QUICK SERVICE RESTAURANT HOLDINGS

Quick Service Restaurants Holdings Pty Ltd

Submission to the

Department of Industry, Innovation, Science, Research and Tertiary Education

Franchising Code of Conduct – 2013 Review

---

red rooster®
it's gotta be red

chicken treat

oporto™

Contents

1. Background 1
2. Summary of QSRH's Concerns regarding the Franchising Code 1
3. The Obligation of Good Faith 1
Good Faith is Honesty 2
Good Faith as Fairness 2
Good Faith as Reasonableness 3
The ACCC's view on Good Faith 4
The Federal Government's view on Good Faith 5
4. Franchisee's Rights at the End of their Franchise Agreement 9
5. Operation of the Competition and Consumer Act 2010 ("CCA) 15
6. The Cost Impact of the introduction of a Specific Defined Obligation to Act in Good Faith 18
7. Discussion Questions 19
8. Conclusion 19

Attachment A
Attachment B
Attachment C
Attachment D
Attachment E
Attachment F
Attachment G

Executive Summary

This is a submission from Quick Service Restaurants Holdings Pty Ltd to the Department of Industry, Innovation, Science, Research and Tertiary Education regarding the review of the Franchising Code of Conduct ("the Franchising Code").

1. Background

1.1 Quick Service Restaurants Holdings Pty Ltd ("QSRH") is a wholly owned Australian company and is home to three iconic Australian chicken brands, Red Rooster, Chicken Treat and Oporto.

1.2 Currently the group employs 4200 people directly across Australia. Through our franchise network our brands employ a further 20,000 across Australia.

1.3 With its operational genesis in Perth in the 1970's, the Group has carved a unique place in the Australian corporate landscape.

2. Summary of QSRH's Concerns regarding the Franchising Code

2.1 QSRH has 2 major concerns regarding possible changes to the Franchising Code

These relate to:

- The possible introduction of the definition of "good faith".
- the right of a franchisee to be compensated at the end of the term of their franchise agreement for any contribution they have made to the "goodwill" of a franchise system.

3. The Obligation of Good Faith

3.1 The notion of acting in good faith in the course of franchising matters is unequivocal. It is indeed implicit in Australian case law.

3.2 Our concern is the possible introduction of a definition of good faith into the Franchising Code when Australian case law has clearly demonstrated that there is no consensual agreement as to what constitutes good faith in commercial law.

3.3 In an article entitled "Franchising and the Quest for the Holy Grail, Good Faith or Good Intentions?" [1] the authors Andrew Terry[2] and Cary Di Lernia ("the Authors") analyse in depth the meaning of "good faith" having regard to established Australian case law. In that article they consider the variety of approaches taken by Australian judges in an attempt to define good faith and conclude that good faith has been defined variously as:

- the antithesis of bad faith (often referred to as the excluder approach.)
- honesty.
- fairness.
- the absence of opportunistic conduct and extraneous or ulterior purposes.
- legitimate interests.
- reasonable expectations.
- community standards.
- reasonableness.
- or a combination of the above concepts

3.4 In Western Australia the proposed Franchising Bill 2010 endeavoured to define "good faith" to mean acting "fairly, honestly, reasonably and cooperatively."

3.5 Each of these types of good faith are examined by the Authors separately and we reproduce their conclusions below:

Good Faith is Honesty

3.6 The Authors consider that the most uncontroversial proposition is that good faith at least requires parties to act honestly but as the Authors note:

> "The major problem with a standard of "honesty" is not only the evidentiary challenge to a franchisee of proving dishonesty but also that it will not catch many forms of bad faith which are categorised by honest behaviour yet which nevertheless impact negatively and significantly upon the legitimate interests or expectations of the other."

Good Faith as Fairness

[1] [2009] MULR 19

[2] Andrew Terry is an Emeritus Professor with the Australian School of Business at the University of New South Wales.

3.7 The Authors consider that if good faith requires parties to act "fairly" towards one another this poses great challenges in its administration because the idea of "fairness" is too abstract an ideal.

