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Franchising Code Review Secretariat
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Dear Mr Wein

2013 Review of the Franchising Code of Conduct: supplementary information to ACCC submission

At our meeting on 25 February 2013, you requested some additional information to supplement the ACCC's submission to the Franchising Code Review, including the ACCC's view on how the Australian Consumer Law (ACL) might apply to certain end-of-term conduct by a franchisor, and to the re-sale of a franchise that repeatedly fails.

You also asked for an explanation of the ACCC's approach to promoting compliance with the Competition and Consumer Act (including the ACL and the Franchising Code of Conduct (the Code)).

Finally, you asked for guidance on the approach the ACCC would take if it had the ability to seek civil pecuniary penalties and the power to issue infringement notices for breaches of the Code.

I hope you find the following information useful.

1. Application of the ACL to end-of-term conduct and the re-sale of a continually failing franchise

A franchisor risks breaching the ACL in its dealings with franchisees and prospective franchisees if, for example, it engages in conduct that is unconscionable or misleading or deceptive. Below is a discussion of how the ACL could apply to two specific types of franchisor conduct: the non-renewal of a franchise agreement and the re-sale of a continually failing franchise.

Non-renewal of a franchise agreement at the end of its term

Whether or not the non-renewal of a franchise agreement is likely to raise concerns under the ACL will depend on all of the relevant circumstances. The following demonstrates some typical examples.

Examples

1. *A franchisee is in the fourth year of his second five year term (the franchise agreement is due to expire in 10 months). The franchisee would like to renew for a third term. The franchisor receives advice from its accountant that company-owned stores are far more profitable and that all franchised stores should gradually be converted to company-owned stores. On this basis, the franchisor advises the franchisee that it has decided not to renew his agreement.*

This behaviour is unlikely to raise concerns under the ACL or the Code. The franchisor has provided more than the amount of notice required under the Code (six months) and is making a genuine business decision.

2. *A franchisee is in the final year of his five year franchise agreement. The franchisee is regularly late in making payments and has breached the agreement on several occasions. The franchisor has also received multiple complaints about the franchisee's customer service. Seven months before the end of the agreement, the franchisor advises the franchisee that because of the reasons set out above, it will not be renewing his agreement.*

This conduct does not raise concerns under the Code or the ACL. The franchisor has provided the franchisee with sufficient notice and is making a genuine business decision to protect the value of its brand.

3. *A franchisee is in the ninth year of a 10 year franchise agreement. He paid \$500,000 for the franchise and is making an average net profit of \$55,000 per year. With 18 months of the franchise agreement term remaining, the franchisor decides that it will not be renewing the agreement. However, relying on the terms of the franchise agreement, the franchisor requires the franchisee to build a new showroom at a cost of \$300,000. The new showroom takes 10 months to complete. With eight months remaining on the agreement, the franchisor advises the franchisee that his agreement will not be renewed.*

So long as the possibility of unforeseen capital expenditure is disclosed in the disclosure document, there has not been a breach of the Code. However, the conduct could amount to unconscionable conduct under the ACL. The franchisor has forced the franchisee to outlay \$300,000 for a new showroom, knowing that it does not intend to renew the franchisee's agreement.

4. *Before buying a franchise, a franchisee was concerned that he may not be able to recoup his investment within the five year term, so he sought assurance from the franchisor that his agreement would be renewed. The franchisor provided a verbal guarantee that if the franchisee did not breach his agreement, it would be renewed for a further term. In fact, the franchisor intended to offer the franchise to his brother, and would only renew the franchisee's agreement if his brother was not interested in running the franchise. Every Christmas since then, the franchisor has given the franchisee a present and verbally reassured him that his agreement will be renewed at the end of its term. After four years, despite the franchisee having never breached the agreement, the franchisor advises the franchisee that he won't be renewing the agreement for personal reasons (his brother has accepted the offer to take on the franchise). The franchisor apologises for any inconvenience this has caused.*

This conduct is likely to raise concerns under the ACL (e.g. misleading or deceptive conduct). It is unlikely that the franchisee would have purchased the franchise had the franchisor not been willing to guarantee the renewal of the agreement.

Re-selling a franchise that keeps failing

Whether or not the re-sale of a failed franchise is likely to raise concerns under the ACL (most likely unconscionable conduct or misleading or deceptive conduct) will also depend on all of the relevant circumstances. Two examples follow.

Examples

- 5. A franchise has failed twice in the last year, with each of the franchisees forced into bankruptcy. Both franchisees had raised concerns with the franchisor about the lack of foot traffic in the area and the low turnover levels. Despite this, the franchisor puts the franchise on the market again for the full price (\$500,000). A prospective franchisee asks the franchisor why the previous franchisee left. The franchisor explains that the previous franchisee had to leave for health reasons and convinces the prospective franchisee to purchase the franchise. The franchise fails months later.*

This conduct is likely to raise concerns under the ACL (e.g. misleading or deceptive conduct and/or unconscionable conduct). The franchisor has sold the franchise for its full price despite knowing it is likely to fail, and has lied about the reason for the previous operator exiting the system.

