

Discussion Paper: Review of the Franchising Code of Conduct

Mr Alan Wein

January 2013

© Commonwealth of Australia 2013
ISBN 978-1-922218-15-5



All material presented in this document is provided under a Creative Commons Attribution 3.0 Australia licence (<http://creativecommons.org/licenses/by/3.0/au/>). To the extent that copyright subsists in a third party, permission will be required from the third party to reuse the material.

The document must be attributed *Department of Industry, Innovation, Science, Research and Tertiary Education, Discussion Paper: Review of the Franchising Code of Conduct, 2013*.

HOW TO MAKE A SUBMISSION

Request for feedback and comments

The information contained in this document is for discussion purposes. It is aimed at facilitating a comprehensive and independent review by Mr Alan Wein of the issues outlined in the terms of reference. Information in this document does not represent the views of the Australian Government, its policies or the direction of future policy. Feedback and comments received will inform Mr Wein, who is conducting the review on an independent basis and will report to government with his findings and recommendations.

Your feedback and comments are sought on the issues outlined in this paper that affect the rights and obligations of franchisors and franchisees under the Franchising Code of Conduct (the Franchising Code). The Franchising Code is a mandatory industry code under section 51AE of the *Competition and Consumer Act 2010* (CCA).

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. You are welcome to submit an additional PDF version.

Closing date for feedback: 15 February 2013

Email: franchisingcodereview@innovation.gov.au

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

Confidentiality

All information (including name and address details) contained in submissions may be made available to the public on the Department of Industry, Innovation, Science, Research and Tertiary Education website or in future papers, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked as such in a separate attachment, and identify the particular information to be kept confidential and provide reasons for the confidentiality. A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

CONTENTS

Foreword	5
Terms of Reference	6
Part One: Setting the scene	7
The franchising sector and the economic climate it is operating in.....	7
Franchising laws and recent federal inquiries into franchising.....	8
State inquiries into franchising regulation.....	9
Further reading	10
Part Two: Disclosure under the Franchising Code of Conduct.....	12
Overview	12
Franchise failure	13
Discussion questions:.....	14
Further reading:	14
Expenditure and other payments	14
Discussion questions:.....	16
Contract variation, transfer and novation	16
Discussion questions:.....	18
Disclosure regarding franchisor conduct.....	18
Discussion questions:.....	19
Disclosure exemption for foreign franchisors	19
Discussion questions:.....	20
Efficacy of the disclosure amendments as a whole.....	20
Discussion questions:.....	20
Part Three: Good faith in franchising.....	21
Overview	21
Discussion questions:.....	23
Further reading:	23
Part Four: End of term arrangements for franchise agreements.....	24
Overview	24
Discussion questions:.....	25
Part Five: Dispute resolution in franchising.....	26
Overview	26
Dispute statistics.....	27
Discussion questions:.....	27
Further reading:	27
Part Six: Enforcement of the Franchising Code.....	28
Overview	28
Role of the ACCC	31
Discussion questions:.....	33
Appendix A: Summary of 2008 and 2010 amendments.....	34

Foreword

Franchising is a significant component of Australia's small business sector. There are approximately 73 000 franchise units in Australia, with an annual turnover in the order of \$131 billion, and employing around 407 000 people.

Franchisors and franchisees have a unique business relationship. A franchisor's success is heavily dependent on the success of its franchisees, and vice versa. This, and the potential disparity of bargaining power between franchisors and franchisees, has led to a lively debate over the years about regulation of the sector.



The Franchising Code of Conduct has been reviewed several times since it was first introduced in 1998. The primary purpose of this review is to examine the efficacy of amendments to franchising regulation that were made in 2008 and 2010. This includes changes to the enforcement regime for the Franchising Code.

Amendments to the Franchising Code which took effect on 1 March 2008 were designed primarily to promote disclosure between franchisors and current or prospective franchisees, and to increase the transparency, quality and timeliness of disclosure by franchisors. The 2010 amendments primarily dealt with end-of-term arrangements, disclosure of additional information by franchisors, behaviour by franchisors and franchisees in the dispute resolution process and good faith. Additional enforcement tools for the Australian Competition and Consumer Commission were introduced in 2010, including the introduction of a power to audit businesses for compliance with mandatory industry codes.

I have been asked to undertake this review and report to the Minister for Small Business owing to my long-standing connection with the franchising sector, both as a participant in the sector and as a service provider to the sector. In recent years, my principal business has been to provide mediation services to the sector. In this role I have had the opportunity to appreciate the dynamics of the relationship between franchisors and franchisees.

The Department of Industry, Innovation, Science, Research and Tertiary Education will provide secretariat support throughout the review.

This discussion paper is intended to start a conversation on the issues covered by the terms of reference for the review (set out over the page) to assist me in gathering evidence for a report to the Minister for Small Business with findings and recommendations. This discussion paper canvasses some of the issues that are raised by the terms of reference, and poses questions to guide the development of submissions.

It is essential to the success of the review that industry and interested State and Territory stakeholders share their experiences and views on franchising. Submissions on the issues covered by the terms of reference for the review are strongly encouraged.

A handwritten signature in black ink, appearing to read 'Alan Wein', written in a cursive style.

Alan Wein

Terms of Reference

Introduction

In 2008, the Franchising Code of Conduct (the Franchising Code) was amended following a Review chaired by Mr Graeme Matthews (*Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006).

Following an inquiry into franchising by the Parliamentary Joint Committee on Corporations and Financial Services (*Opportunity not opportunism: improving conduct in Australian franchising*, December 2008), and a report from a Government Expert Panel (*Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, February 2010), the Government made amendments to the Code in 2010.

As part of its response to the Parliamentary Joint Committee report, the Government undertook to review in 2013, the efficacy of the 2008 and any 2010 amendments to the Code.

In making this commitment, the Government stated that a 2013 review 'would allow for a review after an adequate number of contracts, established after the amendments were implemented, have run their course (and that) the franchising sector deserves some certainty and stability before instigating another review'.

Terms of Reference for the Review

The reviewer is required to inquire into the efficacy of the amendments to the Code contained in the:

- Trade Practices (Industry Codes – Franchising) Amendment Regulation 2007 (No 1); and
- Trade Practices (Industry Codes – Franchising) Amendment Regulation 2010 (No 1).

Further, the reviewer is required to inquire into:

- good faith in franchising;
- the rights of franchisees at the end of the term of their franchise agreements, including recognition for any contribution they 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.

The reviewer is required to prepare a report suitable for public release to the Minister for Small Business, the Hon Brendan O'Connor MP, within three months of the date of commencement of the review. The report is to include findings and recommendations, based on evidence presented to the reviewer and these terms of reference. In gathering evidence to support findings and recommendations for the final report, the reviewer is required to undertake appropriate consultation, including with industry and interested State and Territory stakeholders.

Part One: Setting the scene

The franchising sector and the economic climate it is operating in

A walk through any major Australian shopping centre highlights the popularity of franchising in the small business sector. It is easy to imagine that almost every business in the centre could be franchised, if it is not already.

There are approximately 73 000 franchise units in Australia, and approximately 1180 business format franchisors.¹ The Australian Bureau of Statistics' 2010-11 Business Characteristics Survey indicates that just over five per cent of Australian businesses are franchisees.²

In 2010-11 the small business sector had a total annual profit of \$131 674 million, and was responsible for employing 4 818 000 people. It value added \$312 839 million to the Australian economy in that financial year.^{3 4}

On 22 October 2012, in releasing the Mid-Year Economic and Fiscal Outlook 2012-13, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, stated that the fundamentals of the Australian economy remain strong. Although some sectors have been affected by global economic conditions, a high dollar, and changing consumer behavior, as a whole, the Australian economy is expected to outperform every major advanced economy this year and next, with growth underpinned by strong investment, strong growth in export volumes and solid growth in consumption.⁵

However, the small business sector and, in particular, the retail sector, is facing some challenges. Griffith University's *Franchising Australia 2012* report noted that retail franchises experienced a decline in turnover from 2009/2010 to 2010/2011. In contrast, non-retail franchises improved their average sales over the same period.⁶

Overall, multiple sources confirm that the franchise sector is experiencing net growth, notwithstanding the weak conditions for retail franchises.⁷

Responsibility for franchising across government – who does what?

Minister for Small Business – together with ministerial colleagues, decides on whether there should be changes to the regulation of franchising including the Franchising Code.

¹ Griffith University, *Franchising Australia 2012*. Note that the 73 000 figure excludes motor vehicle and fuel sale franchises. Griffith University estimates there are an additional 6 500 fuel retail outlets, and 4 403 motor vehicle retail outlets.