Good Faith as Reasonableness

3.8 Over a century ago, Bowen LJ in his judgment *The Mogul Steamship Co Limited v MacGregor, Gow & Co* warned of the difficulty of imposing an obligation to act reasonably in commercial transactions:

> "I myself shall then deem it to be a misfortune if we were to attempt to……adopt some standard of judicial "reasonableness" ……to which commercial adventurers, otherwise innocent were bound to conform." [3]

3.9 Having considered the judgment by Bowen LJ the learned Authors state:

> "The equating of good faith with reasonableness has, not surprisingly, been criticised as "being more confusing than instructive.
>
> As Peden has observed:
>
> > "There was no precise meaning given, but rather repetition of well worn phrases and quotes, without explanation of how and why they fit together. There is, furthermore, no explanation of why "reasonableness" is a justified inclusion in the meaning of good faith and why it is considered identical to good faith.""

3.10 In practical terms, we consider that the real issue is that what one person considers constitutes "reasonable" behaviour will differ from the view of another particularly when parties have divergent interests.

3.11 Further:

> "A requirement to satisfy a standard of reasonable behaviour is more demanding than the requirement of good faith." [4]

3.12 Having considered the plethora of cases relating to an implication of "good faith" in Australian commercial law, the Authors note the observations of Kirby J in Sanpine[5] are equally applicable to the burgeoning law on good faith:

---

[3] (1889) 23 QBD 598 at 620.
[4] Jane Stapleton, "Good Faith in Private Law" (1999) 52 Current Legal Problems 1, 8
[5] (2007) 233 CLR 115 at 152

> "Because the common law develops from hundreds of judicial decisions, sometimes over long periods of time, it is often the case that the conceptual framework that affords structure to a group of related legal principles is at first imperfect and unclear. Its falls to judges and scholars to attempt to derive rules that are coherent, practical, just and (so far as possible) conformable with past decisions."

3.13 In practical terms the message the Authors are endeavouring to convey is that the law relating to good faith in Australia is in an embryonic state but developing over time. As it currently stands the concept is imprecise and difficult if not impossible to define uniformly.

The Authors conclude that:

> "While an understanding of good faith as requiring "a fair go" would be enthusiastically perceived as a panacea for both the real and imagined ills of the sector, the reality of good faith as a legal concept is quite different. If franchisor opportunism is a problem warranting legislative intervention, this should be addressed by carefully crafted legislative responses rather than by defaulting to an undefined and overreaching standard of indeterminate scope and application."

In their opinion, a single definition of "good faith" has the:

> **"…potential to propel a franchising sector into a new era of uncertainty, disputation and litigation, with notions of good faith being sought to be applied to an indeterminate range of real and imagined grievances and breaches."**

3.14 We consider that the difficultly in defining the notion of good faith is best summarised by Warren CJ in Esso Australia:

> "The difficulty is that the standard is nebulous. Therefore, the current reticence attending the application and recognition of a duty of good faith probably lies as much with the vagueness and imprecision inherent in defining commercial morality. The modern law of contract is developed on the premise of achieving certainty in commerce. If good faith is not readily capable of definition, then that certainty is undermined." [6]

The ACCC's view on Good Faith

3.15 The sentiments expressed by Andrew Terry and Cary Di Lernia are echoed by the Australian Competition & Consumer Commission

[6] [2005] VSCA 228

("ACCC") in their submissions to the Federal Inquiry[7]. In their submissions [8], the ACCC considered that a good faith obligation:

> "may introduce ambiguity and confusion about the rights and responsibilities of franchisors and franchisees, and potentially increase disputes and conflict among franchising participants."

3.16 In paragraph 6.2 of their submissions the ACCC stated:

> "If a general provision of good faith were inserted into the Code as a separate course of action, the ACCC would have concerns about the practical implications such a clause could have on the operation of the Code and the work of the ACCC."

3.17 The ACCC went on to state:

> "Specifically, we note there is a degree of uncertainty about the meaning of a statutory obligation to act in good faith. The ACCC's view is that good faith is difficult to define independently or reduce to a rigid rule, and if an obligation to act in good faith were included in the Code, the meaning of good faith would have to be considered separately in each case depending on its particular facts. This may introduce ambiguity and confusion about the rights and responsibilities of franchisors and franchisees, and potentially increase disputes and conflicts amongst franchising participants."

