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DISCUSSION PAPER
ON THE CONCEPT OF INTRODUCING
A REGIME FOR PENALTIES AND A DUTY OF GOOD FAITH
INTO THE FRANCHISING CODE OF CONDUCT

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Contents

1 The purpose of this discussion paper

(1) This discussion paper has been prepared in anticipation of the Commonwealth commencing to formulate its policy on the scope of the proposed review of the *Franchising Code of Conduct* (the Code) expected to take place in 2013.

(2) There has been a suggestion that the review might include a proposal for the Commonwealth to amend the Code to introduce:

(a) A codified duty (or obligation) of good faith into every franchise agreement that is regulated by the Code; and

(b) A regime of penalties to be imposed for breaches of the Code.

(3) This suggestion appears to be based on a perceived need to address the concerns of a group of State politicians in WA and SA who have been demanding reforms be made by the Commonwealth to the Code.

(4) State franchising reforms have already commenced in those States after the demanded reforms were not forthcoming from the Commonwealth following the last Code reviews in 2008 and 2010.

(5) These demands included a requirement for greater investigative and enforcement powers for the ACCC and amendments to the Code to include a penalty regime and to introduce a codified duty of good faith into every franchise agreement regulated by the Code.

(6) In formulating its policy the Commonwealth should take into account the stated preference of all parties that the Code should have primacy nationwide and that duplication of the Code at State level can result in unnecessary duplication of red tape and conflict between Commonwealth and State roles in the regulation, investigation into compliance and enforcement of the Code.

(7) Such a policy may then intend or have the effect of creating a disincentive for those States (being WA and SA) to continue with their reforms and simply allow the Commonwealth to continue to regulate franchising in Australia through the Code.

(8) There is no assurance that the Commonwealth's future policy will stop state based reforms in franchising in either WA or SA or any other State or Territory without a decisive move to amend Section 51AEA of the Competition and Consumer Act 2010.

(9) The States and Territories that currently do not intend to pursue reforms are directly affected by the reforms proposed by SA & WA. As a consequence these proposals will result in a change that affects every State and Territory even though support for those changes may not be strong in those other States and Territories (or even lead to disputes as to extra-territorial application of the reforms).

(10) Before committing to a policy and seeking consultation, the Commonwealth would be mindful to also consider whether the review should also expressly include:

(a) Removal of any current interpretational problems with the Code that could give rise to unfairness or uncertainty if a penalty regime and good faith regime were included.

(b) Including specific defences and mitigating circumstances to be taken into account and providing in various cases the specific consequences that will apply to a breach.

(c) Whether there should be an express right to appeal a prosecution or determination that a breach has occurred to a court of appropriate jurisdiction.

(d) Whether there should be practical improvements to access to the Courts for expedited relief including the ability of an applicant or respondent to fast track any hearing or appeal process.

(e) These issues apply equally to any proposed penalty regime and to any codified mandatory duty of good faith (whether defined or not).

(11) Whilst those considerations are relevant and important it will make the whole process more complicated and time consuming.

(12) The Commonwealth should ensure that any consequential changes made to the Code (or provisions of the CCA that are intended to contain these changes) do not have an unintended consequence or effect upon participants that is difficult to correct until the next review presumably some three (3) years later. Notably since its inception, the Commonwealth has not made additional changes to the Code outside of its regular three (3) yearly reviews.

2 Introduction

(1) I am not an academic but a franchising lawyer in private practice. As a consequence this paper is not designed to discuss or put forward a view on what "good faith" is as a concept, duty or obligation nor that matter the benefit or otherwise of its concept or application. It focuses on practical issues and considerations.

(2) The majority of my practice involves advising clients in the franchising sector. I have direct practical experience in the day to day practical application of the Code to legal matters for franchisees, franchisors, master franchisees and service providers to the sector. I am well known in the Sector for my contribution to the development of the Code over the years and my extensive submissions to Governments (State and Commonwealth) in a variety of capacities.

(3) As a consequence I am acutely aware of the provisions of the Code and the CCA and practical and interpretational problems that arise when parties seek to apply its terms as well as the attempts by the States to commence reforms.

(4) I am not an advocate for a complete overhaul of the Code nor do I think there is an overwhelming need to implement either a codified duty of good faith or express penalties for breach of the Code. I am more concerned that some States (notably SA and WA) have reforms in motion that will (if successful) do so and as a consequence disrupt the current balance of national regulation of the sector.

(5) I am of the view that the Courts are able to grant appropriate relief under the CCA and that the Regulator has been relatively effective in policing the enforcement of the Code given restrictions on its human, physical and funding resources.

(6) I am of the view that the common law already does impose a so called implied duty (or obligation) to act in good faith on parties to a franchise agreement and that the idea of codifying one is unnecessary and unhelpful and should be left to the Courts.

(7) There has been a great deal of talk about a concept of a "*duty*" but in layman's terms the Courts seem to indicate that the "*obligation*" to act in good faith is a necessary incident to certain types of contracts and should be implied as a contractual term by law. The use of the word duty is therefore to some extent confusing but irrespective of that many lawyers believe that an agreement which regulates a franchise relationship is one of those types of special contracts that a "*duty*" or "*obligation*" does already apply.

(8) I am of the view that there is a benefit in having certain express consequences for breach of some provisions of the Code that lend themselves to a direct consequence for breach. This would allow the parties to know with certainty how it affects them or their obligations without having to go to the Court or a regulator to interpret them. I have given some examples of those clauses and suggested commercial consequences that could easily be made to apply for consideration. They could work either in conjunction with or without the need for a penalty regime.

(9) Introduction of a regime to allow applications to the ACCC (similar to the existing authorisation or notification regime) to clarify the application of the Code to certain agreements would be beneficial.

(10) I am of the view that deliberate anti avoidance of the Code still exists (albeit in isolated cases including by overseas franchise systems) and that it is not so called "unscrupulous or rogue franchisors" who are to blame but organisations in a wide variety of industries who either deliberately or inadvertently do not comply with the Code at all. Focus on deliberate anti-avoidance by the regulator would assist to improve the image of the sector which is being tarnished by those operators and exposing consumers to loss and damage.

(11) Many of these non-complying organisations simply call themselves "licensors" or argue technical reasons why the Code does not apply to them rather than openly taking on the mantle and responsibility of a "franchisor". It confuses consumers and often it is difficult to prevent it occurring without those willing to come forward to the regulator prepared to identify the problem and pursue a complaint. Often consumers are more concerned with preserving their investment and the likelihood of immediate retribution or adverse financial consequences to them if they came forward to make a complaint.

(12) I prepared this discussion paper to outline my concerns that I do not think that the Commonwealth can simply adopt a policy to overlay a codified duty of good faith and a penalty regime with the current language of the Code without conducting a major overhaul of the Code provisions.

(13) I am not of the view that a complete overhaul is currently necessary, but I also believe that the introduction of these two (2) proposals could unfortunately make it necessary.

(14) If these proposals are included, there will also be an immediate perception by the Sector that the Commonwealth has (by introducing these two (2) proposals) acceded to these proposals in an attempt to prevent further state based franchising reforms occurring. Irrespective of whether this was true, implementing these proposals would not necessarily stop current or future franchising reform initiatives by the States or advocates for change.

(15) If the intent of policy development is primarily based on a desire to prevent further State based franchising reforms (such as those in SA and WA) undermining the primacy and effectiveness of the Code then rather than focusing a review of adding unnecessary changes to the Code on the Sector which may be unwelcomed or unnecessary, the Commonwealth should also consider including in its policy initiatives the review and amendment of the provisions of Section 51AEA of the *Competition and Consumer Act* which currently provides:

> **"Concurrent operation of State and Territory laws**
>
> *It is the Parliament's intention that a law of a State or Territory should be able to operate concurrently with this Part unless the law is directly inconsistent with this Part."*

(16) Even though it may require a degree of consultation and cooperation through COAG, the States originally agreed to a national approach for franchising on the platform of one mandatory industry code controlled by the Commonwealth applying for the sector. It may be as simple as the Commonwealth amending the section to provide clarity as to how the words "*directly inconsistent*" are to be interpreted or applied in respect to a prescribed mandatory industry code that regulates nationally an industry sector and empowers the Commonwealth to investigate breaches and police enforcement of that Code.

(17) It may never have been intended that Section 51AEA could be used by change advocates to allow the States to:

(a) empower them to prescribe their own industry codes of conduct which are identical to (by adoption or reference) or based on wording or provisions contained in the current Commonwealth Codes;

(b) empower themselves to investigate compliance with the Commonwealth Codes;

(c) empower themselves to impose a regime of penalties and other concepts (such as good faith) not otherwise included in the Code,

that effectively removes a national approach to regulation of the sector.

(18) If that review and amendment was possible and undertaken then it could immediately remove the continuing prospect of States running parallel overlapping industry code regimes that contain provisions that the Commonwealth does not support.

(19) The advocates for State reforms have defended the legislative attempts based on the application of Section 51AEA and the argument that the legislation they are enacting will not be "*directly inconsistent*" with the CCA. That argument includes that there are currently no express penalty provisions in the Code or duty of good faith in the Code or in the CCA and that it is not inconsistent for the States to introduce a law that sought to implement them or allow them to adopt the Code as a State based industry code. That ability then gives them the right to investigate compliance, impose a penalty regime for breach and compel the production of documentation and information and attendance at a form of conciliation to resolve disputes that relate to franchising.

