



**Small Business
Development Corporation**

Our ref: D23/7513

Franchising Review Secretariat Unit
Small and Family Business Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Dr Schaper

REVIEW OF THE FRANCHISING CODE OF CONDUCT

The Small Business Development Corporation (**SBDC**) welcomes the opportunity to make this submission to the Review of the Franchising Code of Conduct (**the Review**).

Background

The SBDC is an independent statutory authority of the Government of Western Australia (**WA**), established to support and facilitate the growth and development of small businesses in the State¹.

In early 2012, the SBDC's structure and governing legislation² was enriched with the introduction of the role of WA Small Business Commissioner (as Chief Executive Officer) and establishment of Dispute Resolution Services (**DRS**). In 2020, the Small Business Commissioner was granted greater ability to inquire into conduct that is having an adverse impact upon small business in WA³. To this end, the Commissioner has established an Investigations and Inquiry Unit whose role, amongst others, is to investigate poor and unfair business practices which may extend into franchising-related matters.

As part of its Business Advisory Services, the SBDC offers franchising advice and guidance to clients operating in, or considering entering, a franchising model. This includes general assistance on starting and running a small business; advice in evaluating the advantages and disadvantages of entering a franchise; leasing business premises; and understanding the Franchising Code of Conduct (**the Code**) and associated laws and regulatory framework.

The SBDC's DRS assists small businesses with disputes relating to *inter alia* contracts, leases, non-payment or non-performance, unfair terms and franchising. The DRS can offer specific assistance to parties to a franchising dispute, so long as one of those parties is a small business based in WA.

¹ The views presented here are those of the SBDC and not necessarily those of the WA Government.

^{2, 3} See the *Small Business Development Corporation Act 1983 (WA)*.

The DRS can assist franchising parties to clarify the issues in dispute and attempt resolution, including identifying when further legal assistance may be necessary. The DRS can also offer access to a subsidised, low-cost mediation service (at a cost of \$125 per party per mediation session), which can provide a valuable opportunity for parties to resolve specific concerns and fulfil the requirements of their franchise agreements or the Code.

Parties may also benefit from using the DRS and mediation service, as they are not limited to resolving issues solely related to the franchise arrangement itself (as limited under the Code's dispute resolution provisions) but can encapsulate other related matters (for example, their commercial tenancy arrangements).

The SBDC works closely with and feeds relevant franchising issues and emerging trends to relevant authorities including the Australian Competition and Consumer Commission (**ACCC**) and the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**).

Disputes involving a WA-based franchising party may also be referred to the ASBFEO if they specifically relate to matters under the Code (not for other franchising matters such as issues with the franchisee's landlord). This is the only criteria that applies for referral to the ASBFEO (in other words, there are no other thresholds involved).

While opting for the ASBFEO pathway is at the decision of franchising parties, the DRS advises clients to consider it carefully as it is a costlier option.⁴

For the period 1 July 2020 to 14 September 2023, the SBDC has referred 22 franchise-related disputes to its DRS. A yearly breakdown of the number of franchise-related disputes is per the table below.

Financial year	Number of franchise-related disputes referred to DRS	Referred to Mediation	Resolved via Mediation
2020/21	11	3	1
2021/22	4	0	N/A
2022/23	6	0	N/A
2023/24 (to 14 September 2023)	1	N/A	N/A

⁴ Due to mediation costs of at least \$2000 per party, depending on the complexity of the matter and extra costs associated such as travel expenses and expert reports.

Disputes raised with the SBDC's DRS during this period relate to *inter alia*:

- contractual matters, including unfair contract terms, breaches of the franchise agreement or the Code, negotiation of a new franchise agreement, and negotiation of exiting from a franchise agreement;
- misleading and deceptive representations prior to the purchase of a franchise business;
- failure to pay by the franchisor (even after the introduction of the Franchise Disclosure Register);
- supply issues, including third line enforcing;
- use of marketing funds;
- misrepresentation, including of earnings potential; and
- issues relating to the sale of the franchise business, including commercial leasing disputes.

Another of the SBDC's key strategic objectives is to influence the policy and regulatory environment affecting the small business sector in WA. In this regard, the SBDC has contributed to several Government and Parliamentary inquiries and reviews into the Code and the sector over the past decade or more.