3.18 The ACCC concluded that it is their view that:

> **"A general obligation to act in good faith should not be included in the Code."**

The Federal Government's view on Good Faith

3.19 Similar conclusions to those of the ACCC were reached by the Federal Government in both the Senate Standing Committee on Economics ("the Unconscionable Conduct Report") and the Commonwealth Government response to the Federal Inquiry.[9]

3.20 In the Unconscionable Conduct Report delivered in December 2008 the Senate Standing Committee declined to recommend the insertion of a definition of good faith into the CCA (then the Trade Practices Act)

[7] These views are in contrast to that expressed by Frank Zumbo, Associate Professor, Australian School of Business, The University of New South Wales in his article "Concerns about WA Franchising Bills can be Address" published in Economy News on 17 November 2010.
[8] See attachment A
[9] See attachment B

commenting that the introduction of a definition of good faith would only add uncertainty.

3.21 The matter was further considered in the Federal Inquiry. Notwithstanding Recommendation 8 of the Federal Inquiry (which recommended the insertion of a clause in the FCC requiring parties to act in good faith in all aspects of franchising agreements the Federal Government considered:

"there are several problems with the suggested approach:

- The law on good faith is still evolving. The scope of the requirement is unclear. From a commercial perspective, uncertainty would be increased by an express statement of the requirement in the Franchising Code. Neither franchisors nor franchisees would be certain of the occurrence of a breach. Indeed it would require Court proceedings to establish that.

- From an economic perspective in any given situation, it is almost certain that the franchisor's perspective on the scope of the concept will differ from that of the franchisee. While the franchisor may have ready access to legal advice on what good faith means, a franchisee will not, so there will be an information gap."

3.22 The Federal Government concluded that:

> "The extra uncertainty created by the inclusion in the Franchising Code of Conduct of a general, undefined good faith obligation could be expected to have adverse commercial consequences for franchisees. Franchisors would seek compensation for the extra risk they face through larger franchise fees and more onerous terms and conditions in other parts of the agreement. And banks and other financiers would be more reluctant to provide credit to the franchisees and franchisors in these more risky commercial circumstances."

3.23 Similar sentiments were also expressed by the Honourable Dr Craig Emerson MP (the then Minister for Small Business) in a keynote address to the BRW Franchising Conference in Sydney on Wednesday 3 March 2010. [10]

3.24 During the course of that keynote address, Dr Emerson stated:

> **"After extensive investigation, the Government has concluded that a well-defined good faith obligation is not achievable.**

[10] See attachment C

> The law on good faith is still evolving and there is not a single definition or an agreed, standard set of behaviours that constitute good faith.
>
> Because of this, the inclusion of a general obligation of good faith in the Franchising Code would increase uncertainty in franchising.
>
> Neither Franchisors nor Franchisees would be certain of the occurrence of a breach.
>
> In fact, Court proceedings would be required to establish whether or not a breach had occurred.
>
> Our difficulty is not with the principle of good faith, or indeed with the parties acting honourably in their dealings with each other. Our difficulty is with the inability to define good faith clearly enough for it to be inserted into a mandatory code of conduct."

The Western Australian Government's View on Good Faith

3.25 The Economics Industry Standing Committee of the Western Australian Parliament held an inquiry into the Franchising Bill 2010 in Western Australia.("the Inquiry")

3.26 The Bill endeavoured to introduce a statutory definition of the expression "good faith".

3.27 In its Report to parliament the Committee concluded:

> "Codifying the common law concept of good faith with an exhaustive definition using four imprecise terms will cause uncertainty. Additionally, litigation will not be decreased and may even be increased."[11]

3.28 The Committee noted at paragraph 213 of its Report that the level of response it received in connection with the attempt to codify good faith including the varied opinions and interpretations that were presented was a testament to the ambiguity of the definition.

3.29 The Committee expressed concern that if such a definition were introduced:

> "these opinions and interpretations will be argued in a court and at some indeterminable point in the future, a body of case law would emerge[12]".

[11] See paragraph 212 in report No 7 on the 38th Parliament of the Economics Industry Standing Committee Inquiry into the Franchising Bill 2011("the Report")

[12] See Paragraph 213 of the Report.

3.30 In conclusion, the Committee indicated that it was not opposed to the development of a "general" duty of good faith for franchising at a Commonwealth level but recommended that any statutory obligation to act in good faith should be left undefined.[13]

3.31 The Western Australian State Government agreed with the recommendations of the Committee as outlined in its government response to the Inquiry.[14]

3.32 Specifically the Government indicated that it supported the

> "recommendation to leave undefined any statutory obligation to act in good faith".
>
> The Western Australian Government agrees with the Committee's finding that there are problems with defining and interpreting what it is to "act in good faith" (with each term having its own definitional issues), which would likely create uncertainty for franchising participants regarding what is and what is not acceptable behaviour.
>
> Following on from this, the vagaries of the duty's definition and terms may increase disputes between franchising participants about conduct that may not be in "good faith"."