² Business Characteristics Survey 2010-11, Australian Bureau of Statistics, (Cat No. 8167.0).

³ Profits, employment and value added data are for selected industries only and exclude *financial and insurance services*, and the general government component of *public administration and safety, education and training and health care and social assistance*.

⁴ Australian Bureau of Statistics, *Australian Industry 2010-11, Cat. No. 8155.0*, June 2012.

⁵ The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, Media Release, Mid-Year Economic and Fiscal Outlook 2012-13, 22 October 2012.

⁶ Griffith University, *Franchising Australia 2012*, page 35.

⁷ Griffith University, *Franchising Australia 2012*; IbisWorld, *Franchising in Australia*, May 2012; PwC, *Franchising holding strong in tough times*, Private Clients Franchise Sector Indicator.

Australian Competition and Consumer Commission – has primary responsibility to ensure that individuals and businesses comply with the Commonwealth's competition, fair trading and consumer protection laws. As part of this it engages in education and compliance activities in relation to industry codes such as the Franchising Code.

Department of Industry, Innovation, Science, Research and Tertiary Education – provides policy advice to the Minister for Small Business on the Franchising Code.

The Treasury portfolio – has responsibility for competition and consumer policy and administration of the *Competition and Consumer Act 2010* (Cth), including the industry codes framework.

Office of the Franchising Mediation Adviser (OFMA) – is appointed by the government to facilitate mediation of disputes between franchisors and franchisees.

Franchising laws and recent federal inquiries into franchising

Australian franchising is primarily regulated by the Franchising Code of Conduct. The Franchising Code is a prescribed mandatory code under the *Competition and Consumer Act 2010* (Cth) (“CCA”).⁸ It was introduced in 1998 and its purpose is “to regulate the conduct of participants in franchising towards other participants in franchising”.⁹ There are consequences for non-compliance.

In addition to the Franchising Code, general laws relating to fair trading and business operations also apply to franchisors and franchisees. These laws include certain provisions of the Australian Consumer Law (ACL).¹⁰ The unwritten law (also known as common law or judge-made law) also applies to franchisors and franchisees.

The Government has also published *Policy Guidelines on Prescribing Industry Codes under Part IVB of the Competition and Consumer Act 2010* (Cth). These policy guidelines outline the nature of industry codes as a form of regulation and considerations for prescribing a new industry code. When reviewing industry codes (such as the Franchising Code) the guidelines are a leading consideration.

The Franchising Code was amended in 2008 and 2010.¹¹ The 2008 amendments followed a 2006 review of the Franchising Code's disclosure provisions.¹² The 2010 amendments responded to a Parliamentary Joint Committee report, *Opportunity not opportunism: improving conduct in Australian franchising*,¹³ (“Joint Committee report”) and a 2010 expert panel

⁸ Part IVB of the *Competition and Consumer Act 2010* (Cth).

⁹ Refer to *Trade Practices (Industry Codes – Franchising) Regulations 1998*, Schedule (Franchising Code of Conduct), clause 2.

¹⁰ See Schedule 2, *Competition and Consumer Act 2010* (Cth).

¹¹ The amendments to the Franchising Code referred to as “the 2008 amendments”, are contained in the *Trade Practices (Industry Codes - Franchising) Amendment Regulations 2007*, but did not commence until 1 March 2008.

¹² Refer to the *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006.

¹³ Refer to the report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, December 2008.

report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*¹⁴ (“Expert Panel report”).

In December 2009, in foreshadowing the amendments that would be made to the Franchising Code in 2010, the Australian Government undertook to review in 2013, the efficacy of the 2008 and 2010 amendments.¹⁵

Why do we have a Franchising Code?

The Government's *Policy Guidelines on Prescribing Industry Codes under Part IVB of the Competition and Consumer Act 2010 (Cth)* state that industry codes are co-regulatory measures, designed to achieve minimum standards of conduct in an industry where there is an identifiable problem to address, and can be used as an alternative to primary legislation in instances where a market failure has been identified.

It is important for the provisions of an industry code to address an identified market failure. Otherwise, industry codes run the risk of contributing to the ‘red tape’ burden on small business by imposing unnecessary or unjustified requirements on it.

One form of market failure is ‘information asymmetry’. This is when firms (such as potential franchisees) possess insufficient information about factors such as price, quality or industry capability to make effective and efficient decisions. This is the kind of market failure that can often occur in franchising, since – at least to begin with – the franchisor has most (if not all) of the information about the franchise system and a prospective franchisee has a limited ability to find out that information except from the franchisor. This is why disclosure is such a key part of the Franchising Code.

State inquiries into franchising regulation

In addition to the Joint Committee report and Expert Panel report, four inquiries have examined franchising in Western Australia and South Australia in recent years:

- A 2008 inquiry chaired by Mr Chris Bothams, supported by the Western Australian Small Business Development Corporation, resulting in a report titled *Inquiry into the Operation of Franchise Businesses in Western Australia*;
- A 2008 inquiry by the South Australian Parliament's Economic and Finance Committee, resulting in a report titled *Franchises*;
- An inquiry by the Western Australian Parliament's Economics and Industry Committee into the Franchising Bill 2010 (WA), resulting in a self-titled report; and
- A 2011 inquiry by the South Australian Parliament's Economic and Finance Committee, resulting in a report titled *Franchises*, to supplement its 2008 report.

¹⁴ Refer to the report of the expert panel, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, February 2010.

¹⁵ Refer to the Government Response to the report *Opportunity not opportunism: improving conduct in Australian franchising*, at page 6.

The above state inquiries into franchising have either led to or responded to calls for state specific legislation to regulate franchising in addition to the national Franchising Code. In particular, the state inquiries have focussed on the issue of good faith, the rights of franchisees at the end of the term of their franchise agreement, and the question of whether stronger penalties should apply for breaches of the Franchising Code. These matters are discussed in depth in subsequent chapters of this discussion paper.

The South Australian *Small Business Commissioner Act 2011* commenced on 22 March 2012. That Act created the Office of the SA Small Business Commissioner. It also amended the *Fair Trading Act 1987* (SA) to provide new powers to the State Government to prescribe industry codes by regulation. The South Australian Government has stated its intention to consider using these laws to introduce a franchising industry code to apply in South Australia, which would be in addition to the national Franchising Code.

There have also been attempts to regulate franchising through the introduction of private members' bills in Western Australia.¹⁶ The most recent Western Australian bill (which lapsed on 14 December 2012 with the prorogation of the WA Parliament) contained provisions which sought to obligate parties, or prospective parties, to a franchise agreement to act in good faith, and also would have allowed a court to impose civil monetary penalties in relation to contraventions of state regulation (which incorporates the national Franchising Code).¹⁷ Additionally if it had been passed it would have allowed a court to order a franchisor to renew a franchise agreement in certain circumstances.¹⁸

A private member's bill currently before the New South Wales Parliament contains provisions which, if the bill were to be passed, would allow the government to introduce codes which provide for good faith obligations in commercial dealings. The New South Wales bill would also make it an offence punishable by imposition of a monetary penalty to contravene a code of practice.¹⁹

Further reading

- The Franchising Code of Conduct (Schedule to the [Trade Practices \(Industry Codes – Franchising\) Regulations 1998](#))
- [Policy Guidelines on Prescribing Industry Codes under Part IVB of the Competition and Consumer Act 2010 \(Cth\)](#), Australian Government Department of Treasury, May 2011
- [2006 report by Graeme Matthews, Review of the Disclosure Provisions of the Franchising Code of Conduct \(Matthews Report\)](#)
- [Government response to the 2006 Matthews Report](#)
- [2008 report of the Parliamentary Joint Committee on Corporations and Financial Services, Opportunity not opportunism: improving conduct in Australian franchising](#)

¹⁶ Franchising Bill 2010 (WA), defeated 2 November 2011 and Franchise Agreements Bill 2011 (WA), which lapsed on 14 December 2012 with the prorogation of the Western Australian Parliament.

¹⁷ Franchise Agreements Bill 2011 (WA) (lapsed), Part 3 and Part 4 respectively.

¹⁸ Franchise Agreements Bill 2011 (WA) (lapsed), Part 4.

¹⁹ Small Business Commissioner and Small Business Protection Bill 2012 (NSW), part 3.

