



OUT19/16587

The Proper Officer
Australian Government Franchising Taskforce
By email: franchising@employment.gov.au

Dear Sir or Madam

FRANCHISING TASKFORCE REGULATION IMPACT STATEMENT (RIS)

The New South Wales Small Business Commission ('NSWSBC') is focused on supporting and improving the operating environment for small businesses throughout NSW. The NSWSBC advocates on behalf of small businesses, provides mediation and dispute resolution services, speaks up for small business within government, and makes it easier to do business through policy harmonisation and reform.

The NSWSBC has consistently supported a franchising policy framework that supports equitable, transparent, and mutually beneficial relationships between franchisors and franchisees. New South Wales is home to approximately one third of Australia's 79,000 franchisees¹ - a cohort consisting overwhelmingly of small businesses.²

We engaged extensively with the 2018-19 Inquiry into the operation and effectiveness of the *Franchising Code of Conduct* ('the Inquiry'; 'the Code'),³ the Franchising Taskforce issues paper, and a range of prior consultations.⁴ These exposed a range of serious and systemic issues for a great many of the nation's franchisees - with exploitative⁵ and opportunistic⁶ conduct perpetrated by franchisors against franchisees only too common. This picture is reflected further in at least four separate inquiries,⁷ a series of damning media exposes,⁸ and findings by the Fair Work Ombudsman against many prominent franchise networks.⁹

¹ Frazer, L. Weaven, S. Grace, A. & Selvanathan, S. (2016), *Franchising Australia 2016*; Griffith University Asia Pacific Centre for Franchising Excellence, p. 18

² Spencer, E. (2009), 'Consequences of the Interaction of Standard Form and Relational Contracting in Franchising', *Franchise Law Journal*, vol 29, p. 31

³ Office of the NSW Small Business Commissioner (2018), *Submission – Inquiry into the operation and effectiveness of the Franchising Code of Conduct*; Office of the NSW Small Business Commissioner (2018), *Supplementary information to the inquiry into the operation and effectiveness of the Franchising Code of Conduct*

⁴ For example, the 2013 review of the *Franchising Code of Conduct* conducted by Mr Alan Wein; Office of the NSW Small Business Commissioner (2013), *Submission – Review of the Franchising Code of Conduct*

⁵ Spencer, E. (2009), 'Consequences of the Interaction of Standard Form and Relational Contracting in Franchising', *Franchise Law Journal*, vol 29, p. 33; Buchan, J. (2009), 'Consumer protection for franchisees of failed franchisors: Is there a need for statutory intervention?', *QUT Law and Justice Journal*, vol 9, p. 236

⁶ Terry, A. & Di Lernia, C. (2009), *Franchising and the quest for the Holy Grail: Good faith or good intentions?*, *Melbourne University Law Review*, vol 33, p. 546

⁷ Parliamentary Joint Committee on Corporations and Financial Services (2019), *Fairness in Franchising*; Wein, A. (2013), *Review of the Franchising Code of Conduct*, Department of Jobs and Small Business; Weaven, S., Frazer, L. & Giddings, J. (2010), *New perspectives on the causes of franchising conflict in Australia*, *Asia Pacific Journal of Marketing and Logistics*, vol 22, no 2, p. 137

⁸ See, for example, Sydney Morning Herald (9 December 2017), *Cup of sorrow: the brutal reality of Australia's franchise king*; Sydney Morning Herald (25 February 2017), *The Domino's effect*; The Age (25 November 2016), *Caltex accused of squeezing service station operators and workers*; Sydney Morning Herald (31 August 2015), *Revealed: How 7 Eleven is ripping of its workers*

⁹ Fair Work Ombudsman (18 January 2019) '\$335,664 in penalties for underpaying workers at 7-Eleven outlet and restaurant'; Fair Work Ombudsman (7 September 2018) 'FWO audits 33 Domino's stores'; Fair Work Ombudsman (15 June 2018) '\$217,700 in penalties after Pizza Hut franchisee engages in sham contracting'; Fair Work Ombudsman (5 June 2018) '\$192,780 in penalties for Brisbane 7-Eleven outlet'; Fair Work Ombudsman (10 April 2018) 'More than \$192,000 in penalties for former 7-Eleven operators who underpaid vulnerable workers'; Fair Work Ombudsman (2

We therefore submit that reforms of genuine ambition are nothing short of imperative. Significant - indeed, sweeping - change is necessary to drive a future of fairness, transparency, and mutual prosperity for the sector. In relation to each of the seven principles identified by the Taskforce as shaping its response to the Inquiry, the status quo cannot suffice.

To this end, we commend the Taskforce on many of the potential reforms considered in the Regulation Impact Statement ('RIS'). We are pleased to provide the following recommendations and commentary concerning specific options raised therein.

Summary of recommendations

Recommendation 1: The Taskforce should support the implementation RIS options 1.1.2 and 1.1.3.

Recommendation 2: That the Code be amended to stipulate that franchisors must provide a 'reasonable estimate of a franchisees personal workload' in running the franchise business based on comparisons and case studies of similar operators within the franchise

Recommendation 3: The Taskforce should support the implementation of reforms under Option 1.2.2 with the national register being available at no cost.

Recommendation 4: The Taskforce should support the implementation of Option 1.3.3.

Recommendation 5: The Taskforce should support the implementation of Option 2.1.2.

Recommendation 6: The Taskforce should not support the implementation of Option 2.1.3.

Recommendation 7: The Taskforce should support the implementation of Option 2.2.2.

Recommendation 8: The Taskforce, only if Option 2.2.2 is not feasible, should implement Option 2.2.3 which provides an improvement, if all but limited, to the current arrangements.

Recommendation 9: The Taskforce should support the implementation of Option 2.3.2.

Recommendation 10: The Taskforce should support the implementation of all of the options under Option 3.1.2, including amending the Code to provide that the financial statements provided by franchisors must disclose:

- The fund balance
- Deposits, and the identity of parties making deposits
- Receipts and expenses, categorised (e.g. as consumables and administration, internet advertising, television advertising, etc.) and
- Costs related to administration and audit of the fund.

Recommendation 11: The Taskforce should provide that marketing funds provided by franchisees must be spent on activities that directly support the interests of those franchisees.

Recommendation 12: The Taskforce should support the implementation of the options under Option 4.1.2.

Recommendation 13: The Taskforce should amend the Code to provide that at least 50% of the value of any rebate received must be provided to the purchaser franchisee.

Recommendation 14: The Taskforce should support the implementation of Option 4.2.2.

March 2018) 'Melbourne company facing court over allegations relating to a 7-Eleven outlet and Ramen restaurant'; Fair Work Ombudsman (11 August 2017) 'Pizza Hut franchisee underpaid staff almost \$20,000'; Fair Work Ombudsman (27 January 2017) 'Fair Work Ombudsman report reveals non-compliance in major fast-food franchise'; Fair Work Ombudsman (April 2016) 'A report of the Fair Work Ombudsman's Inquiry into 7-Eleven: Identifying and addressing the drivers of non-compliance in the 7-Eleven network'; Fair Work Ombudsman (31 July 2013) 'Workplace practices at Domino's improved through Proactive Compliance Deed'

Recommendation 15: The Taskforce should amend the Code to include a standalone requirement that, prior to requiring significant capital expenditure, a franchisor must provide statements concerning the rationale for the investment, the capital required, and the expected outcomes, as well as the expected benefits and risks identified by an independent expert.