3.33 It was for this reason that the Government indicated it would support the good faith obligation being left undefined in any proposed Western Australian Legislation.

Our View on Good Faith

3.34 In summary, the introduction of a specific obligation to act in good faith <u>in a defined way</u> is directly inconsistent with not only the CCA but also with the approach taken by the ACCC and both the Federal and Western Australian Governments.

3.35 Accordingly, until there is clear consensus in Australian case law as to the scope and operation of an obligation of good faith the expression is incapable of proper definition – it is a subjective response following a review of all the particular facts.

3.36 For these reasons we do not support the introduction of a definition of "good faith" in the Franchising Code of Conduct.

[13] See recommendation 4 of the Inquiry.
[14] See the Government Response to the Western Australian Legislative Assembly's Economics and Industry Standing Committee Report No 7

4. Franchisee's Rights at the End of their Franchise Agreement

4.1 The Franchising Bill 2010 (WA) endeavoured to address the rights of a franchisee at the end of their agreement, by proposing that any party (whether it be a franchisee, franchisor or the Commissioner) could apply for a "Renewal Order" which specifically includes an order that the franchisors must renew an expired franchise agreement for a further period and on such other terms, as the Court decides is just having regard to the terms of the old agreement.

4.2 The concept of a Renewal Order is directly inconsistent with the CCA and FCC which is silent as to the requirements to compulsory renew a franchise agreement.

4.3 It is also in direct conflict with the view expressed by the Joint Committee and the Federal Government following the Federal Inquiry.

In finalising its report following the Federal Inquiry the Joint Committee did not support an automatic right to renewal or the requirement for good cause to be shown for not renewing a franchise agreement.

Specifically, the Joint Committee noted that:

"franchisors should be entitled to decline to renew franchise agreements on expiration if that is their choice. The committee therefor does not support an automatic right to renewal or the requirement for good cause to be shown for not renewing a franchise agreement. It is not the role of the law to force unwilling partied to enter into any commercial arrangement, including new franchise agreements"

The Federal Government supported the Joint Committee's views that franchisors should be entitled to decline to renew franchise agreements on expiration if that is their choice.

4.4 The Federal Government did however acknowledge that:

- franchisee's expectations about renewal need to better managed and the financial implications of non-renewal need to be better understood.

- franchise agreements should clearly stipulate what (if any) the end of term arrangements and processes will be and that these arrangements should be fully and transparently disclosed to prospective franchisees

4.5 Accordingly, the Federal Government agreed to amend the FCC to:

- require franchisors to disclose to prospective franchisees the processes that will apply in determining end of terms arrangements (which the Federal Government noted would likely assist in

mitigating disputes where one party has an expectation that the franchise agreement will be renewed.)

- require franchisors to inform franchisees at least 6 months prior to the end of the franchise agreement of their decision either to renew or not renew a franchise agreement (as recommended by the State Inquiry)

4.6 In considering "Renewal Orders" in the context of the Franchising Bill 2010 (WA) the Economics and Industry Standing Committee in its Report acknowledged the comments of Mr Peter Quinlan SC that:

> "Such a power, which would involve a court creating contractual relationships, would be a very unusual power to confer on a court, given that such a power is foreign to what would ordinarily be regarded as judicial power"[15]

4.7 Further Mr Sean O'Donnell advised the Committee that:

> "The form of order appears to subvert the parties' right to contract and allows an agreement to be forced on a party who doesn't want it. That is not how the law presently works. Only in cases where the court finds there is a concluded agreement but one party refuses to perform it can such an order be made. It is not the role of the legislature or Judges to force agreements on unwilling parties on whatever terms the Court deems appropriate"[16]

4.8 From their perspective as a franchisor, Yum! Restaurants International submitted:

> "The right of the parties to allow franchise agreements to expire on their plain terms and conditions is absolutely vital to the ongoing success of the system. Expiry of the agreement is as important, and perhaps the ultimate, security against the progressive diminishment of our brand and system"[17]