- 6. A franchise has failed twice in the last year, with each of the franchisees forced into bankruptcy. Both franchisees had raised concerns with the franchisor about the lack of foot traffic in the area and the low turnover levels. The franchisor puts the franchise on the market again for a heavily discounted price. A prospective franchisee asks the franchisor why the previous franchisee left. The franchisor explains that the two previous franchisees have failed and explains the specific challenges pertinent to this opportunity. Believing he can turn things around, the franchisee decides to purchase the franchise. The franchise fails months later.*

This conduct is less likely to raise concerns under the ACL. The franchisor has sold the franchise at a significant discount and explained the challenges to the prospective franchisee.

2. ACCC approach to compliance and enforcement

The ACCC's approach to compliance and enforcement is outlined in its *Compliance and Enforcement Policy*¹, which is updated annually following a review of the ACCC's priorities. A copy of the recently revised policy is enclosed. This policy is applied to all complaints received by the ACCC, including franchising complaints.

The ACCC proposes to implement any new remedies and powers in a manner that is consistent with its approach to enforcing compliance with the current law.

To achieve its compliance objectives the ACCC employs three flexible and integrated strategies:

- enforcement of the law, including resolution of possible contraventions both administratively and by litigation.
- encouraging compliance with the law by educating and informing consumers and businesses about their rights and responsibilities under the *Competition and Consumer Act 2012*.
- working with other agencies to implement these strategies.

The ACCC has a range of compliance and enforcement tools in order to encourage compliance with

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<http://transition.accc.gov.au/content/item.phtml?itemId=867964&nodeId=78b0956fa087fe1ea3b08b9817ffa964&fn=ACCC%20Compliance%20and%20Enforcement%20Policy.pdf>

the CCA. The tools range from education, advice and persuasion through to enforceable undertakings and court-based outcomes. Court outcomes include declarations that a contravention has occurred, injunctions to prevent further contraventions and penalties to punish contraventions. In deciding which compliance or enforcement tool or the combination of tools to use, the ACCC's first priority is always to achieve the best possible outcome in the broader public interest.

Over the last decade the ACCC has been responsible for enforcing compliance with new laws and seeking newly enacted remedies. The ACCC's approach is based on its experience which is that most businesses are willing to comply with the law. We provide details about the new law to those who want to comply to and work to persuade those who are not convinced about complying.

Example of the ACCC's approach: the first 100 days of the carbon price

The ACCC ran an extensive education campaign in the lead up to the introduction of the carbon price mechanism (1 July 2012) and quickly pursued some early compliance outcomes following its introduction. The balance between education and the quick pursuit of early enforcement helped to show businesses how to do the right thing, with most businesses acting in accordance with the law. When they did not, the ACCC contacted them quickly and worked with them to help them comply.

In the first 100 days following the commencement of the carbon price, the ACCC received close to 2,500 complaints and enquiries – the majority coming from consumers and small businesses seeking information or wishing to report concerns about carbon price claims made in the marketplace. The ACCC conducted 50 initial investigations and 15 in-depth investigations into this conduct.

A number of sectors stood out as attracting a larger number of complaints, including the refrigerants industry. The ACCC through the course of its investigation of these matters received a small number of administrative resolutions and one enforceable undertaking from air conditioning and refrigeration repair companies in relation to alleged false and misleading representations regarding the impact of the carbon levy on the price of refrigerant gas. The ACCC then worked with the industry providing guidance to avoid making misleading statements.

The ACCC also issued over 40 formal and informal warning letters to traders in various sectors and sent out over 50 educative letters to traders providing them with information and guidance material about carbon price claims and the role of the ACCC.

Other public enforcement outcomes included a further enforceable undertaking accepted, one informal undertaking and one infringement notice paid.

ACCC approach to implementing new remedies and powers

New tools enhance its capacity to recognise this and provide a proportionate response to a compliance problem.

The ACCC's general approach is to adopt a two-step process. Firstly, to raise awareness; and secondly, to use the new laws in accordance with its *Compliance and Enforcement Policy*.

The ACCC has a history of working with the regulated community through peak bodies and by way of direct engagement to raise awareness of the new laws and remedies, and the ACCC's approach to enforcing compliance with them. In recent years the ACCC has taken advantage of new media to capitalise on its engagement network to extend the reach of its awareness raising activities through the use of webinars and social media. These new strategies have complimented the use of targeted publications and direct engagement.

3. Guidance on approach we propose to take when issuing Infringement Notices or seeking civil penalties if we were given this power.

The ACCC has almost three years of experience with infringement notices² and civil pecuniary penalties under the ACL. This is in addition to the ACCC's experience with pecuniary penalties for contraventions of the competition law provisions.

This background will inform its approach to any new remedies or powers to secure compliance with the Franchising Code. As outlined above, the ACCC uses a range of compliance and enforcement tools in order to encourage compliance with the CCA and targets their use to each factual circumstance.

ACCC consideration of the most appropriate mechanism to address consumer protection concerns will ordinarily include an evaluation of other options available to the ACCC to address its concerns, including court enforceable undertakings, civil proceedings (including seeking civil penalties), and criminal proceedings.