- [Government response to the 2008 Joint Committee report](#)
- [Regulatory Impact Statement: *Franchising policy reforms and the Government response to the Joint Committee on Corporations and Financial Services' report on franchising*](#)
- [2010 expert panel report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*](#)
- [2008 report by Chris Bothams to the Western Australian Minister for Small Business: *Inquiry into the Operation of Franchise Businesses in Western Australia*](#)
- [2011 report of the Western Australian Parliament's Economics and Finance Committee Parliamentary into the Franchising Bill 2010 \(WA\)](#)
- [2008 report of the South Australian Parliament's Economic and Finance Committee, *Franchises*](#)
- [2011 supplementary report of the South Australian Parliament's Economic and Finance Committee, *Franchises*](#)
- [Franchise Agreements Bill 2011 \(WA\)](#) (currently before the WA Legislative Council)
- Griffith University, [*Franchising Australia 2012*](#)

Part Two: Disclosure under the Franchising Code of Conduct

Overview

This section considers amendments that were made in 2008 and 2010 to improve the degree and quality of disclosure provided by franchisors to prospective franchisees.

While the Franchising Code contains a number of provisions which directly regulate the conduct of franchisors and franchisees, it is predominantly concerned with pre-entry disclosure. That is, the idea that a franchisee should be provided with certain information *before* they agree to enter into a franchise agreement with a franchisor.

The Joint Committee report into franchising noted that 'it is central to good franchising regulation that prospective franchisees are provided with adequate information but franchisors are not unduly burdened by onerous disclosure requirements'.²⁰ Disclosure is fundamental to ensuring franchisees are able to weigh the risks and rewards of entering a particular franchise system.

The Expert Panel report, which considered the need to introduce measures into the Franchising Code to address specific behaviours that may be inappropriate in a franchising relationship, recommended additional disclosure on matters like:

- the potential for unforeseen significant capital expenditure;
- unilateral contract variation;
- attribution of legal costs;
- confidentiality agreements; and
- franchisor-initiated changes to franchise agreements when a franchisee is trying to sell the business.

Accordingly, a number of amendments were made to the Franchising Code with effect from March 2008 and July 2010, to implement the government's response to the recommendations from the Joint Committee and the Expert Panel. For a summary of the 2008 and 2010 amendments to the Franchising Code, see Appendix A: 2008 and 2010 amendments.

A number of other more minor changes were also made that will not be specifically highlighted in this discussion paper, though they still form part of the terms of reference for the current review.

²⁰ See above, note 13, at page 39.

Franchise failure

One issue which was prominent around the time of the 2008 Joint Committee report, and which resulted in amendments to the disclosure requirements under the Franchising Code, was the question of the rights and obligations of franchisees in the event that a franchisor's business fails.

When a franchisor becomes insolvent, this can seriously affect a franchisee's business. For example:

- if the franchisor holds the lease and has sublet the premises to the franchisee, the franchisee may lose their right to occupy the premises;
- the franchisee may be unable to obtain stock, if this is being provided by the franchisor or an associated company;
- the franchisee may lose their rights to use the brand;
- the franchisor may no longer be able to carry out its obligations under the franchise agreement, like providing marketing and training support; and
- potential customers may not want to deal with franchise outlets whose franchisor is insolvent.

The Franchising Code does not deal specifically with the insolvency of the franchisor. However, other Commonwealth legislation provides specific procedures in the event that a company such as a franchisor becomes insolvent or fails.²¹ These laws exist to protect creditors, investors and other parties who have dealings with a company that has failed.

In 2008 the Joint Committee report recommended that the Franchising Code be amended to require that disclosure documents include a clear statement by franchisors of the liabilities and consequences applying to franchisees in the event of franchisor failure. However, the government did not support this recommendation for two reasons. Firstly, it considered that individual franchisees, rather than franchisors, would be better placed to assess the liabilities and consequences applying to them in the event of their franchisor failing. Secondly, such a statement could induce a belief among franchisees that, in the event of franchisor failure, they would not be exposed to any risks other than those noted in the disclosure document.

While the Franchising Code requires franchisors to provide full, detailed and accurate disclosure documents to prospective and existing franchisees, this is intended to assist, not replace, standard due diligence processes. The obligation remains on a prospective franchisee, and their advisers, to adequately assess the business opportunity they are considering.

The government did, however, amend the Franchising Code to require that a franchisor's disclosure documents must include, on the first page, a statement that franchising is a business and that like any business the franchise (or franchisor) could fail during the franchise term. This statement is intended to alert prospective franchisees and their advisers to the risk of

²¹ See the *Corporations Act 2001* (Cth).

franchisor failure and to assist them to undertake their due diligence to adequately assess the business opportunity.

Some parties suggested that the Government should have gone further and included an automatic right of termination for franchisees in the Franchising Code if the franchisor fails. The government was concerned that the inclusion of such a right of termination might have given franchisees an advantage over other small businesses and constituted preferential treatment. It could also provide franchisees with an automatic right under the Franchising Code that is not available to franchisors. Giving franchisees such a right would potentially undermine the viability of a franchised company in the event of insolvency, since franchisees are an asset to a franchised company. If franchisees are provided with the right to 'walk away' from the franchisor this would be likely to devalue the franchisor company, limiting the prospects of the company being sold and resuming trading, which may actually be the preferable outcome for some franchisees.

For these reasons, while the Government acknowledged the serious implications that franchisor failure can have on franchisees, it did not consider it appropriate for the Franchising Code to provide franchisees with a right of termination.

Discussion questions:

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

Further reading:

Detailed information on insolvency and company failure is available on the [website of the Australian Securities and Investments Commission](#). ASIC is the government body responsible for administering Australia's company law framework.

Expenditure and other payments

Another concern raised in previous Franchising Code reviews is the potential for the franchisee to be "surprised" by the need to pay certain amounts in order to operate the franchise. Accordingly, in 2008 and 2010 the Franchising Code was changed to improve the transparency of financial information for franchisees. These amendments were also intended to assist franchisees in conducting their due diligence and making an assessment of their capacity to recoup their investment in the franchise over the term of the franchise agreement.

Payments to third parties

The Franchising Code requires franchisors to disclose details of money payable by the franchisee to the franchisor or collected by the franchisor for another person.

From 2010, the franchisor has also been required to disclose payments to *third parties*, where such payments are within

the knowledge or control of the franchisor, or reasonably foreseeable by the franchisor.

Unforeseen capital expenditure

The Expert Panel in 2010 was asked to consider whether the behaviour of franchisors in imposing unforeseen capital

expenditure on franchisees was inappropriate in a franchising relationship, particularly if such expenditure occurred towards the end of the term of a franchise agreement, or if the term of a franchise agreement was insufficient to allow the franchisee an opportunity to recoup their investment in the business.

The Expert Panel considered that to prohibit unforeseen capital expenditure would unduly constrain franchisors from making valid commercial decisions needed to maintain the competitiveness and responsiveness of the franchise business.

However, the Expert Panel supported further disclosure by franchisors. Following amendments to the Franchising Code in 2010, franchisors must now state whether they will require a franchisee to undertake significant capital expenditure that was not foreseen and, therefore, not disclosed by the franchisor before the franchisee entered into the franchise agreement. Franchisors must also disclose whether the franchisor will consider any significant capital expenditure by the franchisee in determining the arrangements to apply at the end of the franchise agreement.

Significant capital expenditure may include shop re-fits or purchasing new equipment or IT infrastructure.

Attribution of legal costs

In 2010 the Expert Panel considered whether franchisors attributing legal costs to franchisees was inappropriate in a franchising relationship. The Expert Panel found that clauses attributing legal costs may be used for a variety of legitimate business purposes, and are not uncommon in other industries. Accordingly, it did not recommend an outright ban on clauses attributing legal costs.

On the other hand, it was argued that attributing legal costs may serve as a significant financial disincentive for the

franchisee to initiate legal action against the franchisor, and that such clauses may be used inappropriately. As a result, the Franchising Code was amended to require franchisors to disclose whether they will attribute their costs, including legal costs incurred in dispute resolution, to the franchisee.

Disclosure of rebates and other financial benefits

It is important for franchisees to know if a franchisor is receiving rebates and/or other financial benefits from the supply of goods or services to franchisees.

Franchisors are now required to disclose *from whom* they receive rebates and financial benefits (previously the franchisor was required to only disclose whether a rebate would be received and whether it would be shared with franchisees).

Financial reports for marketing and cooperative funds

It is common for a franchise agreement to require franchisees to pay money to a franchisor to market the franchise business (usually known as a “marketing fund”). Concerns have been raised in the past about franchisees not having enough information about how marketing funds are used. The Franchising Code was amended to require franchisors to provide franchisees with a statement detailing the receipts and expenses for such funds each financial year. The statement must be provided within three months of the end of each financial year (previously franchisees were only entitled to receive this information if they specifically requested it, in writing, from the franchisor).

Additionally, a franchisor is now required to have the marketing fund statement audited each year and provide franchisees with a copy of the auditor’s report. However, this is not required if 75 per cent of franchisees agree that it is not necessary. If franchisees agree it’s not necessary, that decision must

be remade every three years for the franchisor to rely on it.