Recommendation 16: The Taskforce should support the implementation Option 4.2.3, to provide explicit franchisee rights to review or challenge capital expenditure.

Recommendation 17: The Taskforce should support the implementation Option 4.3.2.

Recommendation 18: The Taskforce should support implementation of the options under Option 5.1.2.

Recommendation 19: The Taskforce should support the implementation of the options under Option 6.1.2 and Option 6.1.3.

Recommendation 20: The Taskforce should support the implementation of Option 6.2.2.

Recommendation 21: The Taskforce should support the implementation of Option 6.2.3.

Recommendation 22: The Taskforce should support the implementation of Option 6.3.2.

Recommendation 23: The Taskforce should support amendments to the Code to instruct parties on how they are to calculate goodwill at the end of a franchising relationship.

Recommendation 24: The Taskforce should support the implementation of Option 7.2.2.

Recommendation 25: The Taskforce should support the implementation of the following measures to provide for education, awareness, and guidance materials to support franchisees and prospective franchisees:

- Option 1.2.3 - Pre-entry education
- Option 1.3.2 - A new Government online educational resource for the franchising sector
- Option 2.2.4 - Improve education and awareness around leasing and franchising
- Option 3.1.3 - Increase awareness and provide guidance around existing legal obligations
- Option 4.3.3 - Increase awareness around legal rights
- Option 6.3.3 - Increase awareness of how good will is handled in franchising
- Option 7.2.3 - Improved education and guidance on expectations around compliance with the Code

Draft Principle 1: 'Prospective franchisees should be able to make reasonable assessments of the value (including costs, obligations, benefits and risks) of a franchise before entering into a contract with a franchisor.'

Option 1.1.2 - Changes to Franchising Code to increase disclosure; and Option 1.1.3 – Simplified disclosure requirements.

The Inquiry received significant evidence concerning information asymmetries in franchising relationships that favour the franchisor.¹⁰ These findings influenced a series of recommendations regarding increased franchisor disclosure obligations - with the aim of assisting prospective franchisees to assess risk, understand the business model, and the solvency of the relevant business.¹¹ While the NSWSC suggests that disclosure alone cannot serve as a panacea in what is an inherently unbalanced power dynamic,¹² we recognise that improved disclosure can facilitate franchisees to make better investment decisions.

We also note that the measures detailed in Options 1.1.2 and 1.1.3 seek to provide greater transparency and accountability on the part of franchisors.¹³ The Commission therefore welcomes these proposed measures.

Option 1.1.2 (c) - Increased and formal financial disclosure

The likely financial performance of the franchised business will always be of central utility to a prospective franchisee. Such information is plainly much more relevant to a prospective franchisee than financial reporting relating to the franchise network as a whole - as a franchisor is presently required to provide.¹⁴

We are thus particularly supportive of the requirement to disclose the prior two years' Business Activity Statements and other financial information for the relevant franchised business - or a comparable franchised business where the franchised business does not yet exist.

Moreover franchisors deceptively entice prospective franchisees by exaggeratedly promoting franchise ownership as a lifestyle that provides greater independence and work life balance.¹⁵ Plainly this is unrepresentative of the work commitments required by a franchisee when entering into a franchise.¹⁶

The NSWSC acknowledges that whilst the requirement under Option 1.1.2(c) - for franchisors to provide a 'reasonable estimate of a franchisees personal workload'¹⁷ in running the franchise business - will not deter the abusive and deceptive marketing tactics used by franchisors, however it will allow franchisees to make more informed assessments.

¹⁰ See for example, Parliamentary Joint Committee on Corporations and Financial Services (2019), *'Fairness in Franchising'*, p. 9, 59

¹¹ Parliamentary Joint Committee on Corporations and Financial Services (2019), *'Fairness in Franchising'*, p. 59-90

¹² Barry, Q and Marie, A. (2000), *'Power and control in international retail franchising - Evidence from theory and practice'*, *International Marketing Review*, vol.17(4/5) p.354-372

¹³ Parliamentary Joint Committee on Corporations and Financial Services (2019), *'Fairness in Franchising'*, p. xvi

¹⁴ Annexure 1, CI 1

¹⁵ Weaven, S., Frazer, L. & Giddings, J. (2010), 'New perspectives on the causes of franchising conflict in Australia', *Asia Pacific Journal of Marketing and Logistics*, vol 22, no 2, p. 142

¹⁶ Weaven, S., Frazer, L. & Giddings, J. (2010), 'New perspectives on the causes of franchising conflict in Australia', *Asia Pacific Journal of Marketing and Logistics*, vol 22, no 2, p. 146

¹⁷ Franchise Taskforce (2019) *Franchising Sector Reforms: Regulation Impact Statement*. p.14

We therefore suggest that the Code be amended to stipulate that franchisors must provide a 'reasonable estimate of a franchisees personal workload' in running the franchise business based on comparisons and case studies of similar operators within the franchise.

Option 1.1.2 (e) – Leasing disclosure

Clause 13 of the Code provides for the disclosure of leasing information, where a franchisee leases premises from the franchisor for the purpose of a franchised business. However, it does not stipulate that essential information, including the terms of the lease agreement, be disclosed prior to the commencement of a franchise agreement.

Throughout the Inquiry, the Committee heard evidence of exploitative behaviours on the part of franchisors in relation to leasing arrangements, without adequate disclosure to franchisees. In particular, some franchisors intentionally avoid the disclosure of lease terms as a sales tactic to entice a prospective franchisee.¹⁸ This is particularly concerning, as many franchisors seek to impose lease terms beneficial to themselves, rather than mutually beneficial provisions reflective of a balanced franchise relationship. Franchisees are compelled to satisfy highly unfavourable terms - with the lease often extending over five to six years without equitable termination rights.¹⁹

Thus, the NSW SBC strongly recommends the amendment of clause 13 of the Code, in the manner supported in Inquiry Recommendation 20.1²⁰ to provide for substantially increased disclosure of leasing arrangements prior to the commencement of a franchise agreement.

We suggest that reform to this effect would also impart an incidental benefit on franchisors. That is, it would help mitigate against the risk of franchisors being financially penalised as a result of a franchisee breaching or terminating a sublease due to an inability to cover requisite costs. Franchisees would instead have the ability to consider the terms as part of the franchise agreement, and assess prospective financial obligations, to properly determine whether their capacity to meet such terms.

The Commission therefore supports the implementation of option 1.1.2(e) as a matter of priority.

Recommendation 1: The Taskforce should support the implementation of RIS options 1.1.2 and 1.1.3.

Recommendation 2: That the Code be amended to stipulate that franchisors must provide a 'reasonable estimate of a franchisees personal workload' in running the franchise business based on comparisons and case studies of similar operators within the franchise

Option 1.2.2 (a) – Franchisors would be required to include a statement about the accuracy of financial statements

In conducting due diligence, franchisees rely heavily on the integrity of the disclosure documents provided by franchisors.²¹ It is therefore only reasonable that franchisors should be required to verify the accuracy of this information. Absent such a requirement, franchisors may persevere with opportunistic and misleading disclosure practices - undermining the utility of the reforms countenanced in option 1.1.2 (c) regarding increased and formal financial disclosure.