(20) This amendment could essentially stop a state based franchising industry code being prescribed in South Australia without significantly affecting the existing *Small Business Commissioner Bill 2011* in South Australia. It may also prevent further debate on the Bill before the upper house of the Western Australian parliament if initiatives were taken quickly.

(21) This approach would ensure that attempts to introduce a state based mandatory industry code of conduct when one already exists that is the same as or substantially the same as the terms of the Commonwealth Code would be considered to be a "*..law directly inconsistent with this Part*", and that the law of the State or Territory should not operate concurrently in relation to the Code or the enforcement of it.

(22) As a consequence if the policy is being developed now it will require more thought as to the "*scope*" of the review now before the Commonwealth seeks to consult with the sector and request submissions from interested stakeholders. It therefore raises the issue whether the scope of the review should cover other provisions of the Code rather than a simple "*narrow focus*" that has occurred in past reviews.

(23) My reasoning is that I believe there are many current provisions that are "*grey*" and open to interpretation and overlaying for example either regime where there are differences in interpretation will cause greater confusion and uncertainty.

(24) I do not believe the Code needs a major overhaul however correcting some identifiable interpretational issues would be desirable.

(25) Many advocates for "*no change*" believe that the Code is currently well balance, that the Code has been working well for many years and that the Commonwealth should not disturb that balance. Interpretational issues arise but they are not overwhelmingly damaging to the effectiveness of the Code. Clarification of grey areas will assist the parties and practitioners to understand their obligations and encourage greater compliance with the spirit and intent of the Code.

(26) Change advocates have suggested that the Code, the *Competition and Consumer Act* and the ACCC have not been effective to protect the interests of franchisees from unscrupulous franchisors. Many lawyers believe that the problem lies not in the wording of the Code but that access to justice in a cost effective and timely forum is the problem in many franchise disputes.

(27) As a consequence if access to the courts is difficult, expensive and time consuming it is likely that rights of parties may not be pursued and a perception of ineffectiveness exists. If you also consider and overlay the lack of funding and resources of the regulator then you can understand how that perception can arise.

(28) The Commonwealth is introducing a Commonwealth Small Business Commissioner (the SBC) and also implementing initiatives for enhanced dispute resolution alternatives for small business and reviewing general principles in relation to contract law reform.

(29) It would be useful to see:

(a) What role powers and functions the Commonwealth intends to provide the Commonwealth SBC and what role it will have in removing additional red tape, dealing with the regime of industry codes and disputes arising out of them (including its role in dealing with other State SBC's);

(b) What the Commonwealth intends to do to improve or change (if at all) the Part 4 Dispute provisions through a wider improved Commonwealth dispute resolution process for small business; and

(c) Whether any changes will flow from the general Australian contract law review that will impact on franchise agreements regulated by the Code.

3 Executive Summary

(1) The Commonwealth should consider when developing its policy and scope of the review:

(a) Whether a wider review of section 51AEA of the *Competition and Consumer Act* 2010 is also immediately required to clarify how the words "*directly inconsistent*" apply in relation to a State adopting (expressly or by reference) as their own a prescribed Commonwealth mandatory industry code. That review could investigate whether a simple amendment to that section would stop reforms in this area and prevent an overlap between State and Commonwealth regulation and enforcement of prescribed mandatory industry codes by making those initiatives "*directly inconsistent*".

(b) Whether the review should include clarifying provisions that are open to interpretation by making simple changes to the Code.

(c) Whether provisions that provide simple non contentious consequences should be inserted into the Code to give clarity and outcomes for the parties without the necessity for a party to go to Court for an order to identify and achieve those outcomes or wait for the common law to make a decision on the interpretation of the rights or consequences that arise out of a breach of that provision.

(d) Whether the language of the Code is currently appropriate (or would require significant change) when overlaying either a codified duty of good faith or penalty regime. I believe that language will need to be "tighter" to avoid uncertainty and unintended consequences.

(e) Whether the lack of an overwhelming need for change justifies the introduction of these two (2) regimes when overwhelmingly it has the potential to significantly change the balance of the contractual relationship between the parties.

(f) Whether the parties should have a right to contract out of some of the provisions of the Code (particularly in relation to waiving mandatory and inflexible time periods) where they both wish to or the request is made by the franchisee based on informed legal advice.

(g) That the introduction of a penalty regime and or a duty of good faith would also require consideration of other provisions being included in the Code or CCA such as:

(i) Defences;

(ii) Mitigating circumstances;

(iii) Appeal rights;

(iv) Imposing reciprocal obligations onto franchisees where they currently do not exist; and

(v) Providing clarity as to who has the onus of proof to, ensuring that offences are not of strict liability and that legal professional privilege is maintained as a right.

(h) Whether the role and funding of the ACCC should be expanded to give clarity to current interpretational issues.

(2) I believe that adopting a policy to amend the code and impose both a codified good faith obligation and penalty regime is not a simple task. It requires careful consideration of the consequences that will flow particularly if the Code is only to be reviewed every three (3) years.

4 My perception about the need for reforms

(1) The concept of introducing penalties for breaches of the Code has been argued by (generally) change advocates to force franchisors to comply with the Code and provide franchisees with meaningful and effective relief against the actions of non-complying franchisors. On the whole, advocates that do not think that change is required do not agree with that assertion, nor that there is a widespread culture of non-compliance among franchisors.

(2) There has also been a strong argument raised by those change advocates that it is necessary to also define and include an express duty to act in *good faith* into every franchise agreement regulated by the Code.

(3) One of the practical outcomes sought by the inclusion of such a term is to ensure that a decision to renew or not renew or to negotiate a new agreement at the end of a franchise term must be undertaken in *good faith*.

(4) The immediate concern raised by expert commentators was that this may result in the automatic renewal of franchise agreements in perpetuity depending on who will have the onus of proof of establishing that the exercise of the right, power or discretion was in *good faith*. This outcome would be contrary to well established legal principles[1] and create a conflict of laws that may give rise to even greater uncertainty.[2]

(5) There has been strong opposition to these initiatives including significant objections by the Franchise Council of Australia and various legal bodies such as the Law Council and State Law societies. Clearly any policy that sought to introduce a codified obligation of good faith or penalty regime must be carefully drafted and considered in depth including after detailed sector wide consultation.

(6) The perplexing question is whether there is a real (as opposed to perceived) need for these reforms or whether the reforms are in essence simply being considered to be included in the review to appease advocates for change. As I have said I do not think that strategy would be the correct one to adopt when there is a more direct opportunity to do that without implementing an unnecessary change that affects the entire sector.

5 Is there an existing common law duty of good faith?

(1) It is often argued that there is an implied duty (or obligation) to act in good faith in every franchise agreement (whether regulated by the Code or not). The implied duty as it is currently formulated by the Courts has nothing to do with the Code and arguably would seem to apply to a franchise agreement whether regulated by the Code or not.

(2) However many franchising lawyers believe that various State Courts will imply a common law duty or obligation of *good faith* into franchise agreements and that therefore it should be left to the Courts to determine what that duty or obligation of *good faith* means in the circumstances.

(3) This represents the accepted and natural progression of common law as it exists in Australia today, however this progression may not be swift enough for the proponents of introducing a codified obligation. The Code already specifically acknowledges in Clause 23A that this progression may occur.

[1] The so called "rule against perpetuities".

[2] That is that a franchise agreement could be struck out as infringing against the "rule" resulting in the agreement being declared to be void and unenforceable instead of being renewed.

(4) The issue of good faith in contractual relationships is not limited to franchising. This is seen in the general duty imposed on directors of a corporation in Australia to act in *good faith and in the interests of the company*.

(5) Section 22(2)(l) of the *Australian Consumer Law* provides that a Court, in determining whether unconscionable conduct has occurred, may consider the extent to which "the supplier and business consumer acted in good faith."[3]

(6) There are good faith obligations contained in the *Fair Work Act* 2009 (Cth) - a recent decision has considered the obligations of employers to negotiate "in good faith".[4]

(7) Perhaps most relevantly there is also a form of special contract where a codified duty of utmost good faith exists.[5] That contract is between an insurer and an insured.

(8) The common law has held that a contract of insurance is based on the principle that the insurer and the insured must act with the utmost good faith towards each other.[6] The principle is otherwise known as "*uberrima fides.*"[7]

(9) However despite that common law duty the *Insurance Contracts Act* has included a statutory term to act in utmost good faith into every general insurance contract.

(10) That duty applies both to conduct prior to the contract as well as during the term of the contract.

(11) In insurance contracts various manifestations of a "post- contractual" duty of good faith arises in claims either in the way the claims are made or the way the insurer handles them.

(12) As a general rule in Australia no damages are allowed under the common law for breach of the duty of good faith. However there is a specific statutory right to damages set out in the *Insurance Contracts Act* which may allow an adjustment in the payment of the amount of proceeds of a claim.

(13) Interestingly even though a duty of *utmost good faith* is implied into all general insurance contracts by Section 13 of the *Insurance Contracts Act*, it does not define precisely what *good faith* is?

(14) Even though much has been written generally on good faith, the precise meaning of the words is not easy to define. Many would say that its fundamental meaning includes an obligation of fair dealing and that it encompasses notions of fairness, reasonableness and community standards of decency and fair dealing.

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[3] It is worth noting that this provision was included in the Former S 51AC of the Trade Practices Act and adopted as part of the ACL.

[4] *Endeavour Coal Pty Limited v Association of Professional Engineers, Scientists and Managers, Australia [2012] FCA 764 (19 July 2012).*

[5] Section 11 of the *Insurance Contracts Act* 1984 includes a definition of a "duty of the utmost good faith" to mean the duty referred to in Section13 of that Act.