Financial details of franchisor

It is important for franchisees to have confidence and an understanding of the financial position of the franchisor. This is important in assisting franchisees to assess the risk of franchisor failure, among other things (see discussion above).

The Franchising Code requires franchisors to provide franchisees with certain information regarding their financial position as part of the disclosure document. A franchisor must provide a signed statement that, as at the end of the last financial year, there are reasonable grounds to believe the franchisor will be able to pay its debts as and when they fall due (ie, that the franchisor is solvent).

Additionally, a franchisor must provide:

- A copy of an independent company audit in support of the statement that the franchisor is able to pay its debts as and when they fall due; **OR**
- Company financial reports produced in accordance with the *Corporations Act 2001* (Cth).

The Franchising Code was amended to also allow franchisees to request financial reports of any consolidated entity that is required to provide reports under the *Corporations Act 2001* (Cth). This will

assist franchisees where their franchisor is only one member of a group of companies whose finances may be closely intertwined. However, this requirement does not apply if the franchisor provides the franchisee a copy of an independent company audit in support of the statement that the franchisor is able to pay its debts as and when they fall due.

Lease arrangements

A franchisor must disclose in a disclosure document the franchisor's policy for selection of the site to be occupied by the franchised business and the territory in which the franchised business is to operate. A franchisor must also disclose details of whether the territory or site was operated by a previous franchisee and, if so, details of the former franchised business, including the circumstances in which the previous franchisee ceased to operate.

Previously it was possible for the franchisor to only make this information available for viewing by the franchisee (that is, unless the franchisee took the initiative to seek out the information, it wouldn't necessarily be provided to them). Following an amendment in 2008, however, the franchisor must now provide this information to the franchisee with the disclosure document.

Discussion questions:

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

Contract variation, transfer and novation

During the 2008 Joint Committee and the 2010 Expert Panel inquiries, concerns were raised about franchisors varying a franchise agreement without negotiating the variation with the franchisee (known as a unilateral variation). This behaviour was considered particularly

concerning if it occurred while a franchisee was trying to sell a franchise by transferring or novating the franchise agreement.

Under the Franchising Code, a **transfer**, for a franchise, includes an arrangement in which the franchise is granted, transferred or sold, while a **novation** means the termination of the franchise and entry into a new franchise with a proposed transferee on the same terms as the terminated franchise.

Unilateral variation

There can be legitimate business reasons for a franchisor unilaterally varying a franchise agreement (or other documents such as operations manuals which form part of a franchise agreement). While such changes may seem unfair from one franchisee's perspective, the changes may be in the best interests of a franchise system as a whole - for example changes to occupational health and safety policy or changes to products that make the overall franchise business more profitable for all franchise participants. The Expert Panel identified the issue of unilateral variation as a complex one involving competing perspectives.

The Franchising Code was amended in 2010 to require franchisors to disclose to franchisees the circumstances in which the franchisor has unilaterally varied a franchise agreement in the last three financial years and the circumstances in which unilateral variations to their agreement may take place in the future.

Transfer and novation

The ability of franchisors to change the terms of a franchise agreement at the time of sale and the delays associated with making these changes, can be problematic for those franchisees who are wishing to sell the franchise. These changes can also make the franchise less attractive to prospective franchisees; for example, changes could reduce the term of the agreement, reduce the territory of the agreement and/or reduce the potential return on investment for prospective franchisees. Franchisees may feel that when such changes make the business less attractive they are potentially receiving less return on their investment.

On the other hand, franchisors may wish to re-negotiate the terms of a franchise agreement at the time of sale given they are entering into a new relationship. It is also possible that any changes introduced at the time of sale represent changes that the franchisor has already introduced into its other agreements.

The Expert Panel was therefore of the view that the most appropriate approach to this issue is to ensure there is adequate upfront disclosure to prospective franchisees on the processes that will apply if a franchisee seeks to sell the business. Accordingly, following amendments to the Franchising Code in 2010, a franchisor must now disclose whether it will amend or require the amendment of the franchise agreement on or before the transfer or novation of the franchise.

Discussion questions:

5. Have the amendments regarding unilateral variation, transfer and novation been effective in addressing concerns about franchisors' ability to make changes to franchise agreements? Why or why not?
6. Does the sector have any concerns regarding the operation of these amendments?

Disclosure regarding franchisor conduct

During the 2008 Joint Committee and the 2010 Expert Panel inquiry, concerns were raised about franchisor's conduct towards their franchisees. Accordingly, a number of amendments to the Franchising Code were designed to better inform the business decisions of franchisees and prospective franchisees by disclosing more information about the conduct of the franchisor.

Access to franchisees

It is important for prospective franchisees to have information about former franchisees and their businesses. Such information is important because it may assist a prospective franchisee to obtain information regarding the viability of the franchise, practical issues in running the franchise business, and the level of assistance from the franchisor.

Further, the level of movement in and out of the franchise system and the reasons for that movement are also likely to be relevant to a prospective franchisee.

In 2008, the Franchising Code was amended to require that a franchisor's disclosure document must provide contact details for franchisees who have left the franchise system in the last three financial years (unless the former franchisees have requested that their details not be disclosed).

The ability of prospective franchisees to communicate with existing franchisees was also improved by an amendment to clarify that franchisors must not induce prospective franchisees not to associate with other franchisees or prospective franchisees for a lawful purpose.

Confidentiality clauses

It is common for franchise agreements to contain clauses requiring the parties to keep certain information about the agreement or the relationship confidential. The Expert Panel was asked to consider whether this is appropriate in a franchising relationship.

The Expert Panel considered that confidentiality clauses are commonly and legitimately used in ordinary commercial life as a measure to protect commercial interests. However, confidentiality obligations may effectively prevent past and present franchisees from openly discussing their franchise experiences with prospective franchisees, which frustrates in part the intention of 2008 amendments to the disclosure regime to require disclosure to prospective franchisees of the names, location and contact details of past and present franchisees. Additionally, such clauses may effectively prevent franchisees discussing important matters relating to their arrangements with other franchisees in the system, which diminishes the value of (but does not violate) the freedom of association of franchisees and prospective franchisees.

Accordingly, in 2010 the Franchising Code was amended to require franchisors to disclose to prospective franchisees whether a confidentiality obligation will be

imposed on them, and what could be covered by the confidentiality obligation, like:

- Outcomes of mediation;
- Settlements;
- Intellectual property;
- Trade secrets; and
- Particular aspects of individual agreements, such as fees.

Materially relevant facts

The Franchising Code requires franchisors to provide a form of 'continuous disclosure' to franchisees if certain things – known as materially relevant facts – occur in the franchise. Examples include changes in the majority ownership or control of the franchisor, and certain litigation involving the franchisee. Previously franchisors were required to disclose materially relevant facts within 60 days after becoming aware of them; however this has changed to 14 days.

An amendment was also made to include franchisor directors among people about whom certain materially relevant facts must be disclosed. The scope of disclosure was extended by modifying the definition of "serious offence" to include a contravention

of any provision of the *Corporations Act 2001* (Cth).

Undertakings

Undertakings given to the ACCC by a party under the CCA are voluntary and legally enforceable. They might be given in many different circumstances, including to settle or avoid proceedings alleging that the party has breached the CCA.

Previously, franchisors were required to disclose, in their disclosure document, the date of previous orders or undertakings. However, this did not include information about subsequent undertakings. As of 2008, undertakings to the ACCC are materially relevant facts requiring disclosure by a franchisor within a reasonable time (but not more than 14 days) after the undertaking or order is given.

Good faith

The Franchising Code was amended to clarify that nothing in the code limits any obligation to act in good faith under the common law (see Part Three: Good faith in franchising', below).

Discussion questions:

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?
8. Is the information being provided useful to franchisees?
9. What effect has the requirement to provide this additional information had on franchisors?
10. Does the sector have any concerns regarding the operation of the new provisions?

Disclosure exemption for foreign franchisors

A 2008 amendment to the Franchising Code removed an exemption from the Code's requirements for foreign franchisors. As a result the Franchising Code applies to a franchise agreement even if the franchisor is "resident, domiciled or incorporated outside Australia", and grants only one franchise or master franchise to be operated in Australia.

In the review of the disclosure provisions of the Franchising Code during 2006 which led to the 2008 amendments, it was argued that the exemption should be removed on the basis that foreign franchisors were targeting potential Australian franchisees with a view to recruiting single unit franchisees for business concepts that were untested in the Australian market. It was considered that the franchisees being recruited were not experienced business operators, and given the substantial skill and capital that may be required from a Master Franchisee to establish a franchise system in Australia from scratch, it might be problematic for inexperienced operators not to have the benefits of disclosure.

