



21 February 2013

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Franchising Code Review Secretariat
Business Conditions Branch
Department of Industry, Innovation, Science, Research and Tertiary Education
GPO Box 9839
CANBERRA ACT 2601

and via email: franchisingcodereview@innovation.gov.au

Dear Secretariat

Discussion Paper - Review of the Franchising Code of Conduct

I refer to the announcement of 4 January 2013 by the Minister for Small Business, the Hon Brendan O'Connor, noting the commencement of a review of the Franchising Code of Conduct, to be conducted by Mr Alan Wein.

Thank you for the opportunity to give comments on the Discussion Paper. Thank you also for the extension of time in which to do so.

The matter was referred to the Society's Commercial Law Committee. The Society's response is limited to the principle of good faith, and our comments are provided in relation to a selection of questions that are outlined in the Discussion Paper, enclosed in Appendix 1.

The Society notes that underlying issues such as pre-entry disclosure, and consequences of breach or termination, there lies a question of relative power between franchisor and franchisee, and a policy issue whether the best approach is to treat franchisees as consumers requiring protection, or whether relations between franchisee and franchisor should be regulated on an assumption of a notionally equal initial bargaining position.

I trust these comments are of assistance.

Yours sincerely

John White
PRESIDENT

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APPENDIX 1

Franchising Code Review Secretariat
Business Conditions Branch
Department of Industry, Innovation, Science, Research and Tertiary Education
GPO Box 9839
Canberra ACT 2601

BY EMAIL: franchisingcodereview@innovation.gov.au

LAW SOCIETY OF SOUTH AUSTRALIA SUBMISSIONS ON REVIEW OF FRANCHISING CODE OF CONDUCT (the Franchising Code)

Submission by:

Law Society of South Australia

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21 February 2013

Whether Submission is to be kept confidential or not and able to be released to the public:

For public release

Discussion Questions and Responses:

Part Two: Disclosure under the Franchising Code of Conduct

1. Has the additional disclosure requirement regarding the potential for franchisor failure effectively addressed concerns about franchisees entering into franchise agreements without considering the risk of franchisor failure?

Response:

2. Does the sector have any concerns regarding the operation of this requirement?

Response:

3. Have amendments to the Franchising Code improved the transparency of financial information for franchisees? If not, why not? If so, what benefit is this having for franchisees?

Response:

4. Does the sector have any concerns regarding the operation of these amendments?

Response:

5. Have the amendments regarding unilateral variation, transfer and novation been effective in addressing concerns about franchisors' ability to make changes to franchise agreements? Why or why not?

Response:

6. Does the sector have any concerns regarding the operation of these amendments?

Response:

7. Have the changes to the Franchising Code led to improved franchisee knowledge about franchisors and their conduct before they enter into franchise agreements? Why or why not?

Response:

8. Is the information being provided useful to franchisees?

Response:

9. What effect has the requirement to provide this additional information had on franchisors?

Response:

10. Does the sector have any concerns regarding the operation of the new provisions?

Response:

11. What impact has the removal of the foreign franchisor exemption had on the sector?

Response:

12. Has the removal of the exemption caused any issues?

Response:

13. On the whole, do the 2008 and 2010 disclosure amendments ensure franchisees are provided with adequate information?

Response:

14. Is the extra onus on franchisors justified by the benefit this disclosure is providing to franchisees?

Response:

Part Three: Good faith in franchising

15. How effective were the targeted amendments in 2010 to the Franchising Code in addressing specific issues, instead of inserting an overarching obligation to act in good faith?

Response:

The Society does not believe it has sufficient information at hand to make a useful response at this point in time.

16. How effective is section 23A of the Franchising Code, which provides that nothing in the common law limits the obligation to act in good faith?

Response:

The Society doubts if this is effective.

While the common law does appear to be moving towards a general principle of good faith in contractual relationships this will inevitably be determined on a case by case basis. As yet there is no significant body of law that particularly addresses itself to the question of good faith in respect to what is often seen as the "special" relationship of franchisor and franchisee.

It is noted that section 23A only refers to the Franchise Code, in that it is stated that nothing in the Code is to limit any obligation imposed by the common law. It does not require concepts of common law good faith not to be excluded from franchise agreements. It is possible therefore to contract out of obligations that may be regarded by some to be expected in acting in good faith.

17. **What specific issues would be remedied by inserting an obligation to act in good faith into the Franchising Code which would not otherwise be addressed under the unwritten law or by the ACL?**

Response:

While the Australian Consumer Law (ACL) prohibits misleading or deceptive conduct, false and misleading representations and unconscionable conduct the Society anticipates situations where none of these remedies would be available, or for evidentiary reasons difficult to access, in that there is a high bar to be met under the concept of unconscionable conduct.

Anecdotal evidence available to the Society indicates that there would be circumstances arising in a franchise relationship that may well be better addressed under a concept of good faith. Specific examples to this would be:

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

18. If an explicit obligation of good faith is introduced, should 'good faith' be defined? If so, how should it be defined?

Response:

No, attempting to define good faith would be very difficult. A suggested approach is to set out indicia, by way of numerous examples, as to what would constitute a lack of good faith in the nature of guidance to the courts and industry. Non exhaustive indicia have been given, for example, in Section 22 of the ACL.

The Society does not believe that gradual evolution under the common law is the way forward. This would leave too much uncertainty, take too much time, and be at cost to franchisee litigants who can often ill afford such debates.

The legislature should be able to provide some definition of legislative intent by giving such criteria. We suggest it could consider calling upon interested parties to provide examples to assist in the process.

