

*The voice of Australia's leading retailers*

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**February 2013**

# Review of Franchising Code of Conduct



**Australian National  
Retailers Association**

*The voice of Australia's leading retailers*

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## About ANRA

The Australian National Retailers' Association ("ANRA") was established in 2006 to represent the interests of Australia's leading national retailers.

Members of ANRA are:

Best & Less

Harvey Norman

Bunnings

Just Group

Portmans | Peter Alexander | Dotti | Smiggle | Just Jeans | Jay Jays

Coles Group

Luxottica

OPSM | Laubman & Pank | Budget Eyewear | Bright Eyes | Sunglass Hut

Costco

Super Retail Group

Super Cheap Auto | Rays Outdoors | BCF | Goldcross Cycles | REBEL

David Jones

Woolworths

Supermarkets | Big W | Dick Smith

Dymocks

Forty Winks

Their combined turnover exceeds \$100 billion of the \$255 billion turnover across the retail industry, equivalent to more than six percent of Gross Domestic Product.

The members of ANRA employ over 500,000 Australians – 41% of the retail workforce and 4.4% of the Australian workforce. Approximately 100,000 of these employees are located in regional and rural Australia. Over 750,000 people hold shares in members of ANRA.

Members lead the Australian retail industry, across all types of retail goods and services. The spectrum of their businesses, their scale and their contribution to all Australian communities means that the development of robust policies is critical, to strengthen the retail sector and protect the interests of retail businesses and consumers.

A key objective is to ensure that governments and the community understand the vast contribution the retail industry makes to the national economy. ANRA develops and endorses public policies which will enhance the capacity of the sector to meet consumer needs. ANRA recognises that retailers rely on all Australians, and must competitively deliver to consumer needs. Conversely, the industry and members of ANRA in particular, are leading employers, contribute to community and regional development, and strongly interrelate with other Australian industries, not the least of which is the agricultural industry. ANRA's food and grocery retailers overwhelmingly supply Australian produce.



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## **1. Executive Summary**

- 1.1. A number of ANRA members are franchisors, operating franchising networks across Australia. ANRA therefore welcomes the opportunity to make a contribution to this review of the Franchising Code of Conduct ('the Code').
- 1.2. ANRA supports the existence and continuation of the Code, which has helped lift the professionalism of the franchising industry overall and minimized the ability of 'rogue' operators to enter the market. The national framework has been particularly useful for Australia-wide operators, including ANRA members, who can operate their business across state-boundaries without facing additional red tape from multiple state-based codes.
- 1.3. Despite general overall support, ANRA has a number of recommendations regarding how the Code could be improved. With the arguable exception of the United States, the Australian franchising regime is one of the most regulated in the world and there is concern that in its present form some areas of the Code are unreasonably onerous on franchisors, without delivering a significant benefit to franchisees.
- 1.4. Indeed, some aspects of the Code are overly complex and not practically workable in the business environment that franchisors and franchisees operate in. The Code should be aimed at simplifying the franchisee/franchisors relationship and ensuring transparency and clarity around the roles and responsibilities of each party. However, these goals have been lost in unnecessary complexity.
- 1.5. ANRA's key recommendations are summarized below:
  1. **The prescribed order of the disclosure document, as outlined in the Code, should be re-ordered to place the most important financial disclosures at the start of the document.**
  2. **Disclosure in the form of monetary estimates should only be provided for payments made between the franchisee and franchisor or their agents. Payments that currently fall under 13.6A should be noted as a possible cost, without the need for the franchisor to provide a monetary estimate which is, by its nature, not as reliable as payments that directly involve the franchisor.**
  3. **The Code should be amended to improve the practicality of the 14-day disclosure period. The 14-day time should remain for the initial disclosure, but then each subsequent change should be noted via a letter only and without an additional 14-day disclosure period.**
  4. **The 14-day review period should be reduced in instances when a franchisee already has multiple franchise agreements (more than 2) and both parties agree.**