4.9 Dr Jenny Buchan advised that:

> "The economic aspects of the franchise are structured around an agreement operating for a certain number of years. Renewal orders would potentially give franchisees a right of renewal that they did not negotiate or pay for when they purchased the licence. This potential perpetual right of renewal would damage the value of the franchisor's business, make WA more risky for franchisors to do business and lead to future franchisees having to pay for that risk in increased fees."[18]

[15] See Paragraph 273 of the Report
[16] See Paragraph 274 of the Report
[17] See Paragraph 277 of the Report
[18] See Paragraph 278 of the Report

4.10 Not surprisingly the Committee, as part of Recommendation 8 of its Report recommended that the provisions relating to "Renewal Orders" should be removed from the Bill.

4.11 The Western Australian State Government in response to the Report agreed stating:

> "Such a provision would allow a court to require a franchisor to renew a franchise agreement beyond the term that was agreed by the parties when the contract was first entered into, irrespective of whether or not there was a contractual right of renewal or extension.
>
> The Government supports the views of a large number of contributors to the Inquiry that the renewal order goes far beyond existing powers under Australian commercial law and would potentially undermine the parties rights of freedom to contract (i.e. the basic legal principle that individuals should be free to bargain among themselves the terms of their own contracts, without government interference; the practical result of which is that once a contract expires, a party such as a franchisor or landlord cannot be compelled to enter into a new contract).
>
> It is the view of the Government that to confer on a court the capacity to effectively ignore the terms of the franchise agreement and continue its terms beyond that provided could be considered an extreme outcome given the commercial decisions that were made when the agreement was entered into. Such a court-enforced renewal order could also place ongoing pressure on the franchisor/franchisee relationship which, following court action is already likely to be soured or irreparably damaged.
>
> In the Government's opinion, the redress order provisions do not appear to take into account the complex nature of franchise agreements which may involve additional third parties (such as new franchisees as well as lessors and lessees) or changed business foci (such as the commercial decision to withdraw from a particular geographical market)."[19]

4.12 Also the notion of empowering a Court to renew a franchise agreement (potentially in perpetuity) does not sit well with State commercial tenancy laws.

For example in Western Australia the Commercial Tenancy (Retail Shops) Agreements Act 1999 currently provides at best a tenant of a

[19] See Recommendation 4 of the Government Response to the Western Australian Legislative Assembly's Economics and Industry Standing Committee Report No 7 – Inquiry into the Franchising Bill 2010

retail shop lease is only entitled to a maximum statutory tenure of 5 years, pursuant to s13 of the Commercial Tenancy (Retail Shops) Agreements Act 1985,

The notion of extending a franchise agreement without limitation is completely inconsistent with the maximum statutory term offered to a tenant of a retail shop lease under that Act.

4.13 Finally an entitlement for a franchisee to extend their franchise agreement beyond the date of expiry (so it does not lose any goodwill in the business) presupposes that the franchisee has a compensatory right to any goodwill in the business at the date of expiry of the franchise agreement.

The FCC defines a "franchise agreement" in clause 4(1) to mean:

- a right granted by a person (the franchisor) to another (the franchisee) to carry on a business under a system substantially controlled or suggested by the franchisor

- under which the operation of the business will be substantially or materially associated with a trademark, advertising or commercial symbol owned, used or licensed by the franchisor (or its associate),

for a finite period of time:

In practical terms this means that the franchisee has little if any goodwill in the business at the expiry of the franchise agreement because the franchisee no longer has a right to use the system or trademarks or advertising symbols connected with the business.

Any goodwill attached to the business is predominately that of the franchisors (not the franchisees) anyway as it[20] comprises mostly of:

- advertising and brand recognition
- product development
- systems
- control

4.14 Like the concept of "Renewal Orders" the prospect of compensating a franchisee for its contribution to the franchise system at the conclusion of their agreement is fraught with danger and inherent uncertainty and is unworkable.

4.15 We perceive that the difficulties with introducing such a concept include the following:

[20] See Attachment D being a letter from Ernst & Young dated 19 January 2011 explaining principles of goodwill

- how do you quantify the contribution made by an individual franchisee during the course of their agreement (especially in monetary terms) to the total franchise system?

- how do you quantify the contribution made by an individual franchise to the total franchise system in the case of a greenfields site (i.e. a retail site that is new to the existing franchise system).