¹⁸ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 272

¹⁹ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 268

²⁰ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. xxxviii

²¹ Buchan, J. (2014) "Franchising: A Honey Pot in a Bear Trap." *Adelaide Law Review*, vol. 34, no. 2, p.300

We further suggest that this option would not only provide a clear deterrent for franchisors to provide incomplete and or inaccurate information. It would also impose no additional cost or administrative burden on any diligent franchisor - which should already be collecting accurate financial information in any case.²²

Option 1.2.2 (b) – National franchise register

The extent to which the Code allows a franchisee to exercise informed choice is currently limited: A franchisee cannot contextualise a disclosure document or franchise agreement - assessing its merits and pitfalls against the alternatives - because equivalent examples are not publicly available.²³

The Code's disclosure functions would be enhanced by the development of a public database of all franchisors' current disclosure documents and proforma franchise agreements.²⁴ This would allow the vulnerable party to exercise informed choice in the relevant market.²⁵

A register, of the type countenanced in Option 1.2.2 (b), would facilitate such comparison and may incentivise franchisors to offer terms more amenable to prospective franchisees.

Furthermore, such a resource would serve as an invaluable resource for regulators, researchers, and other stakeholders. We note that equivalent databases currently operate in the US States of California, Wisconsin, and Minnesota.²⁶ These have delivered a previously unmatched level of data²⁷ - enabling more informed decision-making as envisaged.

The NSWABC would recommend that due to the likely minimal upkeep costs associated with a register of this kind, the national register should be made accessible at no cost. This will also maximise usage of the register - providing wider use than just for that of franchisees.

The NSWABC acknowledges the concerns raised regarding the potential for prospective franchisees to assume that the documentation may be vetted if it were provided on a national register.²⁸ Accordingly, the status of the documents uploaded to the database and the intention of the register should be made clear to prospective franchisees.

Option 1.2.2 (c) - Third party brokers

Brokers have no interest in how the terms of the contract affect the franchisee, or in assessing the capability of a prospective franchisee's ability to enter into a franchise agreement. Brokers commonly make misinformed or knowingly unreliable warranties to prospective franchisees - contradicting the disclosure documentation and franchise agreement.²⁹

²² Parliamentary Joint Committee on Corporations and Financial Services (2019), *'Fairness in Franchising'*, p. 83

²³ Buchan, J. (2009), 'Consumer protection for franchisees of failed franchisors: Is there a need for statutory intervention?', *OUT Law and Justice Journal*, vol 9, p. 242

²⁴ Miles, K. (2018), *'Franchising's dirty little secret'*, FranchiseED; Spencer, E. (2008), *'Conditions for effective disclosure in the regulation of franchising'*, *International Review of Applied Economics*, vol 22, p. 517

²⁵ Spencer, E. (2009), 'Consequences of the Interaction of Standard Form and Relational Contracting in Franchising', *Franchise Law Journal*, vol 29, p. 36; Spencer, E. (2008), 'Conditions for effective disclosure in the regulation of franchising', *International Review of Applied Economics*, vol 22, p. 512

²⁶ Buchan, J. (2017), *'What is going rotten in the franchise businesses plagued by scandals'*, *The Conversation*

²⁷ Spencer, E. (2008), *'Conditions for effective disclosure in the regulation of franchising'*, *International Review of Applied Economics*, vol 22, p. 521

²⁸ Franchise Taskforce (2019) *Franchising Sector Reforms: Regulation Impact Statement*. p.17

²⁹ Giddings, J. Weaven, S. Grace, D. & Frazer, L. (2011), 'Taking care of business: Are franchise systems structured to promote conflict?', *Australasian Dispute Resolution Journal*, vol 22, p. 44; Frazer, L. Weaven, S. Giddings, J. & Grace, D. (2012), 'What went wrong? Franchisors and franchisees disclose the causes of conflict in franchising', *Qualitative Market Research: An International Journal*, vol 15, no 1, p. 93; Weaven, S., Frazer, L. & Giddings, J. (2010), 'New perspectives on the causes of franchising conflict in Australia', *Asia Pacific Journal of Marketing and Logistics*, vol 22, no 2, p. 143-144

Moreover, franchise agreements commonly make the detachment of brokers from the substance of the agreement explicit, by including a clause to the effect that a broker is not an agent of the franchisor, as well as an 'entire agreement' (merger) clause - providing that the written agreement represents the complete agreement between the parties.³⁰

This severely diminishes the Code's disclosure function and engenders misguided expectations among franchisees - irrespective of the quality of the documentation provided pre-contract in line with the Code's requirements.

The reforms to prohibit 'no agent' and 'entire agreement' clauses in franchise agreements also incentivises franchisors to ensure they are not being misrepresented by brokers. Diligent franchisors may 'pass on' a contractual obligation to brokers not to misrepresent the franchise agreement and would avoid engaging brokers known to contravene such obligations.

Recommendation 3 The Taskforce should support the implementation of reforms under Option 1.2.2 with the national register being available at no cost.

Option 1.3.3 - Mandate all prospective franchisees receive legal and financial advice before entering into a franchise agreement

The Code currently provides that franchisees may waive the requirement that they obtain advice from a solicitor, accountant, or business advisor.³¹

However, and as stated in our previous submission to the Taskforce, the majority of prospective franchisees lack the business and educational background necessary to properly appraise a franchise, or to conduct adequate due diligence.³² This is particularly alarming in light of the tendency for prospective franchisees to waive the requirement that they obtain advice.³³

It is credibly suggested that almost half of all franchisees do not obtain professional advice prior to entering into a franchise agreement.³⁴ This accentuates the already-pervasive power imbalance between franchisors and franchisees.

Moreover, it is widely accepted that franchises draft heavily one-sided agreements that maximise their position. This plainly impacts on the relationship between the franchisor and franchisees. Mandatory disclosure would not remove the opportunity for conflict in all areas of the franchisor-franchisee relationship but would go some way to addressing some of the power imbalances that get embedded in franchising relationships arising from inadequate due diligence of contractual obligations.

The NSWBC therefore strongly supports mandating all prospective franchisees to seek independent legal and financial advice before they sign a franchising document. This will help

³⁰ Spencer, E. (2008), 'Conditions for effective disclosure in the regulation of franchising', *International Review of Applied Economics*, vol 22, p. 518

³¹ CI 10(2)

³² Frazer, L. Weaven, S. Grace, A. & Selvanathan, S. (2016), 'Franchising Australia 2016', Griffith University Asia-Pacific Centre for Franchising Excellence, p. 46-47

³³ See for example, Frazer, L. Weaven, S. Giddings, J. & Grace, D. (2012), 'What went wrong? Franchisors and franchisees disclose the causes of conflict in franchising', *Qualitative Market Research: An International Journal*, vol 15, no 1, p. 95; Spencer, E. (2008), 'Conditions for effective disclosure in the regulation of franchising', *International Review of Applied Economics*, vol 22, p. 514

³⁴ACCC (2019) *Disclosure practices in food franchising: Key findings of targeted compliance checks of franchisors in the food services sector*, p. 1

ensure that franchisees are aware of contractual obligations, and thereby assist in minimising or mitigating disputes between franchisors and franchisees.