Accordingly, the 2006 review recommended the removal of the exemption and the government agreed with this and removed it in 2008.

In 2008 the Joint Committee received a submission from the International Franchise Association arguing that the removal of this exemption was highly burdensome for franchise systems that were not engaged in current sales activity in Australia.²² The Joint Committee did not make any specific recommendation in relation to the foreign franchisor exemption.

Discussion questions:

11. What impact has the removal of the foreign franchisor exemption had on the sector?
12. Has the removal of the exemption caused any issues?

Efficacy of the disclosure amendments as a whole

A key question for this review is whether the 2008 and 2010 disclosure amendments provide adequate information to potential franchisees, without being too onerous and burdensome for franchisors.

In addition to looking at individual amendments, it is important to consider whether any considerations arise from the cumulative effect of the amendments.

Discussion questions:

13. On the whole, do the 2008 and 2010 disclosure amendments ensure franchisees are provided with adequate information?
14. Is the extra onus on franchisors justified by the benefit this disclosure is providing to franchisees?

²² See above, note 13, at page 49.

Part Three: Good faith in franchising

Overview

This section considers calls for an overarching obligation to act in good faith to be inserted into the Franchising Code.

From time to time calls have been made for an overarching standard of conduct – such as an obligation to act in good faith – to be imposed on the franchising relationship by law. Such calls have typically accompanied allegations of opportunistic conduct by franchisors taking advantage of the potential imbalance of bargaining power between franchisors and franchisees.

The question of whether an explicit obligation to act in good faith should be inserted into the Franchising Code has been raised in the context of various recent inquiries into franchising. The Joint Committee report recommended that the Franchising Code prescribe the following standard of conduct:

“Franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.” (Recommendation 8)

Additionally, the 2008 SA Parliamentary report recommended that an obligation to act in good faith be inserted into the Franchising Code.²³ The 2011 WA Parliamentary inquiry considered that, ‘if a general statutory obligation to act in good faith is to be imposed into franchising legislation, it should be pursued at the Commonwealth level during the next review of the effectiveness of [the 2010] amendments...’.²⁴ Former private members’ bills allowing for regulation of the franchising sector in SA and WA have also included explicit obligations to act in good faith.²⁵

Rather than inserting an obligation to act in good faith into the Franchising Code, the government made specific amendments designed to directly address the sorts of issues that were leading to calls for good faith in franchising.

Several other amendments made to the Franchising Code in 2010 – discussed elsewhere in this paper (particularly under Part Two – Disclosure under the Franchising Code of Conduct) were also aimed at addressing specific issues in franchising. Some of these issues may have been addressed indirectly by inserting an obligation to act in good faith into the Franchising Code, however this would have depended on the definition and/or interpretation of an obligation to act in good faith, which could be subject to individual interpretation, and interpretation by the courts. This may require parties to incur legal costs. Addressing specific issues of concern was intended to make it clear to all parties what they needed to do to comply with the Franchising Code.

²³ Refer to: 2008 inquiry by the South Australian Parliament’s Economic and Finance Committee, report titled *Franchises*, at page 98.

²⁴ Refer to the report of the Western Australian Parliament’s Economics and Industry Committee inquiry into the Franchising Bill 2010 (WA), at page xviii.

²⁵ Refer to: Franchising (South Australia) Bill 2009 (SA) (lapsed), Part 2; Franchising Bill 2010 (WA) (defeated), Part 3; Franchise Agreements Bill 2011 (WA) (lapsed), Part 3. See also, Small Business Commissioner and Small Business Protection Bill 2012 (NSW), Part 3.

The Franchising Code was also amended in 2010 to clarify that it does not limit any obligation imposed by the unwritten law (also known as the common law) on parties to a franchise agreement to act in good faith. This explicitly preserved and drew attention to parties' potential ability to take action pursuant to the common law relating to good faith.

Despite the 2010 amendments, some have continued to call for the Franchising Code to include an explicit obligation of good faith. For example, the Franchise Agreements Bill 2011, which lapsed with the prorogation of the WA Parliament on 14 December 2012, contains an explicit obligation requiring franchisors and franchisees to act in good faith.²⁶

The debate regarding good faith in franchising is a polarising one. On the one hand, some believe that to improve standards of conduct, the Franchising Code should contain an explicit requirement that franchisees and franchisors act in good faith. On the other hand, others argue against this, saying it would introduce uncertainty into the franchising relationship and drive up the costs of franchising, without providing any significant additional protection to franchisees. These were key concerns in decisions not to insert an obligation to act in good faith into the Franchising Code.

Franchisors and franchisees are bound by written and unwritten laws relating to contracts. These apply in addition to the Franchising Code requirements and may require franchisors and franchisees to act in good faith toward one another in certain circumstances.

The scope and content of the duty in the unwritten law to act in good faith is uncertain. Generally, it would be necessary for franchisors and franchisees to obtain legal advice to understand how the obligations in the unwritten law affect their actions and the franchising agreement. Franchisors and franchisees are also likely to disagree about whether or not the other has acted in good faith, in which case court proceedings may be needed to establish whether a breach occurred or not.

In addition to the unwritten laws about good faith, franchisors and franchisees are already subject to two over-arching statutory obligations relating to fair conduct. The ACL prohibits, among other things, misleading or deceptive conduct, false or misleading representations and unconscionable conduct. Considerations relevant to whether a party has engaged in unconscionable conduct include the extent to which the party acted in good faith, and the relative bargaining power of the parties.

The question also arises of whether an overarching and unlimited obligation to act in good faith is consistent with the nature of industry codes. It is government policy that industry codes should clearly and unambiguously set out requirements and obligations, rather than aims and ideals.²⁷

These and other factors relevant to introducing an explicit obligation of good faith into the Franchising Code were canvassed in detail in the government's Regulatory Impact Statement to inform the government's response to the 2008 Joint Committee Report (see "Further Reading" below).

²⁶ Franchise Agreements Bill 2011 (WA) (lapsed), Part 3.

²⁷ This is a requirement set out in the *Policy Guidelines on Prescribing Industry Codes*, published by the Commonwealth Treasury in May 2011. See in particular page 6.

Discussion questions:

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?
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?
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?
18. If an explicit obligation of good faith is introduced, should 'good faith' be defined? If so, how should it be defined?
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?
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?
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?
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?

Further reading:

- [Regulation Impact Statement accompanying the Government's response to the Joint Committee on Corporations and Financial Services' report on franchising](#), in particular pages 45 – 65
- [Report of the Parliamentary Joint Committee on Corporations and Financial Services: *Opportunity not opportunism: improving conduct in Australian franchising*](#), in particular Chapter 8

Part Four: End of term arrangements for franchise agreements

Overview

This section considers the position of franchisees at the end of the term of their franchise agreement.

During recent inquiries into franchising, an issue that has continued to cause concern is the rights of franchisees when a franchise agreement comes to an end.

Franchise agreements can end through early termination, through expiry without renewal, or by the sale of the franchised business by the franchisee (usually requiring the approval of the franchisor). When a franchise agreement expires or is terminated early, the franchise business may be closed or be sold to a new franchisee.

Alternatively, a franchise agreement may be renewed. Sometimes a franchise agreement contains clauses which state that a renewal (or multiple renewals) will be offered at the end of the franchise term. This is usually conditional on certain matters, for example if the franchisee is in breach of the franchise agreement then the franchisor may choose to refuse to renew a franchise agreement.

The principal issues regarding end of term arrangements have been:

- Franchisors terminating or refusing to renew franchise agreements when they do not have 'good cause' for doing so; and
- Lack of clarity and/or fairness regarding the benefits the franchisee is entitled to when they leave the franchise, in recognition of their contribution to the 'good will' of the franchise system as a whole.

Evidence presented to the Joint Committee in 2008, and to the various state inquiries into franchising, has indicated that the renewal of franchise agreements is an area where franchisors and franchisees often disagree. Additionally, information from the Office of the Franchising Mediation Advisor (OFMA) indicates that, for the 2011 – 2012 financial year, exit issues were a common reason for enquiring with OFMA. However, it might be expected that the end of a franchise agreement is a common time for disputes to arise between franchisors and franchisees.

In 2010, amendments to the Franchising Code addressed some of the concerns about end of term arrangements. Briefly, the amendments included a new obligation for franchisors to provide six months' notice of their decision to renew, or not renew, a franchise agreement, and requiring franchisors to disclose to franchisees, at the beginning of the franchise relationship, what the arrangements will be at the end of the term of the franchise agreement – for example, whether the franchisee will be entitled to any compensation for 'significant capital expenditure' or an 'exit payment' (a term sometimes used to mean a payment for good will) when they leave the franchise system.