- what if objectively, they have negatively impacted the franchise system?

- who recognises/compensates the franchisee for their positive contributions given that collectively all franchisees benefit (by way of improved brand equity) from a better franchise system?

4.16 Quantifying the contribution of a franchisee to a franchising system is next to impossible. One possibility is measuring the economic benefit derived by the franchisor from the franchisee in the course of the franchise agreement. However when you consider that this is influenced by a variety of outside factors (including but not limited to):

- rents (in relation to retail outlets)

- marketing strategies (adopted by the franchisor)

- menu and product development by franchisors (in the case of quick service restaurants)

- operational assistance by the franchisor

- relevant pay rates of the franchisee's employee's

- the development of intellectual property by the franchise

- the quality of the franchising system

and not just the operational capabilities of the franchisee the contribution made by the franchisee is immeasurable.

Clearly franchisors in providing systems and marks for use by the franchisee play a pivotal role in contributing to the success of the franchise.

Consequently to single out the franchisee for possible recognition or compensation is not only unfair but prejudicial to the contribution made by franchisors.

4.17 Any recognition of the franchise's contribution to the total franchise system must be tempered by the fact that it is generally accepted that franchising outlets outperform company outlets. In better franchised

outlets (where the franchisee is engaged on a full time basis in the business) it is generally accepted there is an incremental sales impact of 15% above the same outlet company operated. The franchisee benefits from the “human capital” investment of franchising.

Further, the better franchisors support franchisees in times of hardship, cash flow stress and general need.

A system that compensates franchisees for their contribution to the total franchise system ignores both these points.

It must not be forgotten that the franchisor generally only receives a fixed royalty (usually based on % of sales) and no capital gain.

Any alteration to this system would likely result in franchisor’s redefining their position, by the introduction of increased royalties and the refusal to provide financial support.

This would have a considerable negative impact on the franchising industry and neither the franchisor nor the franchisee would be significantly better off. (in fact good franchisees that require franchisor support could be significantly impacted if support is withdrawn yet these are the group that need assistance to help establish their business and enable them to flourish).

Finally it must be remembered the franchisor receives no benefit if the franchisee has outperformed the expectations of the investment (but the franchisor supports franchisees in times of need).

In summary the financial outcomes and the risk during the partnership need to be balanced or the terms will change to achieve a protected outcome for the franchisor.

4.18 As we noted above, a franchisee can equally, have a significant negative impact on the franchise system – is this to be taken into account as well (so that in the interests of equity, a franchisee must compensate a franchisor in respect of any negative contribution)?

4.19 Finally, is it appropriate that the franchisor compensates a franchisee for its contribution. In the event of a positive contribution, not only the franchisor, but collectively all franchisees derive a benefit.

To impose some form of compensation on a franchisor (particularly in the context of a global economic down turn) could significantly impact franchisor’s businesses.

In any event a franchisee is adequately compensated for a successful franchise by its rate of return and any significant increase in the goodwill of the franchisee’s business which is accessible upon a sale.

4.20As noted in paragraph 4.13 above, the question whether a franchisee should be compensated for any recognition they have made to a franchise business presupposes they have a compensatory right to any goodwill in the business at the date of expiry of the franchise agreement.

As noted the benefits granted to a franchisee to carry on business using a successful franchise system developed by the franchisor is for a finite period of time only and there is little if any goodwill in the business at the expiry of the franchise agreement given that the goodwill associated with the business is predominately that of the franchisor not the franchisee.

4.21 Further any such compensation potentially gives franchisees a right they did not negotiate or pay for when they acquired the franchise business. It subverts the parties rights and imposes an obligation on the franchisor that is not quantifiable at the point of entry into the agreement.

4.22 As Peter Quinlan SC noted in his comment to the Inquiry, only a court of law could properly and independently assess the form of compensation and this would be "a very unusual power to confer on a court given that such a power is foreign to what would ordinarily be regarded as judicial power".

4.23 For all these reasons we would be against any proposed changes to the Code that endeavours to recognise the contribution of a franchisee to a franchise system.

5. Operation of the Competition and Consumer Act 2010 ("CCA)

5.1 The CCA already provides for a number of remedies for breaches of parts 2-1(Misleading or Deceptive Conduct), parts 2-2 (Unconscionable Conduct), and parts 3 – 2 (Consumer Transactions) of the Australian Consumer Law which forms schedule 1 of the CCA [21] (as well as breaches of the industry codes under s51AD of the CCA) such as injunctions, compensation orders, damages, setting aside or varying contracts and corrective advertising orders.