- 5. ANRA is strongly opposed to the inclusion of 'walk-away rights' for franchisees in the event that a franchisor fails. This objection is based on both legal and economic grounds.**
- 6. The Code should be clarified to allow the disclosure document to be updated annually within 4 months of the end of the franchisors financial year.**
- 7. Franchisors should be able to keep some of the deposit from potential franchisees, even if they do not go on to sign an agreement, in recognition of the legal fees incurred in preparing franchise documentation.**
- 8. ANRA offers support for the inclusion of a clause that requires good faith bargaining, conditional on all parties being compelled to engage in this practice and that no formal definition of 'good faith' is included in the Code.**
- 9. Retail lease legislation should be reviewed in order to resolve the most common end of term issues facing franchisee and franchisors.**
- 10. Compulsory mediation requirements for all parties should be maintained but the ACCC should undertake an educative program across the sector to reinforce the purpose of mediation, which is to resolve disputes.**
- 11. If a further level of enforcement is needed, ANRA would prefer a tribunal type system, to sit between mediation and formal court proceedings. ANRA would not support allowing the ACCC to pursue civil pecuniary penalties for breach of the Code.**

## **2. Introduction**

- 2.1. Overall ANRA members support the existence of the Code and believe it helps lift confidence in the franchising system in Australia. It protects reputable franchisees and franchisors from 'rogue' operators who have tarnished the reputation of this structure in other countries.
- 2.2. Despite this general endorsement of the Code, there is scope to improve its operation.
- 2.3. The disclosure process needs further reform to improve the quality of information provided and the usefulness of the disclosure document. Prospective franchisees are now provided with a large quantity of information prior to and during their agreements, which is not a costless exercise for the franchisors. But it is not clear that this has resulted in an increase in the quality of information and the informed decision-making capacity of franchisees.
- 2.4. The Code has considerable focus on the management of end of term arrangements but it has not been able to over-come the biggest end of term challenge facing franchisors and franchisees – lease arrangements and the relationship with landlords.
- 2.5. The compulsory mediation aspects of the Code are positive, but not all disputes are resolved in this manner and some cases still proceed to full courts, which is a costly process for both franchisees and franchisors.
- 2.6. ANRA's submission to this review puts forward a series of recommendations to improve the practical operation of the Code, while still providing suitable protections for franchisees and franchisors.

### **3. Disclosure issues**

- 3.1. The disclosure requirements of the Code have grown organically over time, and been added to with each Review of the Code. This has created a situation where disclosure documents are now so long and complex that they are unnecessarily onerous for franchisors to provide and are not providing improved quality of information for franchisees.
- 3.2. The disclosure documents of ANRA members are over 50 pages long. This is in addition to agreement documents that are around 100 pages long. Some of the information in these documents is duplicated.
- 3.3. ANRA has a number of suggestions to improve the clarity of documentation for franchising arrangements and how the disclosure system operates.

#### **Re-order the disclosure document**

- 3.4. The prescribed order in which information is provided in the disclosure document, as outlined in the Code, should be re-written so all the important financial disclosure is at the start of the document. In particular, this should cover all the information that is specifically known by the franchisor such as franchise fees, marketing costs and supply costs. Currently, much of the important financial information is much later in the disclosure document and so is not easy for franchisees to find - rendering the document less useful than it could be.
- 3.5. Using the current headings of disclosure document as outlined in the Code, a possible new layout would be:
  - Franchisor details
  - Payments
  - Financing
  - Marketing and other cooperative funds
  - Earnings information
  - Payments to agents
  - Unforeseen capital expenditure
  - Financial details
  - Franchise site and territory
  - Site or territories
  - Supply of goods or services to a franchisee
  - Supply of goods or services by a franchisee
  - Franchisors obligations
  - Franchisees obligations
  - Confidentiality obligations
  - Other conditions of agreement
  - Business experience
  - Litigation
  - Intellectual property
  - Amendment of franchise agreement on transfer or novation of franchise
  - Unilateral variation of franchise agreement

- Arrangements to apply at the end of the franchise agreement
- Costs of dispute resolution
- Obligation to sign related agreements
- Updates
- Existing franchisees
- Other relevant disclosure information
- Receipt

### **Improve usefulness of financial disclosures**

- 3.6. The disclosure document requires franchisors to disclose both payments they levy and payments that they foresee being levied by other parties (section 13.6 and section 13.6A). Many of the 13.6A payments are faced by all businesses, irrespective of size or whether or not it is a franchise arrangement. By their nature, the franchisor will be better able to estimate the section 13.6 type payments. In addition, the payments under 13.6A are likely to vary depending on the franchisee's personal circumstances that the franchisor may not be aware of (e.g. tax payments, legal fees, financial advice fees). But there is no distinction made in the disclosure documents that the section 13.6A estimates are substantially less reliable than the section 13.6 estimates. This diminishes the overall usefulness of the financial information in the disclosure document for franchisees.
- 3.7. A better approach for those costs that fall under section 13.6A would be that disclosure is focused on raising awareness about potential costs, rather than providing any specific monetary values or a range of values. For example, instead of trying to estimate legal costs or tax costs, the disclosure document should simply list the possible payments that a franchisee may need to make, as a business, to other parties such as their advisors and governments.
- 3.8. This approach would allow franchisees to better understand where the potential 'unknown' cost risks may be and focus their attention on managing these – thus leading to better overall business practices amongst franchisees and prevent an unreasonable reliance on the information in the disclosure document.