Recommendation 4: The Taskforce should support the implementation of Option 1.3.3

Draft principle 2: *'Franchisees and franchisors should have 'cooling off' time to consider whether the relationship is right for them after signing.'*

Option 2.1.2 Extend cooling off to 14 days and modify the circumstances which trigger the commencement of the cooling off period

The Inquiry received extensive submissions providing that the seven-day cooling off period should be extended, to better afford franchisees the opportunity to consider disclosure information provided by franchisors.³⁵

It is apparent that to ensure a prospective franchisee enters into the business as an informed partner, the prospective franchisee ought to engage in extensive consideration and analysis. Absent such reflection, the mere provision of information to the franchisee will neither protect nor empower it.³⁶ An extended cooling off period should afford franchisees some assistance in reaching the critical decision to enter into a franchise (or decline to do so).³⁷

Recommendation 5: The Taskforce should support the implementation of Option 2.1.2

Option 2.1.3 Amend the Franchising Code to extend the disclosure period to 21 days, with the ability to waive part or all of this period with written agreement of both parties

It is our view that Option 2.1.3 - to extend the disclosure period to 21 days, with the ability to waive part or all of this period with written agreement of both parties - would undermine the purpose of providing a cooling off period to protect and empower franchisees, as the more vulnerable party in most franchising relationships.

Inherently, a mandated cooling off period that would allow for franchisor to pressure franchisees into waiving a cooling off period would not speak to that objective – and might be seen to undermine it.

Furthermore, we note that franchisors typically impose standard form contracts on franchisees – dictating terms on a 'take it or leave it' basis³⁸. It follows that it is open to a franchisor to afford itself a cooling off period in the franchise agreement, if it determines that it is prudent to include such a term. Indeed, evidence provided to the Inquiry by Dr Courtenay Atwell suggested that franchisors already make use of cooling off provisions much more frequently than franchisees.³⁹

Recommendation 6: The Taskforce should not support the implementation of Option 2.1.3

³⁵ Parliamentary Joint Committee on Corporations and Financial Services (2019), *'Fairness in Franchising'*, p. 141-142

³⁶ Atwell, C. (2015), *'Cooling off periods in franchise contracts: from consumer protection mechanisms to paternalistic remedies for behavioural biases'*, *Taxation and Business Law*, vol 17, no 14, p. 706;

³⁷ Parliamentary Joint Committee on Corporations and Financial Services (2019), *'Fairness in Franchising'*, p. 146

³⁸ Buchan, J. (2009), *'Consumer protection for franchisees of failed franchisors: Is there a need for statutory intervention?'* *QUT Law and Justice Journal*, vol 9, p. 234

³⁹ Parliamentary Joint Committee on Corporations and Financial Services (2019), *'Fairness in Franchising'*, p. 145

Option 2.2.2 – Extend cooling off periods, transparency, and termination rights in relation to leases

The NSWABC, like the Inquiry, is concerned that franchisors can secure the sale of a franchise without having selected a site or provided leasing information to the franchisee.⁴⁰ The leasing terms are a significant component in a prospective franchisee's assessment of the viability and suitability of a franchise agreement.

It is apparent that franchisors impose leasing agreements that are solely beneficial to themselves - with no, or very little, consideration of the ability of the prospective franchisee to fulfil the terms of the agreement. More alarmingly, a franchisee could find itself stuck in a franchise agreement while the franchisor continues drawn-out negotiations with landlords, or remains undecided on a location.

The NSWABC acknowledges that site negotiations for a lease agreement can be protracted and complex. Nonetheless this should not result in prospective franchisees having inadequate information to sufficiently assess leasing agreements as part of the overall viability and suitability of the franchise.

The location of a franchise site and associated costs are of fundamental importance when assessing the financial risks and business viability of a franchise. Plainly, a franchisee requires the same opportunity to analyse and consider the terms of a lease as it does for assessment of the franchisee agreement. As stated above, absent such reflection, the mere provision of information to the franchisee will neither protect nor empower it.⁴¹

Furthermore, compelling a franchisee to enter into a lease agreement that is unfair and partisan without appropriate consideration elicits acrimony between the franchisor and franchisee. Adoption of this Option would protect both the franchisor and franchisee from further disputes and any long-term adversity in the relationship.

Recommendation 7: The Taskforce should support the implementation of Option 2.2.2

Option 2.2.3 – Provide a new cooling off period of seven days where lease terms are 10 per cent above maximum estimates provided in disclosure documents

An actual lease agreement that has terms of 10% above maximum estimates provided in disclosure documents represents a material deviation from expectations for a prospective franchisee which may undermine the case for investment in the franchise.

Furthermore, we submit that this option will simply lead to cases where franchisors adopt deceptive and misleading sales tactics by utilising the 10% leeway to their advantage. Plainly, some franchisors will disclose amounts approximately 10% lower than the estimated amount as a sales tactic, avoiding disclosure of the actual amount. This would further inhibit a vulnerable franchisee the opportunity to accurately assess the agreement.

Plainly franchisees should be provided with the opportunity to make an assessment based on accurate and up-to-date information prior to being locked into a lease agreement. Absent of this, the NSWABC acknowledges that an additional cooling off period where lease terms are 10% above maximum estimates provided in disclosure documents does allow franchisees with a possibility, albeit not optimal, to reassess the agreement to some degree.

⁴⁰ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 328

⁴¹ Atwell, C. (2015), 'Cooling off periods in franchise contracts: from consumer protection mechanisms to paternalistic remedies for behavioural biases', *Taxation and Business Law*, vol 17, no 14, p. 706;

Recommendation 8: The Taskforce, only if Option 2.2.2 is not feasible, should implement Option 2.2.3 which provides an improvement, if all but limited, to the current arrangements.

Option 2.3.2 Extend cooling off to transfers, extensions and renewals

The Inquiry found that the risks faced by a franchisee are analogous whether they are entering a franchise as a prospective franchisee or acquiring a franchisee in a transfer.⁴² This is consistent with the NSWSCB's own industry engagements.

Plainly, the analysis and assessment required when entering a franchise agreement is equivalent to the analysis and assessment that is required in assessing the transfer, extension or renewal of a franchise agreement. The franchisor has the same power to stipulate the terms and conditions of the agreement and is provided with the same opportunity to exploit the vulnerabilities of the franchisee.

As found by the Inquiry, in the case of renewal or extension an extended cooling off period would have minimum impact on franchisors.⁴³ As a franchisee provides significant sunk costs and generates goodwill throughout an agreement it is in their best interest to renew or extend the agreement. Franchisors abuse this by dictating terms on a 'take it or leave it' basis⁴⁴, with the knowledge that the vulnerable franchisee is likely to accept any term to mitigate losing sunk costs and goodwill that the franchise has generated.

Thus the Commission would strongly recommend amending the Code to allow the franchisee sufficient time to assess the amended terms of the agreement in relation to the transfer, renewal and extensions of franchises.

Recommendation 9: The Taskforce should support the implementation of Option 2.3.2

Draft principle 3: 'Each party to a franchise agreement should be able to verify the other party is meeting its obligations and is generating value for both parties.'

3.1.2 – Address inconsistency in the Franchising Code on the treatment of marketing funds and increase reporting standards

The NSWSCB welcomes the option to increase the regularity and detail of marketing fund reporting requirements - thereby providing greater transparency and accountability on the expenditure of those funds.

Franchisors have unfettered control of marketing funds with very few disclosure requirements - providing franchisees with opaque and ambiguous information. It is our firm view that franchisees should be provided with detailed information as to how franchisors are making use of the collective's funds. That is, the Code should provide that the financial statements provided by franchisors must disclose:

- The fund balance;
- Deposits, and the identity of parties making deposits;
- Receipts and expenses, categorised (e.g. as consumables, internet advertising, television advertising, etc.); and

⁴² Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 146

⁴³ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 147

⁴⁴ Buchan, J. (2009), 'Consumer protection for franchisees of failed franchisors: Is there a need for statutory intervention?' QUT Law and Justice Journal, vol 9, p. 234

- Costs related to administration and audit of the fund.