5.2 Two broader provisions of the CCA have particular relevance to franchising notably s22(3) (unconscionable conduct) and, s18 (misleading or deceptive conduct) of schedule 1 of the CCA.[22]

5.3 Briefly 22(3) prohibits unconscionable conduct in small business transactions, having regard to all the circumstances including:

[21] Formerly Parts IVA and IVB and V of the Trade Practices Act 1974
[22] Formerly ss51AC and 52 of the Trade Parties Act 1974

- the relative strength of the bargaining positions
- the imposition of unnecessary conditions
- whether any undue influence, pressure or unfair tactics were used
- whether the conduct was consistent with other dealings.
- whether the requirements of an applicable industry code (such as the FCC) were met
- whether the stronger party was willing to negotiate
- the extent to which the parties act in good faith

5.4 Further s18 provides:

> "A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive."

5.5 Together these provisions afford participants in the franchising industry adequate and comprehensive protection – to the extent that any additional enforcement options would unfairly and prejudicially differentiate franchising law from every other category of contractual law.

5.6 One additional enforcement option that is often talked about but generally rejected is the application of civil monetary penalties for failing to comply with the Franchising Code Conduct.

5.7 As the Law Council of Australia advised to the Economics Industry Standing Committee during the course of its Inquiry:

> "Introducing pecuniary penalties for conduct is a substantial step that should only be taken where there is a clear case for applying a penalty for any conduct that could constitute a breach of the provisions."[23]

5.8 The Ripoll Report recommended pecuniary civil monetary penalties being included in the former Trade Practices Act for breaches of the Franchising Code of Conduct. The Department of Innovation, Industry, Science, Research ("the Department") explained the Government's decision not to implement the recommendation:

> "…industry codes seek to include mutual obligations by way of information exchange in disclosure on business within a sector, such as franchising. Therefore the Government did not consider it appropriate to impose punitive measures in the Franchise Code… given that industry codes are in the nature of light touch regulation."[24]

5.9 Instead the Federal Government at the time chose to implement a range of new protections and enforcement powers under the code and

[23] See paragraph 235 of the Report
[24] See Paragraph 238 of the Report

the CCA, including civil monetary penalties for unconscionable conduct.

5.10 As was noted by Mr Brett Dingli, Legal Counsel for QSRH in the recent Report:

> "these remedies allow the franchisee the aggrieved party, to get a result, which a monetary penalty does not.[25]

5.11 In relation to civil monetary penalties for breaches of the Code, the Law Council of Australia states:

> "Pecuniary penalties for all Code breaches would not be a proportionate response to what appears to be an overstated problem of non-compliance with the Code… the majority of complaints in relation to franchise businesses appear to have arisen from conduct that may contravene the consumer protection and unconscionable conduct provisions of the CCA. Pecuniary penalties are already available for conduct that merits the application of such a remedy. Against that background the case for introducing penalties for the more procedural or disclosure based decisions of the Code has not been made out."[26]

5.12 In summary, as the Department previously noted to the Ripoll Report we must never forget that the Franchising Code of Conduct is an industry code which seeks to allow the dissemination of information and disclosure to enable franchisees to carry out a comprehensive due diligence process prior to the acquisition of the franchise business.

5.13 In our view, the inclusion of pecuniary type penalties as a result of a breach of the Code (especially a trivial one), or a breach where there has been no loss or damage suffered by a franchisee would be harsh and onerous and disproportionate to the actual effect of the breach.

5.14 These circumstances are not dissimilar to that faced by the High Court of Australia in *Master Education Services Pty Ltd V Ketchell* [2008] HCA 38 (the Ketchell case).

5.15 In dispute was whether the franchise agreement between the two parties could be considered illegal and therefore void because of a failure of the franchisor to obtain from the franchisee the required written statement that the franchisee had received, and had a reasonable opportunity to understand the Code.

5.16 In that instance, the franchisee had not suffered any loss or damage as a result of the non-compliance but instead sort to set aside and avoid

[25] See paragraph 239 of the Report.
[26] See paragraph 240 of the Report.

the entire franchise agreement for a procedural failure on the part of the franchisor.