### **Reform to 14-day review period**

- 3.9. Reform is needed with respect to the 14-day review period between when a franchisor provides a franchise agreement and the disclosure document and when a franchisee can sign the document. This reform is two-fold and relates to the need for more clarity around when this 14-day period starts and the need for a fast-track option when the franchisee already has multiple franchise arrangements in place with the franchisor.
- 3.10. Firstly, ANRA members report considerable uncertainty about how the 14-day period and the requirement to provide an agreement "*in the form in which it is to be executed*" should be interpreted. During the negotiation process, some aspects of the agreement may need to be altered slightly. In many cases the agreement is altered at the request of the potential franchisee and for their benefit. For example, the agreement may be altered to include a short-term royalty 'holiday' period. Within a strict interpretation of the Code, each time these amendments are made a

new 14-day period must begin, even if the change is to the benefit of, and at the request of, the franchisee. This makes the process of negotiating and signing an agreement more drawn-out than it needs to be.

- 3.11. A better approach could be to leave the 14-day disclosure period in place for the initial disclosure but then to simply note any future changes via a letter, rather than requiring another 14-day period for each change.
- 3.12. This 14-day period issue needs further clarity to allow for normal business practices during negotiation to be incorporated into the franchise process, while still giving franchisees adequate time to consider the final agreement.
- 3.13. In addition, the Code could be further enhanced by allowing, if both parties agree, for those franchisees with multiple existing relationships (e.g. more than 2) with a specific franchisor to have a shorter (e.g. 7 days or no disclosure) period which they must wait before signing the agreement. This recognizes that the franchisee already has a good awareness of the franchisor and the franchise agreement and will allow new agreements (or renewals) to be executed in a timelier manner than they currently are. This would be particularly useful in situations where franchisees and franchisors are keen to open new premises as soon as possible and meet other deadlines, such as lease and building requirements.

#### **Oppose any move towards 'walk-away rights'**

- 3.14. ANRA is strongly opposed to the inclusion of 'walk-away rights' for franchisees in the event that a franchisor fails. This objection is based on both legal and economic grounds.
- 3.15. From a legal perspective the franchise agreement is still a binding legal commitment in the event that the franchisor folds. Allowing franchisees to 'walk-away' would allow franchisees to obtain a benefit beyond that of other interested parties, such as creditors.
- 3.16. From an economic, or commercial, perspective maintaining the franchise network while the franchisor is in administration is a critical benefit to administrators who are either restructuring the company to make it viable or trying to sell the entire network as a going concern. If some franchisees could walk away it would undermine the ability of a restructure or sale to proceed and greatly increase the risk facing other creditors, such as financial institutions.
- 3.17. There is also a risk to franchisees that may prefer to stay as part of the franchise network. The value of their business would significantly diminish if other franchisees were simply allowed to walk away and weaken the franchise network.

#### **Increased clarity around 'end of financial' year updating**

- 3.18. The Code states that the disclosure document must be updated annually "within 4 months of the end of the financial year." This does not explicitly state if it has to be the standard Australian financial year or if it can be the financial year operated by the franchisor. Being able to use the franchisor's own financial year would be

helpful for those franchisors that operate under alternative time periods for their financial year – such as over the calendar year.

### **Ability to recover legal fees incurred prior to signing of agreement**

- 3.19. Preparing disclosure documents and negotiating a new agreement is not a costless exercise for franchisors. In recognition of this, some franchisors require a deposit to be paid to help cover these costs. This deposit can be kept (in full or in part depending on agreement) if the potential franchisee decides to cancel the agreement in the 7-day cooling off period. However, under the Code it is not possible for franchisors to keep any of this deposit if the prospective franchisee does not ever sign the proposed agreement. This fails to recognise the costs involved in putting together the legal documentation and some recompense from this deposit should be possible.