[6] Lord Mansfield in Carter – Boehm (1766) 97 ER 1162 said "*Good faith forbids either party concealing what he privately knows, to draw the other party into a bargain from his ignorance of that fact and his believing the contrary'.*

[7] An article Published by the National Insurance Brokers Association on "Utmost Good Faith" and sections 12,13 and 14 of the Insurance Contracts Act.

(15) However it is important to remember that the *Insurance Contracts Act* contains express consequences of what happens if the duty of utmost good faith is breached.

(16) In respect to a policy holder it may result in the refusal or reduction of a claim or in cancellation of their policies, whereas in respect to an Insurer, they may not be able to rely on particular provisions of their contracts to avoid liability to pay benefits to the policy holder. A policy holder can also claim damages for breach of the duty from the insurer.

(17) Section 13 of the *Insurance Contracts Act* requires the insurer and the insured to act towards each other in respect to any matter arising under or in relation to it, with the utmost good faith.

(18) It should also be remembered that the *Insurance Contracts Act* does not apply to all insurance contracts and accordingly the common law duty applies to those where the codified duty does not. This includes reinsurance contracts, health insurance contracts, marine insurance contracts, workers compensation contracts and insurance contracts entered into by a friendly society.

(19) The Commonwealth is currently conducting a review of general contractual principles and there is no suggestion that a duty of good faith be included in every contractual relationship. Any attempt to include such a condition into franchising must be on the basis that there are specific needs to be met and outcomes to be achieved, rather than creating a new special type of commercial contract as an application of general principle (and which necessarily has close interaction with other commercial contracts such as leases and terms of trade).

(20) Looking at the way the *Insurance Contracts Act* handles good faith may be a useful starting place. There are specific rights and obligations in that Act which make it clear what happens if there is a breach of that duty. Currently there are no such consequences embodied in the Code irrespective of the possibility that a common law duty of good faith which may allow a party to end the agreement.

6 Can that common law duty be excluded modified or adopted?

(1) An implied duty or obligation may be affected or constrained by the actual contractual language in a franchise agreement that may limit its application, adopt it, modify it, place conditions on it (or on what it does or does not apply to) or otherwise expressly seek to exclude it.

(2) In many circumstances the exercise of rights or discretions or powers may already be expressly subject to a test or condition such as a "*reasonableness test*", for example that a consent or approval to a particular transaction may not be "*unreasonably or capriciously withheld*" by a franchisor. Often that amendment is sought by franchisees when negotiating agreements and is often conceded.

(3) This sort of language will typically differ between agreements. In some cases the exercise of a right, power or discretion may also be linked to an obligation for prior consultation with the franchisee or expressly enable the franchisee to resort to some form of dispute resolution process (in addition to the Code) if it does not agree to the franchisor's exercise of that right, power or discretion.

(4) Part 4 of the Code which deals with dispute procedures usually apply in any event however the exercise of the right, power or discretion may also provide a contractual consequence expressly agreed by the parties limiting the ability to dispute the outcome, if not the application.

(5) One significant (and ongoing concern) is that introducing a mandatory codified duty or obligation to act in good faith has the potential to interfere with agreed contractual terms in unintended ways and with consequences that may not have been contemplated by the parties when they entered into the agreement.

(6) There is a serious consideration as to whether any imposed duty or obligation would be included in agreements entered into before the amendment to the Code and have a retrospective application including in relation to decisions made before the amendment was made. Normally retrospective application of changes is not welcomed or warranted. Any transitional clause to reflect this would need to be included as well.

(7) In addition there is some confusion whether the duty or obligation would be extremely wide and apply to every day "relational activities" of the parties or only to certain things such as the exercise of a right, power or discretion during that franchise term. That confusion also extends to whether good faith obligations apply to things occurring after that relationship ends (such as post termination provisions that may be continuing obligations).

(8) Some proponents have argued that the duty should only be imposed on the franchisor and not the franchisee however there does not appear to be any strong reason to support such a position; any duty should be mutual to ensure that concepts such as "honesty" or "fair dealing" are not considered to be one way obligations.

(9) Certainly the practical expression of a duty of good faith may differ between franchisors and franchisees but within the scope of each party's legitimate business interests there should be no differentiation in an obligation to conduct their business dealings with the other with due candour, fairness and honesty.

(10) Relevant examples of this would include a franchisee observing restraints of trade that apply during the franchise term and not deliberately acting contrary to that restraint or imposing a duty of disclosure so that important information is not deliberately withheld from the franchisor to prevent it taking action to protect itself (such as where a franchisee allows its company to be deregistered but continues to act as if it existed).

7 What are the consequences of breaching a duty of good faith?

(1) It does not appear that there has been much consideration in the "good faith" debate as to what would be the consequence of breaching some mandated common law or codified duty or obligation of *good faith* that would be introduced into the Code.

(2) If a duty or obligation of good faith was imposed into every franchise agreement then the consequence of breaching that duty or obligation should be stated. Does it simply constitute a breach of the Code giving rise to penalties (such as fines imposed by an authority) or is it intended to entitle the other party to additional relief such as damages or any one or more other aspects of relief such as a right to end the agreement and be relieved from some or all of its terms?

(3) The introduction of the duty or obligation without consideration of the consequences of breach is dangerous and will lead to confusion and uncertainty in the sector.

(4) It is not clear how it is intended for any Commonwealth codified duty or obligation of good faith to interplay with any future State based codified duty or obligation of good faith. The

Government of SA has already signalled that a State based franchising regime is being prepared. Similar uncertainty exists with a penalties regime potentially applying both at State and Commonwealth levels.

(5) There is currently the real potential for an overlap between the unconscionable conduct provisions of the CCA and a breach of a duty of good faith emanating out of the same conduct or decision. It is not clear how the Commonwealth intends to deal with that overlap. For example would the Commonwealth deem a breach of a codified duty or obligation of good faith to be unconscionable conduct? It would be necessary to provide clarity on how the concepts will co-exist or be applied particularly if the other concept was also argued in the particular circumstances to seek additional relief.

8 Should "good faith" be defined and codified or left to the common law and the agreed contractual terms?

(1) My strong view is that the Commonwealth should not seek to define and codify "*good faith*" for the purposes of applying some codified duty or obligation of good faith on parties to a franchise agreement regulated by the Code.

(2) In my opinion the imposition of any duty or obligation and what that duty or obligation comprises should be left to the common law and the Courts to determine on a case by case basis.

(3) If a duty or obligation of good faith was to be imposed onto the franchise sector then the logical proposal would be to apply a common law duty to every franchise agreement (whether regulated by the Code or not) and ultimately leave the definition and evolution of good faith to the Courts over time with the ability to look at all of the circumstances and facts on a case by case basis.

(4) Whether the Code should embody a recognition that a common law duty of good faith exists may be some form of concession however it would still require a determination by the courts over time as to what that form and obligations that duty requires. Ideally the consequences of breaching the duty would be detailed (to a greater or lesser extent) and would then be within the jurisdiction of the relevant courts to determine the appropriate outcome.

(5) There have been several attempts by State Legislatures in SA and WA to introduce legislation which included a statutory definition of "good faith" in respect to franchise agreements which have largely failed. These attempts have also highlighted the difficulty of seeking to define what *good faith* includes or what factors must be present to say that the exercise of a right, power, or discretion was exercised in *good faith*. Often these decisions are also intertwined on termination or non- renewal with arguments over "goodwill" and whether a payment should be paid to the franchisee for "goodwill" or compensation at the end of the term of the franchise agreement.[8]

(6) There has been widespread objection not only to the proposed definition[9] which was that "*good faith*" meant that a person had to act "*fairly, honestly, reasonably and in a cooperative manner*" but also objections as to the relief that was proposed to be given if that duty was breached.

[8] Article by Richard Solomon LLB entitled "Should goodwill be paid upon termination of franchise agreements" dated 31 May 2012.
[9] A definition put forward by NSW University Associate Professor Frank Zumbo.

(7) Recently a Province in Canada introduced legislation to define a similar concept of "*fair dealing"*. It also sought to impose a duty of "*fair dealing*" into franchise agreements that includes "*a duty to act in good faith and in accordance with reasonable commercial standards*".[10] That legislation did not then go on to define good faith at all nor did it limit fair dealing to simply acting in good faith. The definition was not exhaustive or all inclusive.

(8) In Australia, whether *good faith* is able to be defined and codified into a "*one size fits all*" approach is unlikely. It may be more logical to simply allow the common law to evolve and determine what that duty is and whether it applies in the relevant circumstance.

(9) The definition in the foreign legislation is quite different to the definition actively proposed by proponents for reform in this area in WA and SA.[11] There is no suggestion that one approach is better than the other or that either of them should be considered, adopted or adapted to something new.

(10) That Canadian legislation also relevantly sought to provide that in discharging the duty it applied to the performance and enforcement of a franchise agreement including the exercise of a right under the agreement.[12] This results in the duty applying to the exercise of a right by *either* party.

9 Is imposing a duty of good faith enough?

(1) The current preoccupation with a *good faith* obligation appears to be coupled with a desire by change advocates for greater changes to be made to the Code. Those changes would seek to add significant additional rights and relief for franchisees including proposed arrangements that would allow a renewal of their franchise at the end of the term of their franchise agreement even if a franchisor decides not to renew (and apparently irrespective of whether there is no right or option to renew remaining).

