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15 February 2013

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

By email: franchisingcodereview@innovation.gov.au

Dear Mr Wein,

Submission in relation to the Department of Industry, Innovation, Science, Research and tertiary Discussion Paper: Review of the Franchising Code of Conduct 2013 ("Discussion Paper")

We are writing in response to your call for submissions to this Review, due by 15 February 2013.

We understand the review is primarily interested in our views on the efficacy of the amendments to the Code, good faith in franchising, the rights of franchisees at end of the term of their Franchise Agreements, and the operation of the Competition and Consumer Act 2010 ("CCA") as it relates to enforcement of the Code.

We have provided our general comments on these issues and answered the specific questions posed in the Discussion Paper. In addition we have provided our views on the need for national uniformity. We would be pleased to comment further on any specific regulatory proposals.

Background - About Yum Australia

Yum! Restaurants Australia ("Yum Australia") is the licensee of the trademarks and systems behind KFC and Pizza Huts in Australia. Yum Australia is a subsidiary of Yum Brands, Inc. based in Kentucky, USA, which has more than 35,000 restaurants in more than 110 countries, making it the world's largest restaurant group by number of restaurants spread across its KFC, PIZZA HUT and TACO BELL brands.

The first KFC store in Australia was launched in 1968 and the first Pizza Hut restaurant in 1970.



There are now around 610 KFC stores in Australia and 280 Pizza Huts, making us one of the largest franchise systems in the country.

Of the Australian KFC restaurants, KFC owns and operates 161 stores, with the remainder owned and operated by our community of 53 franchisees. Pizza Hut Australia is mostly franchised with 183 independent franchisees running these businesses.

The KFC system in Australia employs more than 25,000 people and serves more than 2 million customers per week. Yum Australia has been a registered provider of nationally recognised training qualifications for more than a decade and invests more than \$1.5million in training annually. Almost 1000 employees of Yum Australia attain a nationally recognised qualification each year.

Yum Australia has been a positive supporter of the direction of Commonwealth franchising regulation in Australia, and will continue to support regulation that does not involve multiple, conflicting regulatory regimes or overly burden franchisors in their franchising activities.

Terms of Reference

We note that the specific Terms of Reference are for the reviewer to enquire into:

- The efficacy of the amendments to the Code contained in the Trade Practices (Industry Codes – Franchising) Amendment Regulation 2007 (No 1) and the Trade Practices (Industry Codes – Franchising) Amendment Regulation 2010 (No 1)
- Good faith in franchising
- The rights of franchisees at the end of the term of their franchise agreements, including recognition for any contribution they may have made to the building of the franchise; and
- The operation of the provisions of the Competition and Consumer Act 2010 as they relate to enforcement of the Code.

We understand that the Terms of Reference are intended to build on previous reviews and inquiries regarding franchising in Australia to which Yum Australia has made submissions. We therefore do not intend comment in a substantial way on topics that have previously been covered in those earlier submissions.

Executive Summary

Amendments to Code

Yum Australia is supportive of the current regulatory framework which it believes strikes a fair balance between protection for franchisees and the cost of compliance for franchisors. It believes the 2010 amendments have, on the whole, improved the strength of the Code and increased the amount of information to which potential franchisees are given access has resulted in greater transparency and understanding. We also consider the ACCC to be an effective regulator. Yum does not believe there is evidence of endemic problems in the franchising sector sufficient to justify further regulation.

Statutory Duty of Good Faith

Yum Australia opposes the inclusion of a statutory duty of good faith into the Franchising Code. It believes the common law duty of good faith, combined with statutory protections prohibiting misleading or deceptive and unconscionable conduct under the CCA, already provide franchisees with adequate protection. If there is legitimate evidence of serious issues in franchising of which Yum Australia is not aware, then we believe those issues should be addressed by specific amendments to the Code, rather than a broad catch-all provision regarding good faith. We believe this will introduce greater uncertainty, negatively impact existing long-term contractual arrangements and unfairly disadvantage franchising over other types of business relationships.

Operation of the CCA as it relates to enforcement of the Code

Yum Australia believes the current enforcement framework is entirely adequate to deal with conduct in the franchising sector and that no new court or tribunal is necessary.

The need for uniformity

Yum Australia considers that maintaining uniformity of regulation at a Federal level is extremely important for both franchisors and franchisees, as different requirements on franchisees based in different States not only create confusion and uncertainty within the franchisee community (when consistency among franchisees is fundamental to any franchise system) but lead to additional administrative and cost burdens for both franchisor and franchisees (particularly those franchisees who operate stores in multiple states) without delivering any significant benefits.

Responses to specific questions raised in the Discussion Paper

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

Yum Australia's franchisees and their respective representative organisations have not expressed any concerns to us about the potential for franchisor failure. As such we feel the additional disclosure requirements that were added in 2010 were unnecessary. That said, they have not caused Yum Australia any significant inconvenience.

We would be opposed to any additional disclosure requirements in this area, as we believe that franchisees should be able to raise any concerns they have about franchisor's financial status with their professional advisors in the course of obtaining legal, business or accounting advice as contemplated by the Code.