This would only require franchisors to make available basic information that they should already possess. The costs associated with provision should therefore be no more than nominal. If such negligible expenses were indeed sufficient to prompt a franchisor to cease operating a marketing fund - as the RIS suggests may be the case⁴⁵ - this would strongly suggest deficient administration of that fund. In any such instance, it would be open to question whether franchisees were deriving benefit from such a poorly administered initiative.

More alarming is the indication that some franchisors, in response to increased regulation of marketing funds, will resort to even more opaque and problematic means of funding market activities (such as franchise system fees).

The Code as it stands includes minimum reporting requirements for marketing fees and advertising fees contributed by franchisees⁴⁶ - yet abusive and exploitative management of these funds has occurred.⁴⁷ The Inquiry received a number of submissions regarding expenditure of marketing funds occurring in a manner that confers exclusive benefit on the franchisor.⁴⁸ Perhaps most notably, the ACCC highlighted the practice of franchisors providing statements with insufficient detail to satisfy the requirements of the Code.⁴⁹ Plainly franchisors are obfuscating statements and information that the Code requires franchisors to disclose to franchisees, intended to enable franchisees to make reasonable and informed decisions.

This indicates that further measures are required to deter franchisors from abusing marketing funds, and obligate compliance to clause 31 of the Code. It is our view that disclosure alone does not provide a sufficient incentive to franchisors to refrain from this behaviour. Truly significant reform is required to address widespread power imbalances in franchise agreements and the abusive and exploitative behaviour of franchisors. Disclosure requirements need to be enforced with penalties sufficient to incentivise adherence to reporting requirements.

Greater civil penalties will address the wide-spread non-compliance of disclosure requirements in regards to marketing funds. This would also incentivise greater transparency and equity on behalf of franchisors in managing marketing funds. The NSWBC therefore strongly supports greater civil penalties to ensure appropriate accountability in relation to the administration of marketing funds and deter franchisors from abusing and misusing marketing funds to the detriment of vulnerable franchisees.

Recommendation 10 The Taskforce should support the implementation of all of the options under Option 3.1.2, including amending the Code to provide that the financial statements provided by franchisors must disclose:

- The fund balance
- Deposits, and the identity of parties making deposits
- Receipts and expenses, categorised (e.g. as consumables, internet advertising, television advertising, etc.) and
- Costs related to administration and audit of the fund.

⁴⁵ Australian Government (2019), 'Franchising sector reforms: Regulatory Impact Statement', p. 26

⁴⁶ CI 31

⁴⁷ Frazer, L. Weaven, S. Giddings, J. & Grace, D. (2012), 'What went wrong? Franchisors and franchisees disclose the causes of conflict in franchising', *Qualitative Market Research: An International Journal*, vol 15, no 1, p. 99;

⁴⁸ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 75-76; Office of the NSW Small Business Commissioner (2018), 'Submission – Inquiry into the operation and effectiveness of the Franchising Code of Conduct', p. 10-11

⁴⁹ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 75

The Code requires that marketing funds are used for "legitimate" marketing and advertising expenses. However, it does not define 'legitimate'. While we acknowledge that such expenses may be expected to encompass a wide range of potential activities, the vagary of the clause allows for franchisor abuse. For example, a franchisor typically holding unfettered control of the marketing fund - may regard expenditure to on-sell a vacant business, or support its own online sales, as entirely legitimate. The franchisees paying for these activities but receiving no direct benefit, or even a potential detriment,⁵⁰ are likely to disagree. The Code should require that funds provided to a marketing fund by franchisees are spent on activities directly supporting the interests of those franchisees (subject to the existing proviso that franchisees may agree to expenditure for a separate purpose⁵¹).

Recommendation 11: The Taskforce should provide that marketing funds provided by franchisees must be spent on activities that directly support the interests of those franchisees.

Draft principle 4: *'A healthy franchising model fosters mutually beneficial cooperation between the franchisor and the franchisee, with shared risk and reward, free from exploitation and conflicts of interest.'*

Option 4.1.2 – Address conflicts of interest in the handling of supplier rebates to franchisors by requiring increased disclosure

Third line forcing often supports franchisee exploitation - raising the cost of goods above market while mandating a lower resale price.⁵² The Inquiry heard cases of third line forcing arrangements where a franchisor benefited from increasing purchase order volumes at the expense of the franchisee.⁵³ Indeed, franchisee purchase costs have trended upwards as a proportion of revenue over the past five years, largely due to the requirement that operators purchase stock from a predetermined list of suppliers.⁵⁴

It is apparent that there is a lack of transparency with regards to supplier rebates that is being exploited by some franchisors. This calls for greater disclosure requirements. Indeed the Inquiry received submissions asking for disclosures relating to the franchisor's earnings from rebates, particularly when those rebates have been accrued from purchases made by franchisees.⁵⁵

The NSW SBC strongly supports greater transparency through increased disclosure requirements as this may motivate franchisors to support third party purchasing arrangements genuinely advantageous to franchisees.

Recommendation 12: The Taskforce should support the implementation of the options under Option 4.1.2.

It is apparent that the scope of misconduct in the area of supplier rebates revealed to date also mandates further regulatory reform. It is eminently possible to support a more equitable

⁵⁰ For example, in the case of online sales; CI 12

⁵¹ CI 31 (3)(a)(iii)

⁵² Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising'; Forbes (27 May 2014) 'How Franchisors Squeeze Money from Their Franchisees'

⁵³ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 10

⁵⁴ IBISWorld (2019), 'IBIS World Industry Report - Franchising in Australia', p. 20

⁵⁵ Department of Jobs and Small Businesses, 'Submission by the Franchise Council of Australia to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the operation and effectiveness of the Franchising Code of Conduct', p. 10.; and; Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 104

approach to third party purchasing arrangements. That is, the Code should provide that at least 50% of the value of any rebate received must be provided to the purchaser franchisee.

As the Franchise Council of Australia itself notes, franchisees may benefit from such arrangements when allowed to share in rebates.⁵⁶ Indeed, the Inquiry heard evidence as to how some very successful franchise systems pass the benefits of rebates on to franchisees.⁵⁷ While such an arrangement would not preclude a franchisor requiring a franchisee to purchase at a net price above the market rate, it would drive fairer arrangements in this space.

Recommendation 13: The Taskforce should amend the Code to provide that at least 50% of the value of any rebate received must be provided to the purchaser franchisee.

Option 4.2.2 – Modify the Franchising Code to define significant capital expenditure and provide rights for franchisees to recoup the value of significant capital expenditure

Currently the Code allows for significant capital expenditure to be defined with reference to the franchisor's own assessment,⁵⁸ providing the franchisor near-absolute discretion to dictate what constitutes necessary spending. The clause allows for both unjustified spending and outright franchisor abuse.

Plainly, a lack of clarity regarding the definition of 'significant capital expenditure' has supported franchisors to impose unreasonable costs onto franchisees. Thus, the NSW SBC strongly supports the option to reform the Code to define significant capital expenditure.

Furthermore capital expenditure requirements can have significant impacts on the franchisee, particularly with regards to franchisees ability to recoup the value of significant capital expenditure⁵⁹. It is readily apparent that franchisees should benefit from the return on investments that have been rendered from finances extracted from the franchisee by the franchisor.