(2) There is no doubt that it is possible for good faith obligations to be implemented in any Code amendment without the necessity for other significant changes to be made (although I maintain that any good faith obligation inserted into the Code will require consequential changes to be considered). In my view the proposal to introduce a duty of *good faith* into every franchise agreement that is captured by the Code is not the sole objective by advocates for reform.

(3) A properly balanced policy requires consideration of how a duty or obligation of good faith could be recognised and incorporated into the Code, including how Clause 23A would need to be varied and what other consequential changes would need to be made to give effect to the duty and consequences for its breach. Those changes also clearly include interpretational guidance, defences, rights to appeal and mitigating circumstances where appropriate.

(4) The Code is prescribed as a mandatory industry code and as a consequence parties are unable to contract out of its application. There is some limited scope to structure a transaction

[10] In the Canadian Provence of Manitoba they have recently introduced a bill legislation called the *Franchises Act* which imposes on each party to a franchise agreement a duty of *fair dealing* in the performance and enforcement of the agreement. If that duty is breached a party has a right to an action for damages (refer to sections 3(1) and 3(2)).

[11] Associate Professor Frank Zumbo has proposed a definition of good faith in draft legislation in WA as having a meaning that requires you to act "*fairly, honestly, reasonably and in a cooperative manner*". This is not the common law implied duty and arguably not every decision that must be made will necessarily be fair but could have been made in good faith.

[12] Clause 3(3(b) of the *Franchise Act.*

in a way that the agreement does not fall within the definition of a franchise agreement or if it is a franchise agreement that the Code does not apply to it.[13]

(5) The result could be that franchise agreements not captured by the Code would not be subject to a codified duty of *good faith* (but may still be subject to some common law duty of good faith). Direct examples include agreements covered by the Oil code or agreements that are fractional franchises.

(6) Some franchise systems might then have franchise agreements regulated by more than one mandatory industry code with different duties of *good faith* applying. This will no doubt be confusing for them and possibly an unintended consequence of this proposed reform if the changes are made to the Code alone.

10 Unconscionablilty and good faith

(1) The current standard for behaviour in franchising relationships is that the parties are not to engage in 'unconscionable conduct'. This term, like *good faith*, is incapable of exact definition and it is unhelpful (if not impossible) to define every possible example or instance of conduct that might be regarded as *unconscionable*, although interpretive assistance is given both in the *Australian Consumer Law* and at common law.

(2) Some change advocates may hold the view that the concept of *unconscionability* has failed as a standard for behaviour in the franchise sector. There is a small, and slowly growing, body of case law on the issue which is refining the scope of unacceptable behaviour however its practical application is certainly limited at present.

(3) One reason for the alleged failure of the current standard is the difficulty and expense of proving such conduct in a Court although arguably this has more to do with the deficiencies in the dispute resolution model and the cost of access to justice than with the standard itself.

(4) Advocates for reform imply that *unconscionability* is too hard to prove but that *good faith* is more readily accessible to franchisees. I do not agree this necessarily follows, and although it does seem logical that *good faith* may have a lower threshold of proof it may not be any easier to establish.

(5) One difficulty with *good faith* as opposed to *unconscionability* is that it deals primarily with the subjective intent of actions, whereas the latter is primarily concerned with the objective consequence of actions.

(6) There has been some discussion in legal circles that the difference between the concepts can be summed up in terms of a positive obligation (to act in *good faith*) and a negative obligation (not to engage in *unconscionable conduct*). If correct, then the real issue is not the expression of the standard to be applied but how unacceptable conduct can be more readily held to account.

[13] The Code will apply to relationships that are captured under the definition of a "*franchise agreement*" unless the Code is expressed not to apply to those franchise agreements in the circumstances listed in clause 5. Clause 4(1) contains the threshold test and outlines the elements that must be present to be a franchise agreement. All 4 elements must be present or it is not a franchise agreement unless it is deemed to be a franchise agreement under clause 4(2).

11 Should a regime of penalties apply just to the Code or should it apply to all industry codes and how?

(1) It is not in dispute that most franchisors do attempt to comply with the Code. Their perception is that the introduction of penalties is unnecessary and unhelpful and will discourage existing and future participants to engage in an otherwise vibrant sector.

(2) This discussion paper does not examine all of the arguments for and against a penalty regime or whether specific penalties for specific sections should be provided for, however it is clear that problems arise if a regime of penalties and or a codified duty of good faith is introduced without any simultaneous amendment of the Code to address interpretational deficiencies and to include the consequences of breach.

(3) Penalties for breaches may be less beneficial than an express statutory consequence giving rise to enforceable rights rather than a fine for offending conduct. Whilst there is no assurance that penalties will change future conduct, they can have a serious adverse effect on the future viability of entire franchise systems.

(4) There may be good policy grounds to provide a right to prosecute an offender for breach of the Code and to fine them where that conduct is so abhorrent as to justify it. It should not be used as a means of imposing fines for minor technical and inconsequential breaches nor to impose consequences so severe that it will ruin the investment of franchisees not affected by that conduct.

(5) It is important to note that the ACCC already has extensive powers to require compliance and their use of Court enforceable undertakings to ensure future compliance is recognised as an effective deterrent.

(6) The debate on introducing a Commonwealth penalty regime has to date been limited to applying it only to the *Franchising Code of Conduct* and not to breaches of other mandatory industry codes prescribed under the *Competition and Consumer Act*.

(7) If penalties are to be implemented then consideration of penalties for breaches of other industry codes should also be considered for consistency (for example to the Oil code).

(8) The legislative question of where the Commonwealth would introduce the relevant provisions for penalties and any defences or interpretational guidance is also unclear.

(9) Conceivably these proposals could be implemented by amendments to the *Competition and Consumer Act 2010* or by regulation or by amending the Code itself and including those penalties and defences in the various clauses of the Code. If the Code was to be preferred then a complete review of the Code may be necessary.

(10) There appears to be a preoccupation to focus on penalties for the franchising sector however there are also well publicised incidents of inappropriate conduct being exhibited by manufacturers, licensors and distributorships who are not otherwise subject to an applicable code at all.

(11) Whilst those relationships may generally be regulated by the ACCC under the *Competition and Consumer Act* and the *Australian Consumer Law* they may not have a Commonwealth or State based voluntary or mandatory industry code applying to them now. They may also be subject to an implied common law duty of good faith.

(12) There does not appear to be overwhelming evidence to suggest that this focus on the franchising sector is justified compared to other disputes and complaints made to the ACCC about small business.

(13) In many cases licence and distribution agreements are not captured by the Code[14] because of the definition of a franchise agreement and as a consequence those parties do not necessarily have the same recourse as franchisees whose agreements are captured and regulated by the Code or the Oil code.

(14) This is ultimately a question of balance for Government to protect those that need protection from unscrupulous operators irrespective of what they may call their agreement or its technical legal form.

(15) If penalties were imposed it is likely that unscrupulous operators may seek to promote their business opportunities as licenses or as being exempt from the application of the Code. Greater ACCC focus on deliberate anti-avoidance would be justifiable.

12 Strict liability, onus of proof and legal professional privilege

(1) It is concerning that it has become increasingly common for both State and Commonwealth legislatures to enact legislation that contains provisions that:

(a) reverse the onus of proof to the person who is alleged to have breached that legislation; and

(b) impose offences of strict liability; and

(c) compel the production of documentation or information without the well accepted protection of legal professional privilege that may otherwise have normally applied.

(2) There must be strong objection to the introduction of any form of a "*reverse onus of proof*" into any penalty regime applying to the Code or any concept of strict liability applying to offences for breaches of the Code without meaningful and considered defences or mitigating circumstances.

(3) The right to claim the benefit of Legal Professional privilege should continue to be observed as a fundamental recognised legal right.

13 General comments about the development and reviews of the Code

(1) The Code is couched in a relatively simplistic style and general language which has also been used as a template for another Code.[15]

(2) However changes to the Code (since its introduction in 1998) have not necessarily been contemporaneously made to the Oil code and often there is a delay or gap in consideration of their respective reviews which typically take place every three (3) years. This causes confusion.

[14] Many licenses and distributorships are not captured by the Code if they are not deemed to be franchise agreements under clause 4(2) or they fall within the fractional franchise exception in clause 5(3)(b) or they are regulated by another mandatory industry code such as Oil code by clause 5(3)(a) of the Code.

[15] The Oil code which was introduced after the *Franchising Code of Conduct* and contained many of its template terms.

(3) Amendments to the Code have been made at a variety of different times and their transitional implementation has often left short amounts of time for franchisors to absorb the changes.[16] Any changes proposed need appropriate adequate time for consultation and reasonable transitional provisions before the amendments commence to apply.

(4) Typically, these amendments have been introduced in final form with minimal time for participants to absorb, understand and implement changes.

(5) The policy and timing of amendments has typically been driven solely by political considerations rather than to allow a reasonable transition time to cause minimal disruption and cost to the sector.

(6) On several occasions the new amended versions of the Code were not made available prior to their commencement to be used in updated disclosure documents. This has caused delays to transactions in the past and should not be allowed to occur in the future.

(7) The Code contains only a few guidance notes[17] and some definitions of words or expression scattered[18] throughout the Code, many of which are to a limited extent useful. There are many areas in the code which are still "grey" or subject to some degree of open interpretation (and therefore also some degree of non-compliance).

(8) There has been little case law dealing with the interpretation of the terms, expressions, rights or obligations under the Code and the effect of breaches of the Code.