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

No. See above

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

Yes. Although Yum Australia provided much of the data and information brought in by the amendments to prospective franchisees previously, the amendments have resulted in potential franchisees receiving a more consistently structured, comprehensive package of information. This has been beneficial to franchisees because it has given them a clear, consistent understanding of how Yum Australia's systems works and allowed them to understand and plan for possible expenditure they may not have previously thought of. We do not believe further disclosure is necessary.

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

No but the requirement to provide all of this information does increase our administrative and financial burden.

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

We do not know if these amendments have adequately addressed the franchisee's concerns. In relation to the requirement to disclose the circumstances in which a franchisor has unilaterally varied a franchise agreement in the last 3 financial years and the circumstances in which unilateral variations may take place in the future, this obligation is problematic for Yum Australia because its operations and policies manuals form part of the Franchise Agreement. Technically, the requirement now requires Yum to record and disclose all changes to its manuals, which might include minor changes to the systems, for example, a change to a particular packaging process for a product, a change to an incident reporting process, a change to a type of menu board etc. This is an onerous obligation and we do not believe that the benefit received by franchisees outweighs the effort required on Franchisor's behalf. The requirement to disclose this information to potential franchisees (as opposed to only existing franchisees) also forces us to disclose confidential information regarding our systems to persons who may not necessarily end up being franchisees.

In our view, franchisors such as Yum Australia, should have the flexibility to make changes to their operating manuals and policies, without having to record and disclose absolutely every change. This is necessary to ensure the system remains relevant to the market. We would therefore like to see this requirement amended so that franchisor is only obliged to disclose unilateral variations to the franchise agreement that are "material", with that term being clearly defined.

Further, it is worth noting that the commercial reality is that Yum Australia cannot generally make substantive changes to its systems and processes without first consulting with franchisees about these changes and offering them reasonable timeframes within which to implement them. In the context of an existing long term relationship with multiple franchisees, it is practically difficult to do otherwise.

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

Yes. Please see our comments above in relation to the unilateral variation requirement.

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

Yes. We believe the disclosure of contact details of franchisees that have left the system has been useful, as it has enabled prospective franchisees to discuss any concerns they may have about the system or Franchisor with a third party who has first-hand knowledge of the system and no longer any interest in it.

8. Is the information being provided useful to franchisees?

We believe so.

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

The impact has been minimal.

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

No.

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

We believe this was a positive amendment for the sector.

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

Not from Yum Australia's perspective.

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

Yes, we believe the amendments ensure franchisees are provided with more than adequate information. Since the 2010 amendments, franchisors are now required to disclose details of payments to third parties, unilateral variation, confidentiality, significant capital expenditure and end of term arrangements. Franchisees have a wide variety of information from which to understand the business arrangement on offer.

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

The onus on franchisors to disclose information is significant. Whilst we consider it can be justified to date by the benefit that franchisees are receiving from the additional information being provided, we believe any further requirement would be unnecessary and would impose unreasonable additional compliance obligations. Yum's disclosure document (including the Code and franchise agreement) is approximately 150 pages long, and we are concerned that this amount of information is already overwhelming for many prospective franchisees who may not read all of the information provided. In our view, any further disclosure material cannot be justified.

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

We believe the targeted amendments, together with what are already significant disclosure requirements which are backed by a strong legal system, are very effective in addressing any issues regarding the conduct of franchisors and franchisees toward each other.

We do not believe that inserting an overarching obligation to act in good faith into the Franchising Code is necessary or appropriate. Franchisors and franchisees are already bound by several written and unwritten laws relating to contracts and by statutory provisions that prohibit misleading and deceptive conduct and unconscionable conduct. Further, the common law rules of good faith are already preserved in the Code. Any inappropriate or undesirable conduct should be addressed by specific regulation focused on the conduct and not by a broad "catch-all" provision.

We note that some franchisees such as Competitive Foods have strongly argued that a statutory duty of good faith should be introduced into the Code in order to prevent a franchisor from ending a long term franchise agreement with the franchisee without "good cause". The argument is often couched in terms that a franchisor should be obliged to "renew" an existing long term agreement. However, in reality, what the franchisee is really arguing for here is an automatic right to receive a new long term agreement unless they are in breach of their existing agreement.

The current legal position on the issue of end of term arrangements is appropriate, clear and does not need to be changed. It is articulated well by the High Court in the case of *Ranoa Pty Ltd v BP Oil Distribution Limited* [(1989) 91 ALR 251] where, the court noted that "*on expiry or termination of the [franchise] agreement, the franchisee has no right to continue operating the business and no right to share in any goodwill that may have accrued to the system during the franchisee's tenure*" (p257).

We also believe this position is fair. A franchise agreement is, by its nature, a limited term license to operate a system under a certain trade mark using systems generally devised and owned by the franchisor, and it is priced accordingly. In the event some form of compensation was required to be given to franchisees at the end of the franchise term, then that would fundamentally change the nature of the franchise business model and potentially require franchisor to modify its structure, including

the possible charging of higher royalties and/or other amounts. A long-term tenant under a commercial tenancy has no right to receive compensation for any improvements it may have made to a property whilst renting it and a franchisee should not be treated any differently.