We submit that this could be achieved franchisees funding only a pro-rata portion of the capital investment that would allow an appropriate return on investment within the term of the agreement. A franchisor would then be required to fund the remaining portion incentivising franchisors to invest in capital expenditure that provides a return to the franchise and not exclusively to the franchisor.

Recommendation 14: The Taskforce should support the implementation of Option 4.2.2

Furthermore, the fact that the provision allows for the assessment of anticipated benefits and risks to be undertaken by the franchisor itself gives rise to a potential conflict of interest. A party seeking to justify an investment cannot be expected to have necessarily undertaken a dispassionate assessment of its benefits and risks. To enhance the integrity and reliability of the statement of anticipated benefits and risks, the Code should require that such an assessment is undertaken by independent expert.

⁵⁶ Franchising Council of Australia, 'Submission by the Franchise Council of Australia to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the operation and effectiveness of the Franchising Code of Conduct', p. 9.

⁵⁷ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 111

⁵⁸ CI 31 (2)(e)

⁵⁹ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 296

Recommendation 15: The Taskforce should amend the Code to include a standalone requirement that, prior to requiring significant capital expenditure, a franchisor must provide statements concerning the rationale for the investment, the capital required, and the expected outcomes, as well as the expected benefits and risks identified by an independent expert.

Option 4.2.3 – Clarify franchisee rights when significant capital expenditure is required

The Committee heard evidence regarding the lack of clarity with regards to capital expenditure on the part of the franchisor and franchisee.⁶⁰ Plainly franchisors have complete discretion to stipulate the timing and scope of required capital expenditure, which has led to unjustified spending and abuse by franchisors.

The NSWABC strongly supports greater clarity regarding franchisees rights, particularly regarding the right to review or challenge capital expenditure.

Recommendation 16: The Taskforce should support the implementation Option 4.2.3, to provide explicit franchisee rights to review or challenge capital expenditure.

Option 4.3.2 – Banning or limiting the circumstances in which franchisors can unilaterally vary franchise agreements

The Inquiry received evidence concerning the unilateral manner in which franchisors amend contractual terms, as well as operations manuals that franchisees are contractually required to abide by.⁶¹ Indeed, franchisors have commonly exploited franchisee vulnerabilities in this manner.⁶²

The NSWABC is gravely concerned with the unfettered power of franchisors to unilaterally vary contracts in this manner, with little concern as to the impact of amendments on the franchisee. Indeed, a franchisor's right to affect unilateral variation may well arise from an unfair contract term.⁶³ Plainly, the franchisor's ability to unilaterally vary franchise agreements becomes a vehicle for the exploitation of franchisees, supporting abusive behaviour around contractual interpretation and enforcement.⁶⁴

It is apparent that Option 4.3.2 - to amend the Code to ensure unilateral variations to franchise agreements, manuals and policies, can only be made with the agreement of the majority of franchisees or representatives elected by a majority of franchisees - will empower franchisees to collectively bargain for fairer, less exploitative and abusive unilateral variations that have a net benefit to the franchisee.

Thus the NSWABC strongly supports Option 4.3.2 to provide for greater collective bargaining rights for franchisees. We further submit that franchisees may face retribution from a franchisor as a result of negotiating for fairer and less abusive unilateral variations.

⁶⁰ *Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the operation and effectiveness of the Franchising Code of Conduct*, p. 295

⁶¹ *Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the operation and effectiveness of the Franchising Code of Conduct*, p. 139 and 224

⁶² Spencer, E. (2009), 'Consequences of the Interaction of Standard Form and Relational Contracting in Franchising', *Franchise Law Journal*, vol 29, p. 33; Buchan, J. (2009), 'Consumer protection for franchisees of failed franchisors: Is there a need for statutory intervention?', *QUT Law and Justice Journal*, vol 9, p. 236

⁶³ Australian Competition and Consumer Commission, 'Submission by the Franchise Council of Australia to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the operation and effectiveness of the Franchising Code of Conduct', p.

⁶⁴ Terry, A. & Di Lernia, C. (2009), 'Franchising and the quest for the Holy Grail: Good faith or good intentions?', *Melbourne University Law Review*, vol 33, p. 546

Plainly franchisors have the capacity and resources to take retributive action against franchisees, over time disincentivising franchisees to collectively bargain for fairer and less exploitative unilateral variations. We submit that the Taskforce consider greater protection measures for franchisees against franchisor retribution be implemented in conjunction with Option 4.3.2. It is apparent that increased civil penalties applied to all breaches of the Code would act as a protection measure for valuable franchisees against franchisor retribution.

Recommendation 17: The Taskforce should support the implementation Option 4.3.2

Draft principle 5: 'Where disagreements turn into disputes, there is a resolution process that is fair, timely and cost effective for both parties.'

Option 5.1.2 – Expand options for dispute resolution, and streamline mediation procedures and services

Option 5.1.2(b) – Strengthen third party involvement in dispute resolution, including pathways for binding dispute resolution

While the right to seek mediation of a franchising dispute is unquestionably of value to both franchisees and franchisors, it is not a panacea. There is evidence to suggest that franchisors may be using mediation as a subtle method of leveraging their dominant power position in the franchising relationship.⁶⁵

In particular, numerous studies, expert reflections and our consultations have found that franchisors often approach mediations in bad faith⁶⁶. Franchisors are well placed to impose their will without compromise,⁶⁷ and even in the event the franchisee resists, they are much better resourced for any subsequent litigation.⁶⁸ Such practice is clearly not conducive to what might reasonably be considered satisfactory resolution from the standpoint of either a franchisee or a regulator.

Arbitration affords franchisees a potential solution to the issue of franchisor bad faith in mediations. An arbitrator, as an expert third party, would not be guided by coercive franchisor behaviour in arriving at an outcome. The *Food and Grocery Code of Conduct* - regulating relations between supermarkets, grocery wholesalers, and their suppliers - empowers the parties to a dispute under the code to seek both mediation and arbitration, provided these processes are not sought concurrently.⁶⁹ The NSWSCB strongly recommends that the Code's dispute resolution regime should be expanded to include equivalent provisions.

Furthermore, as suggested in the RIS the constitutionality of the Commonwealth to compel parties to participate in arbitration appears open to question at least. Indeed, compulsory alternative dispute resolution, preceding and not precluding recourse to the judiciary, is a common feature of many regulations⁷⁰ without seeming to offend the constitution. It is therefore arguable that the Code's arbitration provisions would not allow arbitrators to exercise

⁶⁵ Giddings, J, Frazer, L, Weaven, S, Anthony, G. (2009) 'Understanding the dynamics of conflict within business franchise systems' Griffith University, p.29

⁶⁶ See Levingston, J. (2008), 'Franchise mediations: Experience, problems and solutions (reflections of a franchise mediator)', Australian Dispute Resolution Journal, vol 19

⁶⁷ Spencer, E. (2008), 'Conditions for effective disclosure in the regulation of franchising', International Review of Applied Economics, vol 22, p. 522

⁶⁸ Weaven, S., Frazer, L. & Giddings, J. (2010), 'New perspectives on the causes of franchising conflict in Australia', Asia Pacific Journal of Marketing and Logistics, vol 22, no 2, p. 147

⁶⁹ Competition and Consumer (Industry Codes - Food and Grocery) Regulation 2015, cl 38-39

⁷⁰ For example, the Family Law Act 1975 (Cth)

'judicial power', and so would not offend the Constitution. However, the Commonwealth should seek suitably expert advice in relation to its ability to compel parties to participate in arbitration.