(9) There has been one high profile and important decision of the High Court in 2008 relating to the technical effect on the validity and enforceability of a franchise agreement resulting from a technical breach of the Code.[19]

(10) That case revolved around the immediate consequence of a failure by the Franchisor to obtain a statement under Section 11 of the Code from the franchisee before entering into a franchise agreement. There was no dispute that the franchisee had actually received a disclosure document it was simply that no Section 11 Certificate could be produced. The franchisee's lawyers tried to argue a technical breach of Section 11 excused their client from all liability to the franchisor (due to the doctrine of illegality) and the amount of liability involved was insignificant to the enormous legal precedent it had the potential to set when the judgement was given in the lower Courts.

(11) The case revolved around the consequence of that failure and whether the breach had any automatic consequence such as the agreement being void for illegality.

(12) Arguments were raised by Counsel looking at what was originally intended by parliament and the potential for unfairness to franchisees should a franchisor be entitled to rely on a technical breach to invalidate or excuse itself from the agreement for illegality. Arguably if this had been made clearer there would have been no necessity for this to reach the High Court.

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[16] The Code commenced on 1 July 2008 although some provisions commenced on 1 October 2008, a variety of amendments have been made over the years and amendments have been made to commence on 1 March 2008 and 1 July 2010.

[17] The Guidance Note in clause 1 of the definition of *trade mark,* the guidance note in clause 6B , the guidance note in clause 10 to the Electronic Transactions Act, the Note in clause 18 relating to Part VIIC of the *Crimes Act 1914* and disclosure of spent convictions. There are also notes in Annexure 1 and 2.

[18] Definitions appear in a variety of clause including 3, 4, 20(5),24, 31(4).

[19] Master of Education Services – v – Ketchell.

(13) In Australia, whilst there is currently no codified duty for parties to a franchise agreement to act in good faith, the Code was amended in July 2010 to make it clear that nothing in the Code limits any obligation imposed by the common law on the parties to a franchise agreement to act in *good faith.*[20]

(14) The Code contains a very limited description of the purpose of the Code[21] and the purpose of ancillary obligations such as a disclosure document.[22]

(15) It prescribes certain restrictions on pre-contractual behaviour as well as provisions that relate to conduct and things that occur during and after the franchise agreement ends. It specifies the general form, layout and content of disclosure documents and when they are required to be given and by whom.

(16) It contains transitional provisions which indicate that certain provisions were not to apply to pre-existing agreements when those amendments came into force.[23]

(17) It does not allow for any agreement to be reached to contract out of the application of any one or more of its terms irrespective of whether the franchisee is the entity making that request.

(18) The obligations and time periods specified within which obligations must be done are inflexible and cannot be waived or extended by agreement.[24]

(19) Its provisions do not expressly create defences to a breach of a particular clause nor on the whole do they contain examples of conduct which may be taken into account by a Court in mitigating the effects of the breach. In fact there are very few clauses that actually seek in any way to give guidance in that way.[25]

(20) As a consequence it is imperative to review the language in various provisions of the Code to identify interpretational issues and clarify them so that if a penalty regime is implemented the risk of inadvertent breaches occurring would be minimised.

14 Would the current language of the Code actually work with a penalty regime and should it be changed?

(1) With the exception of the provisions of Part 4 of the Code (which includes an obligation for a franchisee to attend and participate in mediation and contribute to costs of the mediation) all of the important express obligations are imposed on a franchisor or master franchisee and not a franchisee.

(2) In Part 4 of the Code there is also an express obligation placed on the mediator.[26] To my knowledge there is no suggestion that any penalty regime should or would apply to a mediator who breached that provision of the Code. No doubt mediators could be concerned to learn that

[20] Clause 23A was inserted.
[21] Clause 2 which provides that the purpose is "*to regulate the conduct of participants in franchising towards other participants in franchising".*
[22] Clause 6A outlines the purposes of a disclosure document.
[23] Clause 5(1A) was introduced in March 2008 and clause 5(1B) was introduced in July 2010 .
[24] Clause 10(d) and (e) - 14 day disclosure period, Clause 14(1) and (3) – one month period to give lease documentation, Clause 18(1) – 14 day notice provision, Clause 19 - 14 days to give disclosure document, Clause 20(4) – 42 day deeming provision, Clause 20A end of term notice periods 6 months and 1 month.
[25] For example clause 29(8) which outlines circumstances which show a party may be taking steps to resolve a dispute in a reconciliatory manner.
[26] Clause 30(5) requires the mediator to deliver a copy of a certificate to the OFMA and the parties.

now they could now be exposed to a penalty regime for fulfilling their obligations under the Code.

(3) Unfortunately the language of the Code seeks to impose obligations on a franchisor without imposing any reciprocal obligation on a franchisee to do something that enables the franchisor to comply with that obligation.

(4) For example clause 11 of the Code contains a prohibition on a franchisor from entering into an agreement without having received certain written statements from the franchisee. It does not impose any express corresponding obligation on the franchisee to compel them to seek that advice nor does it place an express obligation upon the franchisee to sign and return a statement under clause 11 to enable the franchisor to satisfy its obligation.

(5) It shifts the risk and responsibility to the franchisor to ensure it does so even if the franchisee deliberately seeks for its own benefit not to cooperate or to subsequently confirm that it actually acknowledges those things later.

(6) This clause like some others is couched in language that imposes an obligation on the franchisor without imposing the corresponding obligation on the franchisee to do something.

(7) You will notice that the language in the Canadian *Franchise Act* outlines clearly the consequence of something occurring, it is logical to do so. It has in some cases similar clauses to those that exist in our Code.[27] However it goes further to specify the consequence of a failure to observe that section of the Act.[28]

(8) As a consequence the wording of each section may need to be carefully reviewed to understand the consequence of a breach. Some breaches may simply result in a deeming provision applying as opposed to a penalty.

(9) The purpose of drafting the Code this way presumably was to afford protection and rights for franchisees and restricting actions of franchisors without imposing any meaningful obligations on franchisees.

(10) Dispute resolution is encouraged and it is logical to include obligations on both parties. It may now also be time to impose obligations on franchisees as well.

(11) A penalty regime will require consideration of a change of policy in this area to ensure that franchisors are not held strictly accountable for a breach where the franchisee impliedly should have done something and failed to do so. Possibly that is how the defence or mitigating circumstance should be crafted however it must be dealt with for procedural fairness.

(12) The Commonwealth quite some time ago, appropriately removed the original template Annexure 2 disclosure document that was to be prepared by an existing franchisee to someone they were selling their franchise to. This change removed the obligation that required franchisees to give it to a buyer.

(13) The sector demonstrated that the use of this Franchisee disclosure document was not working and often franchisees did not understand their obligations if they failed to comply. This had a

[27] Clause 4 of the Franchise Act – includes an express right to associate with other franchisees and form or join an association of franchisees.
[28] Clause 4(4) of the Franchise Act deems as void any provision in a franchise agreement that purports to interfere with, prohibit or restrict a franchisee from exercising any right.

direct consequence on incoming franchisees and offered little practical assistance or allow meaningful due diligence.

(14) Conversely with only a few exceptions, the language of the Code confers direct and (again through indirect language) rights on a franchisee[29] and not necessarily a franchisor.[30]

(15) Some rights such as those in Part 4 dealing with dispute resolution may apply to both the franchisor and franchisee and any other party to the franchise agreement. As a consequence there are many obligations and restrictions (on doing things[31]) imposed under the Code on a franchisor (and a master franchisee).

(16) Typically reviews of the Code have focussed on particular areas such as disclosure and marketing fund obligations rather than a sweeping overall review of operative provisions of the Code.

(17) The Commonwealth has received previous submissions identifying obvious errors in original and subsequent drafting of the Code although to some extent interpretational concerns have largely been ignored or considered unnecessary to be addressed at the time of the reviews.

(18) The Commonwealth should ensure that rights and obligations imposed are expressed clearly and if a breach is intended to give rise to a penalty or consequence then it is incumbent upon the Commonwealth to ensure that the provisions are clear and not ambiguous or open to multiple interpretations and that any defences or mitigating circumstances or consequences applying to that provision are made clear.

(19) The template Annexure 1 and Annexure 2 disclosure document will need to be amended if disclosure of whether the franchisor has been fined or prosecuted for a breach of the Code is required. [32]

(20) The ongoing disclosure regime in Clause 18(2)(b) and (f) of the Code means that current franchisees would need to be informed of a "proceeding" or "judgement" on an ongoing basis. It is logical that this be included in the disclosure document under Item 4.1 if the fine or penalty is of a particular kind is applied.

(21) Some consideration would need to be given as to what fines or penalties would need to be disclosed under both Item 4.1 and clause 18(2) of the Code and how much information would need to be included. In addition should an express item of disclosure in both Item 4.1 and Clause 18 include a proceeding or judgement relating to a breach of a duty of good faith by the franchisor or its associates?

(22) Overall some balance to the review and whether sweeping changes are required needs to be reached. This is coupled with the real threat by some States to introduce concurrent codes of

[29] A right under Clause 6C to ask for additional information, a right under clause 13(1) to terminate during the cooling off period, an indirect right under clause 15 to form an association, a right to vote on whether to audit the marketing fund annual financial statement under clause 17.

[30] For example Clause 13 gives a right to deduct its reasonable expenses, clause 17(4) allows a right to recover expenses from the fund, a right to terminate immediately under clause 23 if special circumstances apply, a right under Part 4 to use the code dispute resolution procedures.