Franchisees who argue for a statutory duty of good faith and compensation for their contribution to the franchise system at the end of the franchise term, often argue that such recognition is necessary to prevent “churning”. The expression “churning” is generally used to refer to a practice whereby franchisors attempt to make a profit at the end of a franchise term by acquiring the franchise business for less than market value and then operating that business themselves or selling that business on for full value to a new franchisee.

We believe there is little evidence of churning in Australia. In the event a new franchise agreement is not going to be granted to an existing franchisee for one reason or another at the expiry of the term, most franchisors, including Yum Australia, will provide franchisees with a reasonable opportunity to sell their businesses before the term ends. This is despite the fact that at the end of an agreement, the benefit of a successful franchise has been enjoyed.

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

We believe this provision is adequate – please see above.

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

None.

- 18. If an explicit obligation of good faith is introduced, should ‘good faith’ be defined? If so, how should it be defined?**

Yum Australia strongly opposes any statutory definition of good faith as we believe it would give rise to uncertainty. A statutory definition would either act concurrently with the duty of good faith or replace it. If the two duties were to operate concurrently, it would be difficult to determine the limits of each duty. If the duty replaced the common law doctrine and applied only to franchising, then the statutory definition would have to be judicially tested in the franchising context before its effects were known (and if specific to franchising these cases would be few and far between). The common law duty of good faith is one that already has some history of judicial development and should therefore be retained. Franchising as a model should not be treated differently from other commercial business relationships.

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

Any specific obligation to act in good faith should be a codification of the common law duty, not something different.

There is no need for a specific statutory duty of good faith to extend to:

- the negotiation and execution of a franchise agreement, as the CCA provisions prohibiting misleading and deceptive conduct already provide franchisees with protection at this phase of the franchise relationship;
- the ending of a franchise agreement, as specific provisions of the Code regulate the termination of a franchise agreement and these are supported by the common law duty of good faith, contract law and the prohibition on unconscionable conduct
- dispute resolution in franchising as the Code already sets out specific obligations in relation to the handling of disputes.

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

The consequences should be the same as those that would apply if the common law duty of good faith were breached.

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

The existing common law duty already interfaces with the ACL. If the common law position were codified, then we assume this would provide access to the remedies that are currently available under the Act. There should be no need for additional penalties or sanctions to be introduced.

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

It would depend on how the obligation was worded.

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

Yes. By improving disclosure about and management of end of term arrangements, the franchisee and franchisor have greater clarity around what will happen at the end of the term. The requirement also forces both parties to think about what they want to do some time before the term ends and to make plans accordingly.

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

Yum Australia is not aware of any changes in conduct and behaviour during mediation since the introduction of the 2010 amendments to the Franchising Code.

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

No

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

Yes – the current national framework is adequate. The ACCC has substantial powers and resources, including powers to issue substantiation notices, infringement notices, audit notices and public warning notices without any involvement of a court. It has demonstrated that it is prepared to take proceedings against franchisors and their directors who ignore provisions of the Franchising Code, such as by refusing to mediate or by failing to provide a Disclosure Document in compliance with the Code. The ACCC has increased its enforcement activity in the franchising sector in the last few years and recently provided details of ongoing investigations it has into several franchise systems.

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

1. By simplifying the amount of disclosure material that is required to be provided by franchisors to franchisees. The volume of material being disclosed has become so extensive that we do not believe franchisees take the time to read it all.
2. By strengthening the requirement on the part of franchisees to obtain professional advice unless certain exemptions are met (eg being an existing franchisee). Many franchisees are reluctant to spend money on obtaining such advice even though the Code contemplates that it should be obtained; and
3. By clarifying, simplifying and better defining the requirements and terminology used in some sections of the Code. For example, clause 10 of the Code requires a Franchisor provide a copy of the Code and other documents if the franchisor or franchisee proposes to “extend the scope” of a franchise agreement. However “extend the scope” is not defined and different law firms have come up with different interpretations as to what this means.

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

None.

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

There are an extensive number of options, including:

- making a complaint to the ACCC
- making a complaint to a Federal or State Small Business Commissioner
- making a complaint to the Franchisor’s parent company overseas (in larger franchise systems)
- taking legal action or threatening legal action
- making a complaint to a current affairs program
- making a complaint to a local Member of Parliament
- making a complaint on-line via various blogs, websites and forums

In the circumstances, we do not believe any additional options are necessary.

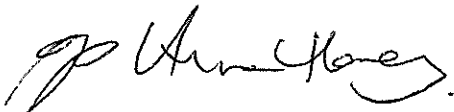
Summary

Yum Australia is of the view that whilst it is appropriate to review the current franchising code from time to time, further change in the form of more red tape, will come at a cost to a mature system with minimal additional benefit (if at all) to franchisees.

Government reform in this area should be concerned with easing regulatory burden on business and promoting one national franchising system.

We would be pleased to answer any questions you may have regarding our submission, and to comment on any specific proposals, at your convenience.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Sally Glover', with a stylized flourish at the end.

Sally Glover

Chief Legal and Corporate Affairs Officer, KFC SOPAC