Option 5.1.2 (c) Clarify the availability of multi-party mediation

The franchisor's superior bargaining and financial power functions as a disincentive to many franchisees seeking formal dispute resolution at all. In 2016, less than one third of franchising disputes formalised through either alternative dispute resolution or solicitor correspondence were initiated by a franchisee.⁷¹

We submit that this is in part due to franchisees' lack of awareness regarding the availability of multi-party options. The NSWABC therefore supports reforms to provide further information about dispute resolution services, and the availability of multi-party options.

The NSWABC also submits that the Code should require that mediation and arbitration commence within a reasonable time after a mediator or arbitrator has been appointed.

The Rules of the Motor Vehicle Insurance and Repair Industry Code of Conduct currently stipulate that mediation should take place 28 days following the appointment of a mediator.⁷² However, in consulting with stakeholders the NSWABC found that franchisees could be disadvantaged if not provided sufficient time to collate the necessary documents required. The extent of time that is required by franchisees to undertake this, can vary widely on a case by case basis.

Recommendation 18: The Taskforce should support implementation of the options under Option 5.1.2.

Draft Principle 6: *'Franchisees and franchisors should be able to exit in a way that is reasonable to both parties.'*

Option 6.1.2 – Limit termination in circumstances where the franchisee seeks mediation, and/or breaches have occurred for fraud or public health and safety reasons, and introduce statutory termination rights into the Franchising Code and Option 6.1.3 – Clarify the termination process available to franchisees and support greater awareness of negotiation pathways

Clause 27 of the Code provides franchisors with near absolute power to terminate contracts where a franchisee has breached an agreement, offering very minimal remediation for the franchisee. Under the Code a franchisee is only provided up to 30 days to remedy the breach, with minor procedural requirements to be undertaken by the franchisor.⁷³

This allows a franchisor to terminate an agreement under which a franchisee has expended hundreds of thousands of dollars for a breach that is trivial in nature yet not remedied immediately. Any outcomes of this nature would be plainly inequitable.

⁷¹ Frazer, L. Weaven, S. Grace, A. & Selvanathan, S. (2016), Franchising Australia 2016, Griffith University AsiaPacific Centre for Franchising Excellence, p. 35

⁷² Rules of the Motor Vehicle Insurance and Repair Industry Code of Conduct approved Determination Scheme Rules s2.1 see: <https://www.abrcode.com.au/site/DefaultSite/filesystem/documents/rules-of-the-motor-vehicle-insurance-and-repair-industry-code-of-conduct.pdf>

⁷³ CI 27(2) and (3)

Moreover, franchisors potentially seeking to generate revenue by 'churning' through franchisees for an established franchised business⁷⁴ may find the provision facilitative of this particularly unscrupulous practice.

The NSW SBC thus strongly supports option 6.1.2, to limit the termination in circumstances where the franchisee seek mediation, and/or breaches have occurred for fraud or public health and safety reasons.

Recommendation 19: The Taskforce should support the implementation of the options under Option 6.1.2 and Option 6.1.3

Option 6.2.2 – Amend franchising agreement requirements and clarify wording of clause 23 of Franchising Code

The Inquiry received submissions regarding the lack of clarity in relation to clause 23 of the Code.⁷⁵ Moreover, our consultations have found that franchisors rely on the lack of clarity in clause 23 to intimidate vulnerable franchisees with the inclusion of unenforceable terms in franchise agreements. In particular restraint of trade clauses as to prohibit franchisees from opening a business in the same town or within a 5km radius of the franchise.

Plainly greater clarity in relation to clause 23 will raise awareness of the unenforceable terms that are included in franchise agreements – that speak to the ubiquitous power imbalances between franchisors and franchisees.

Recommendation 20: The Taskforce should support the implementation of Option 6.2.2

Option 6.2.3 – Codify common law that restraints of trade should go no further than reasonable to protect legitimate interests

Clause 23 of the Code provides for the restraint of trade if a franchisee agreement is not extended. However it does not prescribe the nature of, or constraints that ought to be applied to, restraint of trade terms in a franchise agreement. Equally, the Code does not permit or constrain terms relating to termination contained in franchise agreements. We firmly submit that franchisees lack the legal understanding to identify unfair contract terms⁷⁶ - thus allowing franchisors to impose unfair and inappropriate restraint of trade terms.

This is particularly alarming considering the ACCC, following a review of unfair contract terms, found that restraints of trade were one of the four most common unfair terms found in franchisee agreements.⁷⁷

The NSW SBC strongly supports greater clarification and further guidance under Clause 23 - as well as the codification of common law principles to better protect vulnerable franchisees against unfair and inappropriate restraint of trade clauses.

⁷⁴ Weaven, S., Frazer, L. & Giddings, J. (2010), 'New perspectives on the causes of franchising conflict in Australia', *Asia Pacific Journal of Marketing and Logistics*, vol 22, no 2, p. 143-144

⁷⁵ *Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the operation and effectiveness of the Franchising Code of Conduct*, p. 186

⁷⁶ Spencer, E. (2013), 'The Applicability of Unfair Contract Terms Legislation to Franchise Contracts', *University of Western Australia Law Review*, Vol. 37, No. 1, p.161; and Spencer, E. (2009). 'Consequences of the Interaction of Standard Form and Relational Contracting in Franchising'. *Franchise Law Journal*. vol.29, Iss.1.p.45

⁷⁷ Australian Competition and Consumer Commission, 'Submission by the Franchise Council of Australia to the Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into the operation and effectiveness of the Franchising Code of Conduct*, p. 6

Recommendation 21: The Taskforce should support the implementation of Option 6.2.3

Option 6.3.2 – Clarify the franchisees' rights in regards to goodwill, if any, in the franchise agreement

In its 2008 inquiry, *the Parliamentary Joint Committee on Corporations and Financial Services* examined a considerable body of evidence regarding goodwill - devoting five pages of its report to that evidence. The committee recommended that: "...the *Franchising Code of Conduct* be amended to require franchisors to disclose to franchisees, before a franchising agreement is entered into, what process will apply in determining end of term arrangements. That process should give due regard to the potential transferability of equity in the value of the business as a going concern".⁷⁸

The lack of clarity regarding franchisees rights to goodwill provides for opportunistic franchisors to abuse the power imbalances between franchisors and franchisees and take the goodwill that has been accumulated by the franchisee throughout the agreement.⁷⁹ A franchisee can make significant investments to develop goodwill, which may not be transferable to another operation.

Moreover, there are precedents in the United States of courts determining that a franchisee does create goodwill for the franchise.⁸⁰ In France, the law provides franchisees rights to the franchise goodwill, recognising franchisees' investment in and rights to their business and customers.⁸¹

The Commission therefore strongly recommends that the Code be amended to clarify franchisees rights to goodwill. We also submit that greater clarity will reduce disputes between franchisees and franchisors due to misaligned expectations and allow franchisees to make a reasonable assessment before entering into a franchise agreement.

Recommendation 22: The Taskforce should support the implementation of Option 6.3.2

Issues concerning the quantification of goodwill at the conclusion of a franchise agreement are a recurring feature of NSW SBC's industry engagements. Currently franchisees generate significant and enduring goodwill in a franchise - but receive nothing by way of consideration from the franchisor to account for this when an agreement is not renewed.

Plainly, this practice is fundamentally unfair - amounting to wholesale franchisor appropriation of value generated by the exiting franchisee.

