle of good faith and fair dealing

A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part1 of the Code.

Government's response: The Government agrees with the intention that franchisors franchisees and prospective franchisees act towards each other fairly and in good faith. Section 51AC of the Trade Practices Act 1974 includes 'good faith' as a factor that can be taken into account when determining unconscionable conduct.

26. Standardisation of the audit period

The audit period referred to in Part 2 clause 6(1) of the Code be aligned with the *Corporations Act 2001* audit period.

Government's response: Agreed. Consistency with other statutory requirements is appropriate.

27. Avoidance of providing the details and history of the territory or site to be franchised together with the disclosure documents

Item 11.3 of Annexure 1 of the Code be amended to require the details mentioned in item 11.2 to be in a separate document which is provided with the disclosure document.

Government's response: Agreed. This information should be contained in a separate document to be provided with the disclosure document. Details and history of the site to be franchised is potentially of critical importance to prospective franchisees.

28. Clarification of "other payments"

Part 1 clause 3(1)(b) include the words "real property" so that it reads:

“associate, for a franchisor, means a person...

(b) whose relationship with the franchisor is relevant to the franchise system, including supplying goods, real property or services to a franchisee.”

Government's response: Agreed. Payments for property are often a major expense to franchisees.

29. Consistency with regard to attaching a copy of the Code to the disclosure document

That Item 22.2 of Annexure 1 be deleted.

Government's response: Agreed. A copy of the Code should be attached to the disclosure document as required by clause 10.

30. Clarification of "extend"

Part 2 clause 6B (1) be amended to read:

"(1) A franchisor must give a current disclosure document to:

- (a) a prospective franchisee; or
- (b) a franchisee proposing to renew a franchise agreement or extend the scope or term of a franchise agreement".

Government's response: Agreed. It is appropriate that a current disclosure document be provided whenever there is any extension of either the scope or term of a franchise agreement.

31. Clarification of the time frame for the measure used to determine the use of the Annexure 1 or Annexure 2 disclosure documents

That in Part 2 clause 6(2) of the Code “at any time during the term of the franchise agreement” be added after “turnover” to clarify the time frame.

Government's response: Agreed. This amendment will be made to Part 2 clause 6(2)(a)(i).

32. Definitions of "executive officer" and "officer"

That, in view of the repeal of the definition of “executive officer under the *Corporations Law*:

- (a) clause 6(2)(c) of the Code be amended to replace the term “executive officer” with the term “officer”;**
- (b) Item 2.6 of Annexure 1 be amended in accordance with Recommendation 10; and**
- (c) clause 3(2) of the Code be amended to delete the term “executive officer”, and the usage of that term in the rest of the Code and the Annexures be reviewed.**

Government's response: Agreed in principle. The Government notes recent amendments to the Corporations Law in this area, and will consult further with stakeholders to determine whether an appropriate definition can be formulated.

33. Termination of the agreement and costs within the 'cooling off' period.

Add the intention of Part 3 clause 13 (4) to items 1.1 (d) of Annexure 1 and item 1.1 (e) of Annexure 2.

Government's response: Agreed.

34. Relevance of "site" and "premises"

Add a reference to “and premises” after “site” in Annexure 1 item 16.1(a), so that it reads:

"site and premises selection and acquisition"

Add a reference to “site and” before “premises” in Annexure 1 item 16.1(j), so that it reads:

"maintenance and appearance of site and premises, vehicles and equipment"

Government's response: Agreed.