[31] Such as not preventing an association of franchisees under clause 15, not including certain clauses in their franchise documentation relating to general releases or waivers of representations under clause 16.

[32] Currently Item 4.1 requires amongst other things disclosure of any "current proceedings" that may relate to a contravention of a trade practice law (which would include the Code). It does not require the disclosure document to maintain a list of all prosecutions and penalties arising from them and there is a question whether the penalty regime will be some form of expiation notice arrangement or a civil penalty regime akin to the Small Business Commissioner Act 2011 regime in SA.

conduct and their own penalty regime if changes to the Code are not made at the Commonwealth level.

15 The role of the ACCC in assisting with interpretation of the Code

(1) The ACCC is the regulator charged with enforcement of the Code and the Competition and Consumer Act. The ACCC did not design or draft the Code (although may have made submissions on it and changes to it) but is the government body charged with enforcement of its terms, to receive complaints and to assist in education of participants to encourage compliance.

(2) The ACCC does not currently provide a vetting or registration service in relation to franchise agreements but it does have the power to compel substantiation of claims made by franchisors and to conduct essentially an audit even though the power does not expressly refer to it as an "audit" power.

(3) In several states in the USA (commonly referred to as registration states) a franchisor must register its disclosure document before offering it to a franchisee. Many lawyers in franchising in the US complain that it complicates matters because each of the registration states have different requirements and it makes the process of selling franchises in the US more expensive and complicated. They do not have the same national regime that we do.

(4) Registration and pre-vetting of documentation for approval and use in Australia was considered unnecessary in previous reviews. Many would argue that imposing that regime would just be more red tape, more cost and not advance the interests of franchisees in a meaningful way.

(5) Recent budget stringency has diminished the ability of the ACCC to meet its full range of functions in franchising matters, including investigation, education and compliance.

(6) The ACCC does publish useful educational material and their website offers some assistance to understanding some of the obligations or rights under the Code. The ACCC has also published a compliance manual and has updated it regularly to assist franchisors to understand their obligations under the Code.

(7) Unfortunately the interpretation of the application of parts of the Code including how undefined terms are to be interpreted and the lack of specified consequences for breaches of the provisions of the Code has meant that interpretation and relief have been left essentially to the Courts to determine.

(8) There is no doubt that it remains appropriate for the Courts to have flexibility in applying appropriate remedies under the law to the facts of each case.

(9) In most cases the parties cannot afford to resort to court for guidance on these issues or to seek relief and it has been a common claim that the cost of seeking justice or relief is too high. As a consequence there is a perception by change advocates that those who breach the Code are rarely brought to account. Many franchisees simply chose not to seek legal advice often citing cost as the major reason for refusing to seek advice.

(10) The ACCC publishes details on their investigations and prosecutions which clearly demonstrate that they do seek to enforce compliance but do so having regard to each circumstance and the action they take to achieve the most appropriate outcome. This includes

seeking enforceable undertakings which can compel compliance in future contractual dealings even if it does not always achieve the expected outcome that a franchisee was anticipating.

(11) The ACCC does not currently have any definitive role in providing binding private or public rulings on interpretational issues concerning the Code although they do post on their website some facts based on frequently asked questions. Their target audience may predominantly be franchisees.

(12) In my opinion, providing binding rulings (in similar fashion to the ATO, although by necessity in much more limited scope) may be useful in providing certainty regarding the interpretation of a particular provision unless and until such time as a Court considers the matter. It will also assist the Commonwealth in identifying potential areas of amendment to the Code.

16 Specific examples of interpretational problems and issues

(1) I have set out in this discussion paper a practical example focused on one specific clause of the Code that I believe there is ambiguity in its language.

(2) I intend to demonstrate how interpretation and application of the clause could be directly affected if a duty of good faith is imposed and penalties for breach of the Code are introduced.

(3) The clause is clause 20A which was added in July 2010 together with clause 5(1B) of the Code.

(4) Clarification would be necessary in relation to the following :

(a) What are the precise requirements for the form and content of the Notice and how is it to be delivered?[33] For example does the notice have to contain:

(i) Reasons for any non-renewal decision;

(ii) A reference to or outline of any provision in the franchise agreement that allows the franchisee to challenge or appeal that decision and by when;

(iii) A list of all conditions (if any) that attach to the renewal and when those conditions must be satisfied;

(iv) A qualification, condition or statement outlining the circumstances in which the consent to renew may be withdrawn or lapse or that the consent given is either absolute or conditional;

(v) A copy of the disclosure document and proposed franchise agreement so that the franchisee can assess the terms on which the franchisor is prepared to renew; and/or

(vi) An acknowledgement of receipt by the franchisee to confirm that the notice was received and when.

(b) The franchise agreement normally provides for service of a notice to be properly given in a particular way. In many cases a franchise agreement requires a notice to be given

[33] The Code does not contain any guidance as to how any notice or document is to be "given". The word "give" is commonly used in the Code. Clause 20A requires the franchisor to "notify" as opposed to "give".

by a party to another party under the franchise agreement in forms other than by email. There is no general provision in the Code as to how a notice must be given or notification effective[34]. Accordingly is a notice required to be given under the Code able to be given by email despite any contrary term of the franchise agreement?

(c) Is there a difference intended between having to "give" something and having to "notify" as the language used in different clauses is different.[35]

(d) Will detailed reasons *for not renewing* be required to be included in the notice?[36] If there is to be a duty of good faith in relation to *the decision* whether to renew / enter into a new agreement will the discharge of that duty require the giving of reasons?

(e) Is there a period or process of review of the *decision* and the reasons and will Part 4 apply to a dispute arising out of that decision (particularly in relation to clause 20A(2) notices where the term may have expired)?

(f) Does the obligation to give reasons differ depending on whether *the decision* and *the notice* is required to be given:

(i) Under Clause 20A(1)(a) or clause 20(2)(a) – where there is an option or right to renew; as opposed to

(ii) Under Clause 20A(1)(b) or Clause 20A(2)(b) – where there is no option or right to renew?

Does it apply to both clauses 20A(1) and (2) even though there is no specific express obligation to do so?[37]

(g) If the duty of good faith requires reasons to be given what is the consequence of a franchisor failing to give those reasons?

(h) In respect to decisions relating to Clause 20A(2)(a) or (b) most franchisors would simply want to retain the right to decide whether they want to enter into negotiations to enter a new agreement when it has expired (where there is no contractual right to further renewal) rather than to have to give reasons and potentially incite a dispute over it.

(i) It is logical therefore that in respect to clause 20A(2) that no reasons should be required to be given unless a franchisor elected to do so. It should be made clear that a franchisor is not obligated to give reasons for their decision under this sub-section.

[34] Although there is a requirement for a franchisee's request for a disclosure document under clause 19 to be made in writing

[35] There are many obligations in the Code imposed on a franchisor to "give" something to a franchisee. There is no clarity on what "give" means. For example is it sufficient to post a document on the franchisor's website or intranet and simply email a franchisee a link to that document which must be clicked on to access. There have been examples where this has occurred for marketing fund AFS and audit reports being kept on a secured website intranet location that was accessible to franchisees. Arguably attempting to "give" something in this way requires a positive act on the part of the franchisee to actually receive it. The better view would be that notices or documents would not be "given" simply by giving a link to a site or webpage where the notice or document is kept. This is not clear in the Code.

[36] There is no form of prescribed notice in clause 20A nor does it expressly say the notice must include reasons which differs to clause 20(4) of the Code.

[37] There is no prescribed obligation in the Code to give reasons for non- renewal or for imposing conditions on the renewal.

(j) Will the franchisor have the "*reverse onus*" to prove that it was acting in good faith when it made the decision rather than the franchisee having the onus to show that the franchisor was not acting in good faith when it made the decision? A reversal of the onus has a significant effect.

(k) What things must a franchisor take into account (or not be able to take into account - e.g. the fact that there have been a number of breaches of the agreement even if they have been remedied) to discharge the duty to firstly *make the decision* and secondly to *give a notice* under Clause 20A? It is not possible to conceive an exhaustive list of potential considerations but it may be useful to identify matters for example that a franchisor could not take into account.

(l) Are there any events or circumstances that trigger or cause the obligation to *make the decision* such as:

(i) when a renewal option period commences, is current or has expired;

(ii) the actual exercise of the option by the franchisee;

(iii) another event or trigger occurring – for example an offer of renewal of the lease being agreed or made; or

(iv) is simply making the decision no less than the six (6) months (or one (1) month as the case may be) without regard to any other factors enough to discharge that obligation?

(m) Are there any events or circumstances that trigger or cause the obligation to *give the notice* such as:

(i) when the *decision* is actually made;

(ii) when a renewal option period commences, is current or has expired;

(iii) some other event or circumstance such as a renewal of lease is relevant; or

(iv) is simply giving no less than the six (6) months (or one (1) month as the case may be) notice without regard to any other factors enough to discharge that obligation?

(n) Should there be an amendment to the Code to confirm the timing of when the franchisor's obligation to actually consider and make a decision to renew or negotiate or not commences. Once that decision is made how soon after making that decision does the obligation to give the notice arise, is it simply enough to be a "*reasonable time*" to discharge the duty of good faith?[38]

(o) Should there be an amendment to the Code to confirm the direct or indirect consequence of a franchisor failing to give that notice within the requisite time as well as what right the franchisee has to relief in that event?[39]

[38] By way of example there is an obligation to give ongoing disclosure within 14 days under clause 18 of the Code but none of the events listed include making a renewal decision. A decision on whether to approve a request to transfer must be communicated within 42 days under clause 20.