5.17 The High Court of Australia ruled that:

> "The detailed provisions by the Trade Practices Act for the consequences of non-compliance within industry code, such as the Franchising Code of Conduct, does not support a conclusion that it was intended that the harsh consequences provided by the common law were to follow upon contravention of section 51 AD."

As the High Court noted:

> "One of the purposes of the Code is the protection of the position of the franchisee from entering into an agreement where a franchisor had not complied with cl 11. … It is not to be assumed in every case that a franchisee wished to be relieved of their bargain. To render void every franchise agreement entered into where a franchisor had not complied with the Code would be to give the franchisor, the wrong-doer, an opportunity to avoid its obligations… A preferable result, and one for which the [TPA] provides, is to permit a franchisee to seek such relief as appropriate to the circumstances of the case."

5.18 The comments of the High Court in Ketchell's case are equally applicable in considering whether pecuniary penalties should be introduced for breaches of the Code.

5.19 In our view, (applying the same logic as in Ketchell's case) the imposition of civil and pecuniary penalties that are inflexible in nature and may be imposed even in respect of a trivial and non-consequential or unintended breach of the Code would not be appropriate to the circumstances of the case.

5.20 For these reasons, we consider that the current framework of the CCA is sufficiently flexible to permit franchisees the opportunity to pursue an appropriate and range of remedies in the event of unconscionable or misleading and deceptive conduct.

6. The Cost Impact of the introduction of a Specific Defined Obligation to Act in Good Faith

6.1 We express concern that the imposition of a statutorily defined duty of good faith could result in a significant cost impact to participants in the franchising sector that wish to test the boundaries of that definition.

7. Discussion Questions

Please see Annexure E

8. Conclusion

8.1 The FCA, the ACCC and the Federal and Western Australian State Governments all agree that:

- the concept of "good faith" is incapable of definition as it is an imprecise term that has been interpreted very differently by the Australian judiciary

- the introduction of an explicit defined obligation of good faith will create ambiguity and confusion within the franchising industry.

- it is unnecessary to introduce powers that will allow a Court to compulsorily renew a franchise agreement at the expiry of its term.

8.2 As a consequence it would be pure folly to ignore these views and proceed in a manner that will cause disharmony and ambiguity in the Australian Franchising sector.

8.3 In our opinion it is far better to let Australian case law continue to refine the concept of good faith in consumer and contract law and apply it to the facts of each particular case. As at least one learned scholar has noted, whilst the notion of "good faith" is imprecise, the Judiciary "know it when they see it," or more properly know a breach of it when they see it.

8.4 Indeed the current Federal legislative framework does not preclude considerations of good faith when considering whether a franchising participant has engaged in unconscionable or misleading or deceptive conduct anyway.

Specifically:

- Clause 23A of the FCC (which was introduced by the Federal Government in July 2011 following the Federal Inquiry) states:

> "that nothing in the code limits any obligations imposed by the common law, applicable in a State or Territory, on the parties to a franchise agreement to act in good faith."

- Section 22(3) of schedule 1 of the CCA permits Courts to have regard to the extent to which parties act in good faith in considering whether they have engaged in unconscionable conduct.

8.5 Accordingly:

- QSRH has no objection to the introduction of a duty to act in "good faith" in the Code in the course of negotiating a franchise agreement and during mediation.

- The Code should avoid defining "good faith". The same notion of "good faith" at common law should apply. This allows flexibility and enables the notion of "good faith" to evolve.

- the Code should not empower a Court to extend franchise agreements beyond the date of expiry of their term.

- the Code should not empower a Court to compensate franchisees at the end of their franchise agreement in recognition of their contributions to the franchising System.

- the Code should not introduce a pecuniary penalty for trivial breaches of the Code that do not result in economic/financial loss to a party since the fabric of the CCA is sufficient to properly deal with all relevant franchising disputes.

8.6 QSRH (as one of the largest original Australia based franchisors) has been a very active participant in discussions regarding notions of good faith and the right of the parties at the conclusion of franchise agreements and we would welcome the opportunity for representatives of QSRH to appear before Mr Wein to further present our views.

Dated 15th day of February 2013

Mark Bayliss
Chief Executive Officer

QUICK SERVICE RESTAURANT HOLDINGS

Brett Dingli
Inhouse Legal Counsel

QUICK SERVICE RESTAURANT HOLDINGS