The SBDC's feedback on the key issues explored in the Review's Consultation Paper follows.

Key issues

❖ *A regulatory framework that broadly serves its purpose*

Franchising is a robust business model that provides an entry into business ownership for many thousands of Australians.

The SBDC believes that the comprehensive regulatory framework established by the Code and underpinned by the *Competition and Consumer Act 2010 (Cth)* generally serves its purpose of addressing the power imbalance between franchisors and franchisees and there is therefore no significant market failure that necessitates the Code not being retained.

Despite the Code obligations and protections in place, the SBDC notes the sector continues to be plagued by issues. The media for example persistently report on the misleading and deceptive conduct of some franchisors wittingly selling loss-making stores or making claims about the certain profitability of a franchise unit to unsuspecting franchisees.

❖ ***Further efforts necessary to protect vulnerable franchisees***

Anecdotally, the SBDC is aware of the vulnerability of some of those seeking to buy a franchise; they often are ‘mum and dad’ investors with limited business acumen or experience and migrants with English as their second language, who consider franchising as an opportunity to establish a certain quality of life in Australia.

Unsurprisingly, the franchisees in distress that come to the SBDC for assistance generally have a similar profile. While the 2021 reforms to the Code made some useful progress in terms of enhancing disclosure requirements and protecting the rights of franchisees, it seems further efforts are needed better protect vulnerable cohorts from the predatory behaviours of some franchisors.

❖ ***New car dealership protections to be expanded to farm machinery, motorcycle and truck dealers***

It is noted that the additional protections set out in Part 5 of the Code and that took effect in July 2021 only apply to new vehicle dealership agreements. The industry has been advocating for these automotive-specific protections to also be afforded to farm machinery, motorcycle and truck dealers as the infrastructure requirements, capital expenditure, and business model very much aligns to that of a new car dealer.

The SBDC does not see any compelling reason why such businesses should not have the protections of the Code and strongly supports the industry’s view that the new car dealership protections set out in Part 5 of the Code be expanded to farm machinery, motorcycle and truck dealers.

❖ ***The Franchise Disclosure Register, a positive intent but effectiveness yet to be ascertained***

It is noted that previous reviews and inquiries into the franchising sector strongly focused on addressing the power imbalance characteristic of the franchisor-franchisee relationship, with a range of reforms introduced to improve information asymmetry and upfront disclosure.

While the SBDC is highly supportive of the intent of the Franchise Disclosure Register (**the Register**) introduced as part of the 2021 reforms to increase franchisor transparency and access to key franchise system information, it is difficult to assess whether it has successfully served its purpose.

Anecdotally, the SBDC continues to observe a general lack of awareness among those considering entering into a franchise agreement about their rights and obligations under the Code and franchise agreement. This extends to their awareness of the Register. It is therefore likely that some potentially vulnerable investors enter into a franchise agreement without availing themselves of all necessary information (including comparisons with other franchise systems) before making their decision.

Further, the SBDC is unable to ascertain whether the information provided by franchisors on the Register is accurate and current as required.

❖ Changes imposed to franchisees during the term of the franchise arrangement

The SBDC notes that certain forms of power imbalance during the term of the franchise agreement also persist, mainly because they are legally permissible.

For instance, franchisors may during the term of an arrangement impose management or operational changes that disadvantage franchisees. This issue has recently attracted media attention in the case of Mercedes-Benz replacing its traditional dealership model in January 2022 with a fixed-price, direct-to-customer agency model.

Concretely, Mercedes-Benz retained ownership of the vehicles, set the sales prices and paid dealers a fixed commission on sales. Through the new model, a car could be purchased online, reducing the buyer's contact with a dealership to the time of picking up the new vehicle. Dealers claimed that with this model, they would lose valuable 'customer goodwill' (the value that customer relations bring to a business), and with dealer showrooms already in decline drastically affect their profitability.

The Federal Court rejected the franchisees/dealers' compensation claim as cancelling the existing franchise contracts and asking to sign the new agency agreement in its place was found to not be a breach of the Code or contravened any Australian law.

Although the Code prohibits retrospective and unilateral variations of franchise agreements, the Mercedes-Benz case posits that franchisors can cancel existing arrangements and ask their franchisees to sign a new one.