[39] There is no express consequence in Clause 20A of a failure to give a notice or what happens if the notice is still given but the period of notice is less than the period prescribed by the Code.

(p) Should there be an amendment to the Code to add a specific provision (or defence or mitigating circumstance) to excuse a franchisor from the obligation to either *make the decision or give the notice* where the franchisee has given notice in writing to the franchisor that it does not want to renew or negotiate a new agreement at end of term.

(q) Should there be an amendment to the Code to add a specific provision (or defence or mitigating circumstance) to show the franchisor is acting in good faith if it gives reasons for the decision and those reasons are in the circumstances reasonable and consistent with the terms of the franchise agreement?

(r) Should there be an amendment to the Code to confirm and clarify in respect to a "holding over" and an extension of an existing term:

(i) Whether Clause 20A(2) applies to a holding over of a franchise or an extension of the term on a month by month basis?

(ii) If that requirement exists, is it sufficient to give one (1) notice that is intended to cover an entire holding over period irrespective of the length of each individual holding over period including where it may start at holding over for one (1) month but go for say nine (9) consecutive months?

(iii) A holding over on *a month by month* basis typically expires at the end of each monthly period unless extended by agreement or conduct.

(iv) Whether a new notice is required to be given each month as *a decision* is sometimes made monthly to extend again for a further holding over? If there is no option to renew left remaining in the agreement but the franchisee is allowed to *hold over the franchise on a month by month basis* is the franchisor expected to give a notice at the start of every month during the holding over of whether it intends to renew the franchise or not as you must give not less than one (1) month's notice under clauses 20A(2)(a) or (b)?

(v) The holding over is an extension of the term of the existing franchise which requires the franchisor to give a disclosure document potentially every month.

(vi) Potentially this could lead to a strange outcome where the parties are in a holding over for an indefinite period (but at least a month) and the franchisor must make **a decision** and give a notice and disclosure document **every month** that they extend the term for the holding over period again. This is an unnecessary administrative and cost burden.

(s) Will any codified or implied duty of good faith apply firstly to the decision and secondly to the timing of the giving of the notice?

(t) What is the consequence of failing to make *the decision or give the notice* or alternatively *not act in good faith* when making the decision? This is unclear and should be clarified. Is the Commonwealth considering any one or more of the following:

(i) A right for a franchisee to seek damages if there is a loss suffered;

(ii) A right to impose a fine for breach of the Code (whether or not loss is suffered);

(iii) A right for a franchisee to claim an automatic right to hold over until the minimum notice period has expired (and how does that affect matters such as leases?);

(iv) A deeming provision that failure to give notice by the relevant period stating the intention not to renew or negotiate a new agreement will mean that the franchisor is deemed to have agreed to renew (and if so for what period must it in fact renew);

(v) A right or order that will affect and bind third parties such as landlords;

(vi) A right to apply for some other order or relief; and

(vii) Whether the Code should be amended to take into account mitigating circumstances before any penalty is imposed or relief given particularly in the event of an obvious error or no loss being suffered (for example where the franchisor agrees to hold over the franchise for a period to allow the minimum period of notice to be achieved)?

17 How does Clause 20A work in practice? – some comments on interpretation

(1) This section has not really commenced to apply to existing franchisees yet as it only came in about two (2) years ago and the transitional provision in clause 5(1B) expressly provided it did not apply to pre-existing agreements entered into before 1 July 2010.

(2) Most franchise agreements are for terms of three (3) or five (5) years or more so it may be some time before new agreements entered into after 1 July 2010 are affected.

(3) Many franchisors are seeking to voluntarily adopt the procedure for giving a renewal notice now so that it is entrenched in their procedures when the new agreements entered into post 1 July 2010 start to hit their renewal periods.

(4) Interpretational issues are likely to arise when a franchisor makes a decision that it does not want to renew the franchise or negotiate a new agreement with the franchisee at the *end of term*.

(5) The question about whether they have a common law implied duty to act in good faith when exercising that right or discretion is also a relevant consideration.

(6) There is no guidance on the frequently asked questions on the ACCC website about these issues or Clause 20A at all.

(7) Immediate interpretation issues arise about the obligation to make a decision and give notice in either Clause 20A(1)(a) or clause 20A(2)(a) where the franchisee has the existing right or option to take up a renewal for a further term (*as opposed to negotiating a new agreement where there is no such right or option*) and the franchisor makes a decision not to renew or not to enter into a new agreement.

(8) Typically the franchisor may have either exercised some discretion in their franchise agreement to say “no” or prescribed a condition required to be satisfied for renewal to occur.

(9) There is some legal debate as to whether "renewal" takes place at the time of exercise of the option or whether "renewal" actually takes effect from the day after the original term expires. This is relevant to the timing of the issue of disclosure under clause 6B(1)(b) and whether the obligation to disclose is coupled with giving the notice under Clause 20A before the option period commences so that the franchisee has the disclosure document and franchise agreement at the time it considers and exercised the right to renew.

(10) The language in most franchise agreements dealing with end of term notice are confusing and not every agreement contains a contractual obligation (as opposed to the Code obligation) that the franchisor will give notice whether it will renew or offer to enter into negotiations to enter a new agreement.

(11) As a general comment most agreements provide that even if the option is exercised any renewal is still subject to satisfaction of conditions on or before the last day of the term.

(12) This is relevant to Item 17C of Annexure 1 which requires details of the end of term processes to be outlined in for a renewal of the franchise agreement.

(13) The timing of when the actual disclosure document is given to the franchisee may also vary depending on the franchise system and typically can occur before, during or after the window to exercise an option to renew. Most franchisors do communicate with their franchisees to seek clarification as to whether the franchisee wants to exercise the option and they then send out the disclosure document at that time to reduce costs of preparing a new agreement if the franchisee chooses not to renew.

(14) A franchisee may not necessarily see the item 17C conditions in the new disclosure document before they exercise the option but most if not all conditions would be in the original franchise agreement.

(15) Many franchisors voluntarily remind franchisees of the option period windows although some may choose not to for commercial reasons where leases of property are not involved. In some circumstances franchisees may for their own reasons deliberately choose not to renew. They just decide to walk away and close the business.

(16) Clause 20A is currently inflexible and does not relieve the franchisor of the obligation to make the decision or give notice even if the franchisee communicates to the franchisor in writing that they definitely do not want to renew at end of term. A franchisor would still have to consciously make a decision and give notification of that decision to the franchisee or risk breaching the Code or some duty of good faith.

(17) Clause 20A does not require that the decision or the giving of the notice must occur before some relevant event occurs. It is only referenced to a minimum *period of notice* of either at least one (1) month or at least six (6) months depending on the term of the original franchise agreement.

(18) The link is time based and left up to the franchisor to determine if more notice than that period of notice is required. It could be argued that this was done for flexibility and based on the assumption (as opposed to some express provision) that franchisors would act reasonably and as early as possible. That may still be the preferred outcome.

(19) The timing of the decision whether to renew (or not) and its communication to the franchisee may be of relevance to the franchisee when deciding whether to exercise the option to renew.

(20) The decisions are mutually exclusive decisions and both require notice to be given however in the franchisees case that notice is usually within an option exercise window if it wants to renew.

(21) The timing of the decision will be particularly relevant where there are negotiations to occur for a lease renewal as well. Most franchisees will not renew their lease until they know that they have a franchise although the reverse can also be true. So a decision to renew may be based around a decision to renew a lease and vice versa.

(22) The government publications and media releases at the time of the last amendments did not make it clear as whether the intention of the notice serves to remind the franchisee of the option window period and to let the franchisee know that there are no impediments to them renewing and exercising the option if they chose to and renewing their lease.

(23) It is logical that the decision of the franchisor not renew and communication of this to the franchisee should be made before the option windows for the lease and franchise window would commence. Possibly it should work similar to clause 18 in terms of the franchisor being obliged to give the notice within fourteen (14) days of making the decision.

(24) For a site based system often a renewal goes hand in hand with the franchisee or franchisor securing a new lease and sometimes that does not occur six (6) months before the end of term but much closer to the end of the term (often three (3) months or less) and in some cases renewal of the lease takes place after the end of the term of the franchise which forces a holding over of the franchise and the lease. Lease negotiations can be protracted.

(25) If the franchisor has a discretion not to renew the franchise or there are conditions which must be satisfied for the franchisee to renew, Clause 20A does not make it clear whether those conditions should be clearly identified and contained in the Notice and given to the franchisee before they must consider whether to exercise the option.

(26) In some cases a franchisor has a discretion not to renew (based on previous conduct of the franchisee) and often any renewal is subject to certain conditions that must be satisfied before the end of the term otherwise there is no renewal available (e.g. refurbishment, not being in breach at time of exercise of option or last day of term, paying a renewal fee and costs of renewal, giving disclosure and the franchisee and guarantors signing and returning the renewal documents etc).

(27) The wording of clause 20A does not expressly require a franchisor to *specify the conditions attaching to a conditional consent* in the notice. Whether it is best practice or a discharge of a franchisor's implied duty to act in good faith if it did so is unclear.

(28) The requirement is for a decision to have been made and in communicating that decision the notice must outline *"the decision whether it is renewed or not renewed or whether the franchisor will enter into a new agreement*".

(29) Claus 20A surprisingly does not contain an express obligation to give reasons in the notice (or after the notice) if the decision is not to renew or not to enter into a new agreement even if those reasons are subsequently requested by the franchisee.