These obligations were introduced on the basis that disclosing this information would be likely to assist in mitigating disputes where the franchisee has an expectation (not shared by the franchisor) that the agreement would be renewed. It would also help to address imbalances in power between franchisees and franchisors by assisting prospective franchisees to undertake their due diligence to adequately assess the business opportunity prior to entering into a franchise agreement.

The amendments were in line with recommendations made by the Joint Committee in 2008. The Joint Committee considered that franchisors should be entitled to decline to renew franchise agreements on expiration if that is their choice, noting that it is not the role of the law to force unwilling parties to enter into any commercial arrangement.

One of the purposes of this review is to determine the effectiveness of those amendments in alleviating concerns about opportunistic or unfair conduct at the end of the term of franchise agreements.

Discussion questions:

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?

Part Five: Dispute resolution in franchising

Overview

This chapter discusses changes made in 2010 to facilitate effective dispute resolution between franchisors and franchisees.

As with any business relationship, it is possible for disputes to arise between franchisors and franchisees. However, the co-dependent nature of the franchisor-franchisee relationship makes addressing those disputes more difficult. Accordingly, the Franchising Code sets out a procedure which may be followed in resolving franchising disputes. Essentially, a franchisor or franchisee can notify the other party about the dispute and the parties can then try to agree about how to resolve it. If, after three weeks, the parties cannot agree, then the dispute can be referred by either party to the Office of the Franchising Mediation Adviser (OFMA) to appoint a mediator. Both parties must then attend mediation and try to resolve the dispute.

Submissions to the Joint Committee in 2008, and consultations undertaken at that time, suggested that some parties may be stalling negotiations and acting to deplete resources of the other party to frustrate the dispute resolution process under the Franchising Code.

Accordingly, in 2010, amendments were made to clarify that a party will be taken to be trying to resolve a dispute, as required by the Franchising Code, if the party approaches the resolution of the dispute in a reconciliatory manner, including doing any of the following:

- Attending and participating in meetings at reasonable times;
- At the beginning of the mediation process, making its intention clear as to what it is trying to achieve through the mediation process;
- Observing any confidentiality obligations that apply during or after the mediation process;
- Not taking action which has the effect of damaging the reputation of the franchise system during the dispute, including by providing inferior goods, services, or support; and
- Not refusing to take action during the dispute, including not providing goods, services or support, if the refusal to act would have the effect of damaging the reputation of the franchise system.

In addition to the procedures included in the Franchising Code and the services offered by OFMA, a number of other options are available when a dispute arises in a franchising relationship. One might be to lodge a complaint with the ACCC where one party believes that the other party may have breached the Franchising Code or the ACL. (See Part Six: Enforcement of the Franchising Code')

In some states, where the dispute relates to a contractual matter, it is possible to utilise state government funded bodies like the Victorian Small Business Commissioner (VSBC) or other private dispute resolution services. The VSBC operates services for small businesses which

are similar to those operated by OFMA for franchisees. Finally, and usually as a last resort, there is the option of litigation.

Dispute statistics

ACCC complaints data

Since 1 July 2010, the ACCC has published six-monthly statistical reports on franchising and small business complaints. Between 1 July 2010 and 31 June 2012, the ACCC received a total of 1 224 complaints from franchisees or franchisors, as compared to a total of 6 964 complaints from small business more generally. The most common complaints made to the ACCC regarding franchising relate to contractual issues (eg an allegation by one party to a contract that the other party has not complied with its obligations under the contract) and misleading conduct/false representations.

Complaint levels have more or less remained steady over the two years the ACCC has been publishing statistics, however the number of enquiries (as opposed to complaints) regarding franchising has dropped from an initial high of 224 for the second half of 2010, to 76 for the first half of 2012.

OFMA enquiries and mediations

Between 1 July 2011 and 1 July 2012, the OFMA received 458 enquiries. In total 81 disputes progressed through OFMA were settled and 34 were not settled. In total 110 mediators were appointed by OFMA during this period. The most common issues raised in disputes were compliance with the operations manual, exit arrangements, and misrepresentation/deception. Enquiries were most common in retail trade franchising.

Griffith University research

Griffith University's bi-annual survey of franchisors estimates that approximately 1.5 per cent of franchisees are in dispute with their franchisor.

Discussion questions:

24. Has conduct and behaviour 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?
25. Does the sector have concerns regarding the operation of the amendments?

Further reading:

- [ACCC statistics on the number and nature of complaints and enquiries regarding small business and franchising matters](#)
- Griffith University, [Franchising Australia 2012](#)
- [Website for the Office of the Franchising Mediation Adviser](#)

Part Six: Enforcement of the Franchising Code

Overview

This section considers the adequacy of the existing enforcement regime for the Franchising Code in light of calls for the ACCC to be able to pursue civil pecuniary penalties for breach.

As mentioned elsewhere in this Discussion Paper, the Franchising Code is a mandatory industry code made by regulation under the *Competition and Consumer Act 2010* (CCA). The CCA states that a person must not, in trade or commerce, contravene an applicable industry code. Therefore, a breach of the Franchising Code is a breach of the CCA and the enforcement of the Franchising Code is through the enforcement provisions of the CCA. The Australian Consumer Law (ACL) and, to a lesser extent, the unwritten law, also regulate the conduct of parties to a franchise agreement. The ACCC enforces the Franchising Code, the CCA, and the ACL.

A court is able to apply a range of remedies (see below 'Possible consequences of breaching the Franchising Code') under the CCA when it determines a franchisor or franchisee has breached the Franchising Code. These remedies are aimed at providing redress to industry participants in the event of a breach of an industry code (rather than penalising such breaches). This reflects government policy that industry codes made under Part IVB of the CCA are co-regulatory measures aimed at achieving minimum standards of conduct in an industry rather than a stricter form of regulation.

Possible consequences of breaching the Franchising Code

- Compensation for loss caused by the contravening conduct: section 82
- Injunctions (ie orders that a party must do, or stop doing, an act): section 80
- Remedial orders of a court including an order to void the whole or part of a contract, vary a contract, refuse to allow the enforcement of some provisions of the contract, or require the payment of refunds and/or damages to the aggrieved party: section 87
- Court enforceable undertakings to the ACCC: section 87B
- Public warning notice issued by the ACCC: section 51ADA
- Non-punitive orders, made by a court, such as a community service order, a probation order, a disclosure order and/or the publication of corrective advertisements: section 86C

(References are to sections of the CCA)

In some cases a breach of the CCA and ACL, where it is not dealt with as a breach of an industry code, such as the Franchising Code, can result in a court imposing a civil pecuniary penalty. This might occur when a franchisor makes a misrepresentation when issuing a discussion paper to franchisees, for example.

The CCA contains both criminal offence provisions and civil penalty provisions. In making legislation, the Government has decided whether it is appropriate that particular conduct be punishable by a civil or criminal penalty. It is important to understand the distinction between civil and criminal penalties that results when these provisions are contravened.

Both civil and criminal penalties are imposed with a view to deterring and/or punishing contraventions of the law. However, criminal penalties go one step further than civil penalties and have more significant consequences. These can include the recording of a conviction, the imposition of a higher pecuniary penalty or imprisonment. Recognising these more significant consequences, criminal offences attract heightened procedural protections.

Some in the franchising sector have argued that civil penalty provisions are necessary in order to ensure that there are consequences for non-compliance with the Franchising Code, even if it is difficult to establish a basis for other types of civil remedies, which may, for example, require proof that loss or harm was suffered as a result of the contravention.

During the various inquiries into franchising, there have been several recommendations regarding enforcement of the Franchising Code and the possible introduction of civil pecuniary penalties for breaches of the Franchising Code.²⁸

The Joint Committee Report, for example, recommended ‘...the *Trade Practices Act 1974* (to) be amended to include pecuniary penalties for breaches of the Franchising Code of Conduct.’²⁹

In making this recommendation, the Joint Committee referred to evidence from the ACCC and stated that the ‘implementation of such penalties would also in part address concerns that the Franchising Code and/or the regulator lack teeth.’ Similar recommendations were made in the 2008 SA Parliamentary Report³⁰ and the WA SBDC 2008 report.³¹

Partly in response to these recommendations, and calls for greater enforcement measures for the Franchising Code, in 2010 the Government introduced a range of amendments to the CCA, to strengthen enforcement powers and remedies under the Act. These include giving the ACCC the power to:

- Issue substantiation notices that require a person to provide “information and/or produce documents that could be capable of substantiating or supporting a claim or representation made by the person”;
- Randomly audit parties bound by industry codes for non-compliance with the applicable code;

²⁸ See above, note 12, in particular Recommendations 9 and 10; South Australia Parliamentary Economic and Finance Committee, *Franchises*, May 2008, p. 42; and the Western Australian Small Business Development Corporation, *Inquiry into the Operation of Franchise Businesses in Western Australia*, April 2008, p. 31.