The NSW SBC would strongly recommends that franchise agreements include provisions instructing the parties on how to calculate goodwill at the end of a franchising relationship.

Recommendation 23: The Taskforce should support amendments to the Code to instruct parties on how they are to calculate goodwill at the end of a franchising relationship

⁷⁸ *Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the operation and effectiveness of the Franchising Code of Conduct*, p. 169

⁷⁹ Emerson, R. (2013). *Franchise goodwill: Take a sad song and make it better*. University of Michigan Journal of Law Reform, 46(2), p.351

⁸⁰ See *Hamish v. Sch. Dist. of Phila.*, 732 A.2d

⁸¹ Emerson, R. (2013). *Franchise goodwill: Take a sad song and make it better*. University of Michigan Journal of Law Reform, 46(2), p.359

Draft Principle 7: 'The framework for industry codes should support regulatory compliance, enforcement and appropriate consistency.'

Option 7.2.2 – Application and enhancement of civil penalties to all breaches of the Franchising Code

The Code currently contains 24 penalty provisions that, if breached, may lead to the imposition of civil penalties of up to 300 penalty units (equivalent to \$63,000). The NSW SBC submits that this is a manifestly inadequate maximum penalty, considering some franchisors can generate sales revenues of up to \$12.7 billion per year.⁸²

Moreover, Consumer Affairs Australia and New Zealand found that.... *"If penalties are too low, traders might be prepared to factor the risk of a low penalty into its pricing structures as a 'cost of doing business' rather than a deterrent. Penalties must be sufficiently high that a trader, acting rationally and in its own best interest, would not be prepared to treat the risk of such a penalty as a business cost"*.⁸³

We suggest that the number of penalty units incurred for breaches of the Code be increased to reflect the penalties currently available under the *Australian Consumer Law* ('ACL') of up to \$1.1 million for companies. This would act as a stronger deterrent against breaches of the Code and align remedies under the Code with the penalties under the ACL.

Furthermore, the exploitative and abusive behaviours of franchisors are present from when a franchisee enters a franchise agreement up until the franchisee exits. The Code can not protect the franchisee without providing that civil penalties be extended to all breaches of the Code. Plainly the significant and valuable reforms that have been outlined in the RIS will be undermined unless appropriate consequences are provided to all breaches of the Code.

Recommendation 24: The Taskforce should, support the implementation of Option 7.2.2

Options related to the provision of education and guidance and increased awareness

Franchised businesses are more likely to fail than independent businesses predominately due to lower levels of formal education in the franchisee population.⁸⁴ Moreover, in many franchise networks, 25% or more of all franchisees are of a culturally and linguistically diverse background.⁸⁵ This is likely to serve as an additional, practical barrier to understanding rights and obligations in the franchised business.

The NSW SBC notes prominent support in both the literature⁸⁶ and its own consultations for increased education, awareness and guidance on franchisee arrangements. Correspondingly

⁸² IBISWorld (2019), *'IBIS World Industry Report - Franchising in Australia'*, p.24

⁸³ Australian Consumer Law Review (2017) *Australian Consumer Law Review Final Report*, p. 88

⁸⁴ Weaven, S., Frazer, L. & Giddings, J. (2010), 'New perspectives on the causes of franchising conflict in Australia', *Asia Pacific Journal of Marketing and Logistics*, vol 22, no 2, p.140

⁸⁵ Frazer, L. Weaven, S. Grace, A. & Selvanathan, S. (2016), *'Franchising Australia 2016'*, Griffith University Asia-Pacific Centre for Franchising Excellence, p. 46-47

⁸⁶ See for example, Miles, K. (2018), 'Five main causes of franchise conflict', *FranchiseED*; Frazer, L. Weaven, S. Giddings, J. & Grace, D. (2012), 'What went wrong? Franchisors and franchisees disclose the causes of conflict in franchising', *Qualitative Market Research: An International Journal*, vol 15, no 1, p. 99-100; Weaven, S., Frazer, L. & Giddings, J. (2010), 'New perspectives on the causes of franchising conflict in Australia', *Asia Pacific Journal of Marketing and Logistics*, vol 22, no 2, p. 150

the Committee noted insufficient franchisee education and awareness as a recurring theme throughout the Inquiry.⁸⁷

We therefore commend the Taskforce on developing options that address the lack of education, awareness and guidance materials available to franchisees. Such materials would assist to empower franchisees - providing increased support against abusive and coercive franchise behaviours.

To this end, the NSWABC submits that pre-entry franchisee education provides for people from culturally and linguistically diverse backgrounds, who account for 25% of all franchises, and covers:

- The common business risks of franchising, from a franchisee perspective;⁸⁸
- The limited discretion afforded to franchisees in franchise agreements;⁸⁹
- The importance of franchisee due diligence at the pre-contract stage;⁹⁰
- The basics of how to conduct due diligence;⁹¹ and
- Basic financial literacy.

We are particularly pleased to support option 1.3.2 to provide for the development of a new government online educational resources for the franchising sector. Plainly, franchisees require a single point of reference for comprehensive information regarding the risks, rewards and responsibilities of franchisors and franchisees from an authoritative/trusted source.

The NSWABC, in concordance with the Committee,⁹² submits that these resources should include case studies, including examples of franchisee failings.

Recommendation 25 The Taskforce should support the implementation of the following measures to provide for education, awareness, and guidance materials to support franchisees and prospective franchisees:

- Option 1.2.3 - Pre-entry education
- Option 1.3.2 - A new Government online educational resource for the franchising sector
- Option 2.2.4 - Improve education and awareness around leasing and franchising
- Option 3.1.3 - Increase awareness and provide guidance around existing legal obligations
- Option 4.3.3 - Increase awareness around legal rights
- Option 6.3.3 - Increase awareness of how good will is handled in franchising
- Option 7.2.3 - Improved education and guidance on expectations around compliance with the Code

Next steps

The NSWABC is dedicated to supporting improved transparency and equity for franchisees - and, ultimately, a future of shared prosperity for the sector.

⁸⁷ Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p.46

⁸⁸ Spencer, E. (2008), 'Conditions for effective disclosure in the regulation of franchising', International Review of Applied Economics, vol 22, p. 517

⁸⁹ Spencer, E. (2008), 'Conditions for effective disclosure in the regulation of franchising', International Review of Applied Economics, vol 22, p. 517

⁹⁰ Spencer, E. (2008), 'Conditions for effective disclosure in the regulation of franchising', International Review of Applied Economics, vol 22, p. 517

⁹¹ Frazer, L. Weaven, S. Giddings, J. & Grace, D. (2012), 'What went wrong? Franchisors and franchisees disclose the causes of conflict in franchising, Qualitative Market Research: An International Journal, vol 15, no 1, p. 99-100

⁹² Parliamentary Joint Committee on Corporations and Financial Services (2019), 'Fairness in Franchising', p. 246

We acknowledge the extensive contribution that the Taskforce has made in responding to the Committee's recommendation and in developing significant reforms that address the systemic and corrosive currently present in franchising. To this end, we stand ready, and would welcome further engagement as the Taskforce progresses with its work.

For more information concerning this submission, please contact [redacted]

Yours sincerely

A handwritten signature in black ink, appearing to read "Stephen Brady". The signature is fluid and cursive, with a prominent initial "S" and a long, sweeping underline.

Stephen Brady
Acting NSW Small Business Commissioner
Small Business Commission

11 December 2019