(30) Clause 20A does not have the same form and content wording of the deeming provision contained in Clause 20(4)(b) applicable to requests for consent to a transfer.

(31) That provision relevantly places an obligation on the franchisor to give notice within forty two (42) days after the request is made not only that it withholds consent but also the notice must include *"(b) setting out the reasons why consent is withheld*" otherwise the franchisor will be deemed to have consented."

(32) Whilst disclosing reasons for withholding its approval to renew may be essential for a franchisor to justify that they had reasonable grounds to make their decision in respect to matters in clause 20A(1)(a) or (2)(a), it may be less inclined to want to give reasons relating to a Clause 20A(1)(b) or (2)(b) decision other than something like "*we do not wish to negotiate a new franchise agreement with you*."

(33) There may be a strong argument that a franchisor should give those reasons for making the decision not to renew (where there is an option to renew) to confirm it is acting reasonably or in accordance with an implied common law duty of good faith. This area is not clear and creates potential for uncertainty or unfairness if a penalty is to be imposed for a breach.

(34) No doubt any refusal to renew when there is an option to renew may be dealt with under Part 4 if the franchisee wishes to renew and complies with its contractual obligations.

(35) Part 4 may not apply just to a refusal decision (other than in respect to continuing obligations or disputes in the franchise agreement) if the franchise ends and there is no right to a renewal left in the agreement.

(36) Many franchisors may choose to justify their decision to show they have acted in good faith and conscionably in any event, but it would be meaningful to franchisees to ensure there was an obligation to give those reasons in respect to clause 20A(1)(a) and (b) decisions where there is an option or express right to renew.

18 Should there be specific remedies or consequences included in the Code that are appropriate for a breach as opposed to a penalty?

(1) There are some breaches of the Code that could have consequences or relief specifically dealt with in the Code. These provisions lend themselves to having a logical commercial *consequence* included in the wording of the Code as opposed to a penalty. These would include:

(a) *Section 13(3) The obligation to refund monies* – The consequence of breaching this clause by a franchisor failing to return monies within the fourteen (14) days of the franchisee terminating in the *cooling off* period could be made more appropriate to compel them to do so financially. For example it could provide that the franchisor cannot rely on clause 13(4) and retain its costs either in total (including its legal costs for preparing the agreement) or that interest must be paid on the amount owed pending payment. If a stakeholder holds those funds (such as a lawyer) a third party may be affected by such a provision. You may still have to go to the ACCC to get this enforced and a failure to refund may still be subject to a penalty after notice to return the monies has been given.

(b) *Section 16 Prohibition on a release* – Possibly the most appropriate outcome for an infringement is that the release is just deemed to be void and unenforceable by the franchisor – (most lawyers would argue that anyway if it went to court). There would be no need for the ACCC to be involved and the franchisee could rely on the deeming provision.

(c) *Section 17 Marketing funds* – The consequence of a failure to prepare and give an AFS or obtain and give an Audit report or conduct a vote to non-audit could be that the franchisor simply *cannot recover its costs of preparation* of the AFS *or conducting the audit* out of the Fund (e.g. it creates a financial incentive for them to do so). The ACCC could be involved and a fine could still be appropriate if the franchisor continues to refuse to do it at all even when requested to do so by the ACCC. A defence or mitigating circumstance may be that the delay is caused solely by the acts or omissions of a third party such as the auditor or the financial institution where the funds are kept contributing to or causing the delay.

(d) *Section 20A Notice to renew* – the failure to give the proper renewal / non- renewal notice could be changed to give the franchisee (at its election) the right to *hold over the franchise on the same terms* until the proper notice is given (as opposed to having forced on the franchisor a deeming provision that applies to give a renewal or new agreement if the franchisor failed to make the decision or give the notice). The ACCC could be involved in enforcement and giving the franchisee a right to continue to operate during this time. This may however not work where there is requirement to vacate possession for non-renewal of a lease despite that notice not having been given. It gives a simple and measured outcome for franchisees and proper notice may relate to contents of the notice (e.g. reasons as well as the time period).

(e) *Part 4 Dispute resolution* - failure by a party to actually attend a mediation on the day (without consent or approval to adjourn) or where a party fails to act in a reconciliatory manner or send someone authorised to settle the dispute to the mediation may cause a loss to the other party in terms of wasted costs that are currently not recoverable. A fine does not provide a satisfactory outcome. The Commonwealth could provide a statutory right for a party to seek reimbursement of their costs against the other party in circumstances where the other party does not attend or does not send someone authorised to settle the dispute without lawful or other justifiable excuse (for example genuine illness, a death in the family requiring postponement). Arguably that right should include the right to require the offending party to be solely responsible for the costs of the mediator (and venue hire) that were wasted because the mediation had to be postponed or cancelled. The ACCC would not normally be involved although the OFMA could be and the whole question as to whether the Mediator should have a power to influence who would be responsible for costs leads to a wider and possibly a more controversial consideration as to whether conciliation or a form of arbitration may be more appropriate than simply mediation of franchising disputes. In addition the question whether the Court should be able to make orders concerning a mediation under the Code (including costs orders) based on the recommendation of the independent mediator would also need consideration. This would require more consultation with the OFMA and mediators to determine the benefit of this suggestion.

(2) Some sections that are breached may be better to be subject to a fine or penalty or other express consequence e.g. sections 6(1), 6B, 6C, 10, 11(1), 18 etc.

(3) Obviously consideration as to the consequences of breaching the Code and the loss (if any) suffered is also very important however having an express consequence gives an outcome that is not simply a fine and in some circumstances the outcome or consequence is more important than a fine to a franchisee as it gives certainty of an outcome or right that they have.

19 Conclusion and recommendation on Good faith

(1) I am not an advocate for the introduction of a duty of good faith into the Code (either by simply adopting a common law implied duty or seeking to identify a specific definition of it).

(2) I am of the view that it will cause more interpretational and procedural problems that would need to be expressly considered and dealt with.

(3) If the implied common law duty of good faith was included in every agreement then the Commonwealth should make it clear whether a breach of that duty is a breach of the Code and subject to a fine, penalty or other consequence and whether a right of appeal or defence or mitigating circumstance will be taken into account.

(4) The Commonwealth must address what therefore is the consequence of breaching a codified duty of good faith irrespective of whether it is the common law or a codified duty.

(5) The Commonwealth should be clear if it wishes to impose additional consequences such as one or more commercial remedies available to franchisees for breaches of the duty and whether those remedies relate to specific provisions such as the discretion not to renew or enter into a new agreement with a franchisee at end of term.

(6) Alternatively is it simply intended to be a breach of contract or both giving rise to rights and remedies which can be pursued.

(7) The Commonwealth should also clearly deal with how a codified duty would displace or interplay with:

(a) any existing common law implied duty (or common law definition of *good faith*); or

(b) any other express duty to act in a particular way that has been agreed between the parties to apply; or

(c) any State based duty imposed under another State based industry Code; or

(d) any obligation in the CCA / ACL not to act “unconscionably”.

20 Conclusion and recommendation on penalties

(1) I am not an advocate for the policy of introducing a regime of penalties for breaches of the Code (whether in the nature of some form of civil penalty, fine whether similar to an expiation fine used in SA or not).

(2) It would be dangerous to simply impose a penalty regime without also considering the language of the existing Code to ensure that defences and mitigating circumstances are made clear and that a right of appeal is expressly contemplated.

(3) It becomes difficult to have a regime of enforcement based on penalties if clauses of the Code are open to interpretation and where there is little that can be done for definitive proactive guidance other than approaching the Court for declarations and guidance. That is certainly not an inexpensive exercise.

21 Suggestion on the role of the ACCC with any new penalty regime

(1) The Commonwealth should include in the review a proposal to fund and empower the ACCC with additional powers to consider applications by affected parties to declare certain agreements exempt from the Code because the parties can demonstrate:

(a) that the agreement meets the criteria to qualify as a fractional franchise under Clause 5(3) of the Code; or

(b) that the agreement does not contain nor meet the 4 elements required to fall within the definition of a "franchise agreement" under clause 4 of the Code; or

(c) that they meet the requirements for any other exemption from the application of the Code that may be applicable (e.g. if the foreign franchisor exemption was reintroduced or that Oil code applied to them).

(2) This will make it simpler for franchisees and franchisors to have clarity on those agreements which may be called franchise agreements but NOT subject to the Code.

(3) The Commonwealth already does something similar in relation to rulings and guidance on interpretation given by the ATO.

(4) It may assist to provide a defence or mitigating circumstance that will be available to a franchisor that chooses to apply.

(5) It also demonstrates that they have addressed their mind to the relevant tests at a time before they entered into the agreement rather than after it when they are challenged and simply seek to raise arguments after the event once the damage or breach has occurred.

(6) The ACCC could maintain a register on that determination which is searchable and may be subject to some degree of right to privacy (like applications for authorisation or notification).

(7) It would be useful for the ACCC to be empowered to provide general interpretation of aspects of the application of the Code. For example after consultation and considering submissions it can make public guidance determinations on areas identified as of general sector wide concern.

(8) In addition on application the ACCC could provide a binding private determination as it relates to a specified agreement or agreements in a network (current and future) at the request of an applicant.

(9) Whilst those determinations may not be the same effect as a discretionary power to grant "*exemptions*" they could be used as a defence or mitigating circumstance in any subsequent prosecution where the franchisor has properly acted in reliance upon that determination.

I thank you for the opportunity to submit this Discussion Paper and would be pleased to answer any queries or issues you may have in relation to it

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