The ACCC determines the appropriate enforcement tools to address consumer protection concerns on a case by case basis, taking into consideration the alleged contravention, the business involved and the impact of the conduct on consumers and businesses. A benefit of the infringement notice provisions is that they allow for timely and efficient dispute resolution without the need for litigation.

ACCC approach to infringement notices

Since April 2010 infringement notices have been available for alleged contraventions of certain provisions of the Australian Consumer Law. Over 90 infringement notices have been paid by traders to resolve ACCC concerns.

Generally speaking, the ACCC will only consider issuing an infringement notice where it is likely to seek a court-based resolution should the recipient of the notice choose not to pay.

A recipient will almost invariably have some contact from the ACCC before receiving the infringement notice. The ACCC will raise its concerns with the business, outlining what they are and the options it considers appropriate under its *Compliance and Enforcement Policy* to resolve its concerns. The business will be given an opportunity to address the ACCC's concerns and be able to provide any information or documents to the ACCC that it considers relevant to the ACCC's concerns. It is important to note that before issuing an infringement notice the ACCC will have turned its mind to the prospect of the notice not being paid and be prepared to proceed to court if that is required.

Importantly, it is up to each business to decide whether it will offer an undertaking and/or pay the infringement notice penalty. Where a business declines to resolve a matter in this manner, the ACCC is likely to consider other enforcement options including court proceedings.

On over 15 occasions, multiple infringement notices have been paid in relation to the same matter. Of note are infringement notice penalties paid by Optus, Dodo, TPG and Foxtel to resolve concerns relating to representations in their mass media advertising.

² The ACCC has published Guidelines on the use of infringement notices, which provides background information and general guidance to businesses and their advisors on the ACCC's approach to issuing infringement notices under the CCA.
<http://transition.accc.gov.au/content/item.phtml?itemId=1085234&nodeId=63312bf426f4367e2c89035151812031&fn=Infringement%20notices.pdf>

The ACCC may issue multiple infringement notices where it considers it appropriate to do so, taking into account all of the circumstances. In deciding whether to issue more than one infringement notice, the ACCC takes into account a range of considerations including:

- whether the ACCC believes that there have been multiple contraventions of infringement notice provisions
- where the contraventions have occurred in a number of states or territories
- where the contraventions have involved the use of different types of media, such as online, television, radio, magazines and newspapers, outdoor advertising, and
- whether there are circumstances which make it desirable to issue multiple notices to deter similar conduct by the specific business involved or the broader industry.

ACCC approach to seeking pecuniary penalties through civil litigation to enforce compliance with the law

In general terms, legal proceedings are taken where, having regard to all the circumstances, the ACCC considers litigation is the most appropriate way to achieve its enforcement and compliance objectives. The ACCC is more likely to proceed to litigation in circumstances where the conduct is particularly egregious (having regard to the factors set out in its Compliance and Enforcement Policy), where there is reason to be concerned about future behaviour, or where the party involved is unwilling to provide a satisfactory alternate resolution to the matter.

Where contraventions of the CCA are alleged to have occurred, and those contraventions attract a civil pecuniary penalty, the ACCC ordinarily seeks civil pecuniary penalties where those matters proceed to court. This approach is appropriate as matters that proceeded to litigation are the more significant issues arising from alleged non-compliance with the law. Civil penalties are designed to provide general and specific deterrence.³

For a profile of recent ACCC litigation, please refer to the two latest editions of the ACCC's public quarterly report, *ACCCount*⁴.

Principles used by the Court to determine civil pecuniary penalties

While the ACCC and other parties make submissions to the Court on appropriate levels of pecuniary penalties, the Court independently decides whether to order penalties and the penalty amount. In making this decision, the Courts apply a range of principles when determining appropriate civil penalties:⁵

- the size of the contravening company
- the degree of power it has, as evidenced by its market share and ease of entry into the market
- the deliberateness of the contravention and the period over which it extended

³ *TPC v CSR*

⁴ ACCCount 1 October to 31 December 2012:

<http://transition.accc.gov.au/content/item.phtml?itemId=1104072&nodeId=43c127ac8862a0d78d26d460ed3df31e&fn=ACCCount%20December%202012%20quarter.pdf>

ACCCCount 1 July to 30 September 2012:

<http://transition.accc.gov.au/content/item.phtml?itemId=1088445&nodeId=6d105c0977008d5f26cbfd9070e1e143&fn=ACCCount%201%20July%20to%2030%20September.pdf>

⁵ See *TPC v CSR* and *NW Frozen Foods v ACCC*.

- whether the contravention arose out of the conduct of senior management or at a lower level
- whether the company has a corporate culture conducive to compliance with the CCA, as evidenced by educational programs and disciplinary or other corrective measures in response to an acknowledged contravention
- whether the company has shown a disposition to cooperate with the authorities responsible for enforcement of the CCA in relation to the contravention
- whether the company or individual has engaged in similar conduct in the past
- the financial position of the company or individual, and
- the deterrent effect of the proposed penalty

Should you require any further information or clarification on any of the above, please contact [REDACTED]

Yours sincerely



Dr Michael Schaper
Deputy Chair
Australian Competition & Consumer Commission