### **RECOMMENDATIONS:**

- 1. The prescribed order of the disclosure document, as outlined in the Code, should be re-ordered to place the most important financial disclosures at the start of the document.**
- 2. Disclosure in the form of monetary estimates should only be provided for payments made between the franchisee and franchisor or their agents. Payments that currently fall under 13.6A should be noted as a possible cost, without the need for the franchisor to provide a monetary estimate which is, by its nature, not as reliable as payments that directly involve the franchisor.**
- 3. The Code should be amended to improve the practicality of the 14-day disclosure period. The 14-day time should remain for the initial disclosure, but then each subsequent change should be noted via a letter only and without an additional 14-day disclosure period.**
- 4. The 14-day review period should be reduced in instances when a franchisee already has multiple franchise agreements (more than 2) and both parties agree.**
- 5. ANRA is strongly opposed to the inclusion of 'walk-away rights' for franchisees in the event that a franchisor fails. This objection is based on both legal and economic grounds.**
- 6. The Code should be clarified to allow the disclosure document to be updated annually within 4 months of the end of the franchisor's financial year.**
- 7. Franchisors should be able to keep some of the deposit from potential franchisees, even if they do not go on to sign an agreement, in recognition of the legal fees incurred in preparing franchise documentation.**

## **4. Good faith issues**

- 4.1. ANRA offers conditional support for the inclusion of a clause that requires good faith bargaining. However, this support is conditional on all parties being compelled to engage in this practice and that no formal definition of 'good faith' is included in the Code.
- 4.2. Australian competition law already prevents behavior such as unconscionable conduct and misleading and deceptive conduct. It is also in franchisor's best interest to engage in good faith bargaining to ensure a positive reputation with current and prospective franchisees. It therefore could be argued that it is not necessary to mention good faith in the Code.
- 4.3. Despite this, ANRA believes the inclusion of a good faith clause would enhance the reputation of the franchise industry. Explicitly including the idea of good faith would ensure improved community understanding about the relationships within a franchise system and the protections that are available to franchisees.
- 4.4. ANRA's support of a good faith clause is conditional, however, on the requirement that both parties engage in this. The debate around good faith bargaining often focuses on the behavior of franchisors towards franchisees. However, any mention of good faith bargaining also needs to consider the rights and responsibilities of franchisees. In particular, franchisees need to be aware that they must act such that they do not damage the businesses of other franchisees in the network.
- 4.5. ANRA would also oppose any clause that attempted to define good faith bargaining. The body of law that already exists around the issue of good faith means that any attempt to strictly define it would be inconsistent with standard legal practice; which usually relies on past cases to determine if the parties have acted in good faith or not.
- 4.6. Finally, ANRA is concerned there is poor awareness amongst franchisees about what constitutes unfair bargaining. ANRA acknowledges that there is a risk that putting in a specific 'good faith' bargaining clause could further exacerbate this. Members report that franchisees often believe they have been unfairly treated by the franchisor because the franchisee does not get everything they want in a negotiation, and so have a case to claim unconscionable conduct. Cases of unconscionable conduct are not uncommon in the franchise sector, yet are very rarely successful because reputable franchisors typically do not engage in questionable practices. As a result, any addition of a good faith clause in the Code would be an opportunity to also raise awareness amongst franchisees about what unfair bargaining, in a legal sense, actually is. This would help prevent unfounded and often costly cases being brought against franchisors.

### **RECOMMENDATIONS:**

- 8. ANRA offers support for the inclusion of a clause that requires good faith bargaining, conditional on all parties being compelled to engage in this practice and that no formal definition of 'good faith' is included in the Code.**