In the SBDC's opinion, not only does this decision illustrate a regulatory gap but worryingly it publicly validates the possibility for franchisors to legally take advantage of this loophole to impose changes that will benefit them while significantly disadvantaging their franchisees.

The Code's obligation to act in good faith does not prevent a party to a franchise agreement from acting in their legitimate commercial interests. While this premise is acceptable, the SBDC believes the severity of potential consequences on franchisees should be taken in consideration and afforded appropriate mechanisms or protections.

The SBDC believes that in addition to the Mercedes-Benz situation, franchisees should have the right to terminate or renegotiate their franchise agreement in the event the ownership of their franchisor changes hands. This is especially the case in instances where the franchise brand is swallowed up into a conglomerate of divergent (and possibly) competing brands or taken over by private equity interests which are usually focused on short-term profit-taking than brand maximisation.

The SBDC urges the Review to further consider the rights of franchisees in such circumstances; especially since adopting changes to increase profitability seems unavoidable with today's rapidly evolving technologies and fast-changing consumer trends.

❖ *Ending franchise agreements still favouring franchisors*

In certain circumstances, the SBDC agrees that franchising parties should be able to terminate a franchise agreement early. Although the Code currently sets out certain procedural requirements which parties must follow if they seek to terminate a franchise agreement early, it allows the franchisor to skip these processes in certain exceptional circumstances (such as if the franchisee becomes insolvent, operates the business in a way that endangers public health or safety, or acts fraudulently).

The SBDC believes that franchisees should similarly have the right to terminate an agreement early in exceptional circumstances. These would include changes imposed by the franchisor that would unavoidably lead to the franchisee:

- becoming insolvent or suffering significant financial losses;
- operating the business in a way that endangers public health or safety; or
- acting fraudulently.

Further, an appropriate regulatory response should be considered to provide the right for franchisees to terminate their franchise agreement if the franchisor enters into administration or goes bankrupt. In such circumstances, the commercial tenancy of franchisees can often also be materially impacted where the franchisor is also the leaseholder. The Code is based on the premise that franchisors don't fail.

❖ *Support offered to franchisees and franchisors in dispute*

With franchising issues persisting, it is critical that franchising parties in dispute can access resolution pathways other than court action which is often a costly and lengthy process.

As mentioned in the Background, small business commissions can offer dispute resolution services and may successfully address issues between franchising parties for free or for a nominal fee. The ASBFEO also offers a relatively affordable alternative dispute resolution service (although at a higher cost than that provided by small business commissions) for matters specifically relating to the Code.

These services are important as they may be the only options a franchisee in dispute can financially afford. However, in disputes involving a party that refuses to cooperate, small business commissions and the ASBFEO can find themselves limited as they don't have enforcement powers.

The ACCC can exercise enforcement but will not necessarily take such action in response to every report received and will only look at systemic matters (not individual disputes). It is effective in that it supports several franchisees over one matter, however the fact that there is no alternative pathway to an authority with enforcement power for individual disputes, means that some vulnerable franchisees may be stuck in distressing situations. This is for example the case for a number of (culturally diverse) franchisees of a cleaning franchise the SBDC has attempted to help.

While the 2021 reforms have helped address some of the imbalance regarding legal fees between franchising parties, it is important to continue improving access to, the cost of, and the speed of legal action to result in better outcomes for franchisees.

Concluding remarks

The SBDC has observed that, broadly speaking, despite the system's checks and balances and the legal protections afforded under the regulatory framework, many vulnerable franchisees continue to be caught up in regulatory gaps and left financially and emotionally ruined. It is therefore hoped that this Review can address the power imbalances still blighting the sector as outlined in this submission and better protect small business franchisees.

While recognising that franchise-specific regulatory responses are no fix for poor or unsustainable business models, head office cost and efficiency drives, escalating wage and high rental costs, cut-throat competition, shifting consumer preferences and dynamic market forces, the SBDC believes more needs to be done to promote the mutual benefits that the franchisor-franchisee partnership can bring.

If you would like to discuss this submission in more detail, please don't hesitate to contact Karine Soares, A/ Assistant Director Policy and Advocacy [REDACTED]
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Yours sincerely

A handwritten signature in blue ink, appearing to read 'David Eaton', followed by a comma.

David Eaton
SMALL BUSINESS COMMISSIONER

29 September 2023