19. If an explicit obligation to act in good faith is introduced, what should its scope be? That is, should it extend to: the negotiation of a franchise agreement, and/or the execution of a franchise agreement, and/or the ending of a franchise agreement, and/or dispute resolution in franchising?

Response:

The Society has received a range of views from its Members on the extent to which good faith should apply.

Some Members do not believe good faith should necessarily apply to all steps in the process. They were of the view that it should only apply in respect to parties to a franchise agreement, so the contractual and Code obligations of parties, once they have entered into a franchise agreement, are subject to good faith. That of course does not exclude other ACL remedies eg misleading and deceptive conduct. The concern of these Members is that applying good faith concepts in negotiations could be problematic, and could lead to the expectation that franchisors provide information well beyond the Disclosure Document, akin in some respects to the expectations of information under a capital raising prospectus.

On the other hand, other Members were of the view that there is nothing untoward as to good faith in negotiations, and that application of that concept should not be opposed for the reasons given above; in that in pre franchise negotiations the franchisee should be given all information that the franchisor could reasonably expect would affect the decision of the prospective franchisee on whether to enter into a franchise relationship.

The Society notes the issues raised by the Members of the Commercial Law Sub-Committee formed to consider this matter. While the Society has not taken a position on this issue, the Society would like to draw the reviewer's attention to the views set out above.

20. If a specific obligation to act in good faith was introduced into the Franchising Code, what would be an appropriate consequence for breaching such an obligation?

Response:

Requiring a duty of good faith without consequence would not be an acceptable result.

A penalty of some kind would need to be imposed. This can be in the manner of civil fines.

The introduction of a penalty regime, whether by fines or expiation notices needs to be in the context of an enforcement policy directed towards encouraging compliance rather than punitive in nature. That would, for example, exclude multiple penalties for multiple breaches arising from the same omission or error replicated in a number of documents from a template, and allow for mitigating circumstances, such as genuine attempts to comply and inadvertent error and omission. It would also contemplate the provision of defences in appropriate circumstances.

Flagrant breaches should be differently treated and dealt with more severely from breaches of the more pedestrian kind. A flagrant breach would, for example, be a complete ignoring of Code requirements, repetition of conduct previously the subject of regulatory action and proceeding on a course of conduct already warned by another party as likely being in breach of good faith.

In cases where a breach of an obligation to act in good faith was material in consequence a civil remedy for any loss or damage may be provided. While this may go hand in hand with other remedies that are available under the ACL, that is no reason to exclude a remedy by a civil action.

An action could be expressed to lie in the hands of the ACCC or other regulatory body to be taken on behalf of all franchisees if it affected a significant group or class of them.

21. If a specific obligation to act in good faith was introduced into the Franchising Code, how would such an obligation interact with the provisions of the ACL?

Response:

Such an obligation would add to the provisions under the ACL as may presently apply to a franchise relationship.

If there were the introduction of a penalty regime, then the matters set out in the response to 20 are repeated here.

22. If the Franchising Code was amended to contain an explicit obligation to act in good faith, would there need to be other consequential amendments to the Franchising Code?

Response:

The Society expects that there would need to be a review of a good part of a language of the Code so it is consistent with an overarching obligation to act in good faith.

Once an overarching principle of good faith is introduced as a general term to the Franchising Code then it would be unworkable if further "expectations" were then to follow from a particular obligation in set out in the Franchising Code, in the sense that the further obligation could be expected as a corollary to acting in good faith.

For example, clause 20A requires the franchisor to notify the franchisee at the end of the term of the Franchise Agreement of the franchisor's decision to renew or not to renew the Franchise Agreement or to enter into a new Franchise Agreement.

If importing the concepts of good faith lead to an expectation that a reason should be given, then we suggest considering adding that to clause 20A so that literal compliance with specific provisions of the Code can be regarded as acting in good faith.

Part Four: End of term arrangements for franchise agreements

23. Have the amendments regarding end of term arrangements and renewal notices been effective in addressing concerns about inappropriate conduct at the end of the term of franchise agreements? Why or why not?

Response:

Part Five: Dispute resolution in franchising

24. Has conduct and behaviour during mediation changed since the introduction of the 2010 amendments to the Franchising Code, including requiring parties to approach mediation in a reconciliatory manner? If so, in what ways?

Response:

Yes, but anecdotal evidence suggests not to a sufficient degree.

25. Does the sector have concerns regarding the operation of the amendments?

Response:

The amendments are vague as to the concept of acting in a "reconciliatory manner" and the Society suggests more direction should be given to parties as to what this actually means, and whether there are any consequences from ignoring the requirements.

Part Six: Enforcement of the Franchising Code

26. Is the current enforcement framework adequate to deal with the conduct in the franchising industry?

Response:

Not entirely.

27. How can compliance with the Franchising Code be improved?

Response:

The Society suggests better engagement by the regulatory bodies with complainants. Anecdotal evidence suggests that the ACCC (due to lack of resources) will generally only action "high profile" matters, and not the complaints of aggrieved persons who have had unfortunate experiences with entities that do not have a high profile in the community.

The Society also suggests the Review consider the introduction of a compliance driven, as opposed to punitively driven, penalty regime.

28. What additional enforcement options, if any, should be considered in response to breaches of the Franchising Code?

Response:

See the response to question 20.

29. What options are available to businesses to address breaches of the Franchising Code, or any other adverse conduct in the franchising industry?

Response:

The Society suggests that complaints can be to the ACCC or a small business commissioner. Alternatively, parties may request mediation or commence civil proceedings.