²⁹ See above note 12, page xvii (Recommendation 9).

³⁰ South Australia Parliamentary Economic and Finance Committee, *Franchises*, May 2008, p. 42

³¹ Western Australian Small Business Development Corporation, *Inquiry into the Operation of Franchise Businesses in Western Australia*, April 2008, p. 31. It should be noted that the Corporation’s final recommendations did not include criminal sanctions.

- Apply for civil pecuniary penalties in response to certain breaches of the CCA and the ACL, including unconscionable conduct and false or misleading representations, with maximum penalties of \$1.1 million for corporations and \$220,000 for individuals;
- Apply to a court for an order providing redress to all affected franchisees, without requiring every franchisee to be party to the legal proceeding; and
- Issue public warning notices alerting the public to conduct which may be in breach of certain provisions of the ACL.

However, the government did not amend the CCA to provide that the ACCC can seek a civil pecuniary penalty for breach of an industry code, including the Franchising Code. The reason for this is tied to the nature of industry codes. Industry codes, like the Franchising Code, are '...co-regulatory measures, designed to achieve minimum standards of conduct in any industry where there is an identifiable problem to address. Industry codes can be used as an alternative to primary legislation in instances where a market failure has been identified.'³² Further, industry codes are 'complementary to general prohibitions on unfair practices that may occur in trade or commerce, and should encourage compliance and focus on remedies rather than simply seeking to punish contraventions.'³³

Further, the imposition of large penalties on a franchisor may have the potential to affect the viability of the franchisor's business. While this may be a reasonable repercussion insofar as the franchisor is concerned, there is potential for flow on effects to franchisees. For example, support from the franchisor might be reduced, or the franchisor might increase franchise fees to accommodate the extra risk created by the possible imposition of pecuniary penalties.

Notwithstanding this, the government undertook to keep the matter of civil penalties for industry code breaches under review, while allowing time for the extensive changes to the Franchising Code to take effect.³⁴

It is important to distinguish between a breach of the Franchising Code and a breach of the ACL. While franchisors and franchisees cannot incur a pecuniary penalty for a breach of the Franchising Code, a court can impose a pecuniary penalty for a breach of certain provisions of the ACL, including provisions relating to false or misleading representations about business activities and unconscionable conduct. The same conduct can constitute a breach of both the Franchising Code as well as the ACL.

Example of unconscionable conduct: unreasonable franchise conditions (extract)

A franchisor demanded and obtained from some of its franchisees a 50 per cent weekly fee increase for access to a national telephone number those franchisees relied upon to receive consumer inquiries and work. The franchisor disconnected some of the franchisees from the telephone number when they failed to pay the full fee increase and it also required existing franchisees to vary their franchise agreements to include the fee increase.

The court found that the franchisor abused its position of strength and engaged in conduct that involved misstatements, non-disclosure of information, threats and intimidation. The

³² See above, note 21, at page 3.

³³ See above, note 21, at page 9.

³⁴ See Government Response to the Joint Committee report, at page 11.

court also found that the conduct amounted to unilateral profit gouging and all the elements together, demonstrated that the franchisor's conduct was unconscionable.

(ACCC v Seal-A-Fridge Pty Ltd)

Further reading: [ACCC Business Snapshot – Unconscionable Conduct](#)

Additionally, the ACCC can issue an infringement notice where it has reasonable grounds to believe a person has contravened provisions of the ACL, including those relating to false or misleading representations about business activities and unconscionable conduct. The main difference between a pecuniary penalty and an infringement notice is that a pecuniary penalty is imposed by a court, whereas an infringement notice can be issued by the ACCC without the involvement of the courts.

Payment of an infringement notice is not an admission by the recipient that they have breached the ACL. The penalty amount in an infringement notice will vary, depending on the alleged contravention, but in most cases is fixed at \$6600 for a corporation (or \$66,000 for a listed corporation) and \$1320 for an individual for each alleged contravention. For this reason, the amount payable under infringement notices is usually much less than might be awarded by a court when ordering a pecuniary penalty. The ACCC cannot issue an infringement notice for a breach of the Franchising Code.

Role of the ACCC

The ACCC is an independent statutory authority formed under the CCA. It is important that any consideration of the enforcement of the Franchising Code have regard to the role of the ACCC and its enforcement and compliance policies. It is part of the Treasury portfolio and its primary responsibility is to ensure that individuals and businesses comply with the Commonwealth's competition, fair trading and consumer protection laws. As part of this, it educates the industry about the application of the Franchising Code, the ACL, and other fair trading and competition laws.

The ACCC also funds a pre-entry education program for prospective franchisees, which is administered by Griffith University, and has drawn a large number of registrations. More than 3,500 people have now signed up to do the course.

Statistics regarding enquiries and complaints received by the ACCC regarding franchising are cited at page 27.

Examples of recent enforcement action taken by the ACCC against alleged breaches under the CCA by franchisors include:

- In 2011, the ACCC instituted proceedings in the Federal Court against Sensaslim Australia Pty Ltd and several of its officers alleging misleading and deceptive conduct and false representations in relation to the identity of Sensaslim officers, the Sensaslim spray and the business opportunities offered by Sensaslim. The matter does not involve Franchising Code breach allegations.

- In 2010, the ACCC sought and obtained numerous Federal Court orders against Allphones Retail Pty Ltd and individuals who were involved in misleading and unconscionable conduct and contraventions of the Franchising Code. The court ordered that Allphones and its CEO and COO pay \$3 million in damages to franchisees represented by the ACCC.
- In 2010, the Federal Court found that the national Seal-A-Fridge franchisor had engaged in unconscionable conduct and failed to comply with the Franchising Code of Conduct by unilaterally imposing fee increases on its franchisees for use of the Seal-A-Fridge national phone number, which franchisees used to receive customer enquiries and work requests. The court ordered Seal-A-Fridge to implement and maintain a complaint handling system for three years.
- In 2009, the Federal Court declared that Personalised Chocolates 4U Pty Ltd and its sole director mislead franchisees and engaged in conduct in breach of the Franchising Code.

The ACCC has served audit notices on 33 franchisors since the audit power was introduced. While the majority of the franchisors audited have been found to be compliant with the Franchising Code, the audits have revealed a small number of breaches. The ACCC is working with these franchisors to ensure they are complying with the Franchising Code going forward.

ACCC Compliance and enforcement policy (extract)

The ACCC cannot pursue all the complaints it receives and the ACCC is unlikely to become involved in resolving individual disputes. While all complaints are carefully considered, the ACCC's role is to focus on widespread consumer detriment and the ACCC exercises its discretion to direct resources to the investigation and resolution of matters that provide the greatest overall benefit for consumers. To assist with this determination the ACCC gives enforcement priority to matters that demonstrate one or more of the following factors:

- Conduct of significant public interest or concern
- Conduct resulting in a substantial consumer (including small business) detriment
- Anticompetitive conduct involving cartel behaviour or misuse of market power
- Unconscionable conduct, particularly involving large national companies or traders
- Conduct demonstrating a blatant disregard for the law
- Conduct involving issues of national or international significance
- Conduct detrimentally affecting disadvantaged or vulnerable consumer groups
- Conduct in concentrated markets which impacts on small business consumers or suppliers
- Conduct involving a significant new or emerging market issue
- Conduct that is industry-wide or is likely to become widespread if the ACCC does not intervene
- Where ACCC action is likely to have a worthwhile educative or deterrent effect
- Where the person, business or industry has a history of previous contraventions of competition, consumer protection or fair trading laws

Where appropriate, the ACCC may also pursue matters that test or clarify the law.

Further reading: [ACCC Compliance and enforcement policy](#).

Discussion questions:

26. Is the current enforcement framework adequate to deal with the conduct in the franchising industry?
27. How can compliance with the Franchising Code be improved?
28. What additional enforcement options, if any, should be considered in response to breaches of the Franchising Code?
29. What options are available to businesses to address breaches of the Franchising Code, or any other adverse conduct in the franchising industry?