## **5. End of term issues**

- 5.1. In most cases ANRA members report that the end of the term of an agreement is a straightforward matter, with very few instances in their own networks where a franchisee wanted to renew an agreement but the franchisor did not. This was the case even before the new notification period was added because successful franchisees and franchisors regularly communicate about the business and its future, well in advance of the end of term.
- 5.2. Disputes tend to arise because franchisees have failed to understand that by entering a franchise agreement they are effectively 'leasing' the right to operate a business under the franchisor's brand. They only have the right to operate that business for the term of the agreement – not beyond that timeframe. Once the agreement period comes to an end, then the right to operate this business also comes to an end. This misunderstanding can result in franchisees feeling the franchisor is acting unfairly.
- 5.3. In practice, ANRA members report that it is unusual for franchising agreements to end because of a decision by the franchisor. In reality, it is far more common that the agreement is not renewed because the franchise is sold by the franchisee to another operator. It is clearly in the franchisor's interest to work with both the current franchisee and the potential new franchisee, to ensure a smooth transition of the business and continuing service for customers.
- 5.4. ANRA members report the most common end of term issue relates to lease arrangements and the relationship between franchisees and landlords - not disputes between franchisees and franchisors.
- 5.5. Landlords might be reluctant to give options on retail leases, so most franchisees and franchisors can often only secure a lease equivalent to the initial term of the franchise agreement and not over any further 'option' period. In ANRA members view, the reluctance to offer an option is because landlords do not want to conduct market reviews that are required when an option on a lease is offered, under current retail leasing laws.
- 5.6. Landlords are likely aware the franchisee wants to continue to operate their business in the same location and are therefore in a position to push for substantial rental hikes at the end of a lease. Landlords might also be aware that franchisees may not have recouped their initial capital investment on a site and so must re-sign a lease in order to recover the capital investment and pay creditors.
- 5.7. ANRA members have also experienced landlords interfere in the franchise negotiation process. One ANRA member reported an instance where a landlord actively (and successfully) encouraged a franchisee to not continue the franchise agreement – arguing that the franchise costs were the reason the business was not sustainable. The landlord then charged the ex-franchisee a higher level of rent that was effectively equivalent to the previous rental and franchise associated costs. This allowed the landlord to achieve a significant rental increase and left the ex-franchisee with the same unsustainable costs but without the benefits associated with being part of a national network.

**RECOMMENDATIONS:**

- 9. Retail lease legislation should be reviewed in order to resolve the most common end of term issues facing franchisee and franchisors.**

**6. Dispute resolution issues**

- 6.1. ANRA members are supportive of the current compulsory mediation process and report that most disputes they have been involved in have been resolved by this process.
- 6.2. ANRA's main suggestion to improve this process would be to increase awareness amongst franchisees about the purpose of mediation – to resolve issues rather than just being a step before formal litigation. In some instances ANRA members report that aggressive behavior by legal advisers of some franchisees has impeded the dispute resolution process and made it difficult for the mediator to undertake their role. In these instances the advancement to litigation becomes inevitable. This practice is not in the interests of either franchisees or franchisors.
- 6.3. The quality of the mediated process could also be improved if mediators are able to demonstrate familiarity with franchising through experience. Currently, there is a wide gap in the quality of mediators; many are, in ANRA members' words, 'outstanding', but some appear to lack experience in franchising and so are not as effective.

**RECOMMENDATIONS:**

- 10. Compulsory mediation requirements for all parties should be maintained but the ACCC should undertake an educative program across the sector to reinforce the purpose of mediation, which is to resolve disputes.**

## **7. Enforcement issues**

- 7.1. ANRA members report that they have had minimal interaction with the ACCC with respect to the Code since it came into effect in 2010. This includes both the educative and inspection/enforcement aspects of the ACCC's role.
- 7.2. ANRA is not aware of any successful action by the ACCC against ANRA franchisors for breaches of the Code.
- 7.3. In addition, ANRA members report they have not been assisted by the ACCC in cases where franchisees have breached the Code (such as refusing to attend compulsory mediation) and have had to undertake their own legal proceedings to have the Code's requirements enforced.
- 7.4. ANRA would not support allowing the ACCC to be able to pursue civil pecuniary penalties for breaches of the Code. Such a move would not be consistent with how other industry codes are enforced and their purpose, which is to enforce minimum standards rather than act as another form of regulation.
- 7.5. If further enforcement steps are to be considered for those matters that cannot be resolved by mediation, ANRA would be more supportive of a tribunal type system – rather than any additional formal legal steps being made available to the ACCC.
- 7.6. This Tribunal should be staffed by legal experts with experience in franchise arrangements. The Tribunal would need to have the confidence of both franchisees and franchisors and act in a fair manner to resolve ongoing disputes.
- 7.7. ANRA's preference for a Tribunal is because tribunals tend to provide greater access to remedies for all parties and are reasonably quick and inexpensive compared to traditional litigation through the court system. The use of tribunals to improve speed and cost efficiencies in commercial dispute resolution has already been proven in the context of retail leasing disputes.

### **RECOMMENDATIONS:**

- 11. If a further level of enforcement is needed, ANRA would prefer a tribunal type system, to sit between mediation and formal court proceedings. ANRA would not support allowing the ACCC to pursue civil pecuniary penalties for breaches of the Code.**