Appendix A: Summary of 2008 and 2010 amendments

2008 amendments (See: <u>Trade Practices (Industry Codes - Franchising) Amendment Regulations 2007</u> . The following summary is adapted from the <u>Explanatory Statement</u> that was published in support of the 2007 Amendment Regulations.)	
Franchise agreement	Franchisees will be provided with a copy of the franchise agreement in the form it is intended to be executed with the disclosure document (as opposed to only being provided with a summary of the franchise agreement).
Time for provision of documents	Copies of documents relating to the franchise agreement, where available, must be provided at least 14 days before the franchise agreement is signed. Where the documents are not available at that time, the documents are to be provided to the franchisee or prospective franchisee when they become available.
Disclosure of section 87B undertakings	Details of section 87B undertakings under the then <i>Trade Practices Act 1974</i> by franchisors, must be disclosed to franchisees within 14 days (as opposed to the previous 60 days). These undertakings are voluntary and legally enforceable undertakings that a party may give to the Australian Competition and Consumer Commission to, for example, settle or avoid proceedings alleging that the party has breached the <i>Competition and Consumer Act 2010</i> (Cth).
Disclosure of rebates and financial benefits	Franchisors are required to disclose in their disclosure documents from whom they receive rebates and financial benefits to increase the transparency of the relationship between the franchisor and franchisees.
Marketing and other cooperative funds	Details of the expenses of marketing and other cooperative funds must be provided by franchisors to franchisees. If 75 per cent of franchisees agree that annual audits need not be undertaken, then this requirement does not need to be complied with, however, franchisees have to be renew this decision every three years.
Contact details for ex-franchisees	The last known particulars of name(s) and contact details of each ex-franchisee must be disclosed, unless the ex-franchisee requests that it be withheld. Franchisors are not required to update this contact information nor keep it for more than three years.
Disclosure of business experience	The business experience of all officers of the franchisor ("officers" as defined by the <i>Corporations Act 2001</i> (Cth)) must be disclosed. Formerly, the Franchising Code excluded an "executive officer" from the class of persons about whom a summary of relevant business experience in the last 10 years must be provided. "Executive officer" was defined through a reference to repealed legislation and thus the term was removed.
Provision of financial reports	Financial reports must be supplied within four months, as opposed to the former three months. (This is in line with the <i>Corporations Act 2001</i> (Cth)).

Franchisees can request additional information	Prospective franchisees to whom the 'short form' disclosure document applies will be able to request any of the additional information in the 'long form' document. Formerly, franchisors could refuse to provide this information.
Disclosure of materially relevant facts	Disclosure of materially relevant facts to franchisees must be provided within 14 days. The former requirement of 60 days was considered to be an unreasonably long period of time.
Foreign franchisors	Foreign franchisors are no longer exempt from the Franchising Code.
Disclosure of information re directors	Materially relevant facts concerning franchisor directors need to be disclosed to prospective and existing franchisees and the scope of disclosure was extended from just serious offences (defined as an offence under any Australian law for which there is a jail term of more than 5 years for a first conviction) to also include contravention of any provision of the <i>Corporations Act 2001</i> (Cth).
Freedom of association	Franchisors are forbidden from inhibiting <i>prospective</i> franchisees from communicating with each other or existing franchisees. This added to the former prohibition on franchisors inhibiting franchisees from communicating with each other for lawful purposes.
Waivers in franchise agreements	General waivers (ie broad disclaimers) regarding prior written or verbal representations are not permitted in franchise agreements.
Consolidated entities	Where the franchisor is part of a consolidated entity required to produce audited financial reports under the <i>Corporations Act 2001</i> (Cth) for that consolidated entity, those reports must be provided to franchisees on request. In the case of foreign franchisors, the use of their local accounting standards and auditors is accepted.
Franchise site details	The details and history of the territory or site to be franchised must be provided together with the disclosure document. Formerly this information was not required to be supplied together with the disclosure document, but rather was only required to be made available for viewing. (Note this requirement only applies to the long-form disclosure document, however it can be requested by franchisees whose franchisor provides them with the short-form disclosure document.)
Associates	The definition of "associate" of a franchisor now includes a person who supplies real property to a franchisee. This makes it clear that franchisors have to disclose information about rental and other property expenses.
Copy of the Franchising Code	A copy of the Franchising Code must be provided with the disclosure document.
Extension of term or scope of franchise agreement	A current disclosure document must be provided when either the scope or term of a franchise agreement is proposed to be extended.
Need for long-form disclosure	Clarification that the long-form disclosure document will be required if the annual turnover of the franchised business is expected to be \$50,000 or more at any time during the term of the agreement.

Termination during cooling off period	Franchisors may charge a prospective franchisee for reasonable expenses incurred if an agreement is terminated by the prospective franchisee within the 'cooling off' period. Reasonable expenses will be permitted to be deducted from the amount returned by the franchisor to the franchisee if the expenses or their method of calculation have been set up in the agreement.
Disclosure re conditions relating to site and premises selection	Conditions that deal with obligations for a franchisee regarding site and premises selection and acquisition as well as maintenance and appearance of site and premises, vehicles and equipment within the franchise agreement will have to be noted.
2010 amendments (See: Trade Practices (Industry Codes - Franchising) Amendment Regulations 2010 and accompanying Explanatory Statement)	
Franchise Failure para 1.1(e) Annexure 1	Disclosure document to explain that the franchise/franchisor could fail and this would have consequences for the franchisee.
Payments to third parties para 13.6A Annexure 1	Franchisor must disclose payments within franchisor's knowledge/control, or reasonably foreseeable by the franchisor, that will be payable by the franchisee to a person other than the franchisor (or franchisor's associate)
Significant capital expenditure para 13A.1 Annexure 1	Franchisor must disclose whether the franchisee is to undertake unforeseen significant capital expenditure not disclosed before the franchisee entered the franchise agreement
Attribution of legal costs para 13B.1 Annexure 1	Disclosure document must state whether the franchisor will attribute the franchisor's costs (including legal costs) incurred in dispute resolution to the franchisee.
Unilateral variation para 17A Annexure 1 para 9A Annexure 2	Franchisors to disclose the circumstances in which they have unilaterally varied a franchise agreement in the last three years.
Confidentiality para 17B.1 Annexure 1 para 17B.2 Annexure 1 para 9B Annexure 2	Franchisors to disclose whether they will impose a confidentiality obligation on a franchisee and, if so, the matters concerned, including: <ul style="list-style-type: none"> • Outcomes of mediation; • Settlements; • Intellectual property; • Trade secrets; and • Particular aspects of individual agreements, such as fees.
Arrangements to apply at the end of the franchise agreement para 17C.1 Annexure 1 para 17C.2 Annexure 1 para 17C.3 Annexure 1 para 9C.1 Annexure 2 para 9C.2 Annexure 2 para 9C.3 Annexure 2	Franchisors required to disclose details of the arrangements that will apply at the end of the franchise agreement, including: <ul style="list-style-type: none"> • Whether the franchisee will have any options to renew, extend or extend the scope of the franchise agreement and, if so, the process the franchisors will use to determine whether to renew, extend or extend the scope of the agreement or enter into a new agreement; • Whether the franchisee will be entitled to an exit payment at the end of the franchise agreement and, if so, how the exit payment will be determined or earned;

	<ul style="list-style-type: none"> • Details of the arrangements that will apply to unsold stock, marketing material, equipment and other assets purchased when the franchise agreement was entered into – including whether the franchisor will purchase these assets and, if so, how prices will be determined; • Whether the franchisee will have the right to sell the business at the end of the franchise agreement and, if so, whether the franchisor will have first right of refusal, and how market value will be determined; and • Whether the franchisor will consider any significant capital expenditure by the franchisee during the franchise agreement in determining the arrangements to apply at the end of the franchise agreement.
Transfer or Novation para 17D Annexure 1 para 9D Annexure 2	Franchisor must disclose whether it will amend or require the amendment of the franchise agreement on or before the transfer or novation of the franchise.
Notice of Renewal clause 20A	Franchisor required to notify a franchisee at least six months before the end of the term of the franchise agreement of the franchisor's decision: <ul style="list-style-type: none"> • To renew/not renew the agreement; or • Enter a new agreement.
Good Faith Clause 23A	Nothing in the Franchising Code limits any common law obligation of good faith that applies to parties in a franchise agreement.
Behaviour in Dispute Resolution Sub-clause 29(8)	If either party refers a dispute to a mediator, both parties must attend the mediation and try to resolve the dispute. A party will be taken to be trying to resolve a dispute if they approach the resolution of the dispute in a reconciliatory manner. Behaviours that will be taken to indicate a reconciliatory manner are set out in the Franchising Code.
Costs of Mediation Sub-clause 31(4)	Parties equally liable for the costs of mediation unless they agree otherwise. These costs include: costs of the mediator; room hire; any additional input agreed by both parties to be necessary.