

**REVIEW OF THE DISCLOSURE PROVISIONS OF THE
FRANCHISING CODE OF CONDUCT**

**Report to the Hon Fran Bailey MP
Minister for Small Business and Tourism**

October 2006

Terms of Reference

The Terms of Reference for the review were:

- The Committee is to review the current operation of *Part 2 - Disclosure* of the Franchising Code of Conduct¹.
- The Committee is to identify, where justified, possible amendments that could improve the disclosure provisions of the Franchising Code of Conduct.

In performing its functions, the Committee is to advertise nationally, consult with key stakeholders, receive public submissions, take into account overseas experiences, and seek the views of State and Territory Governments.

The Committee is to protect the confidentiality of the affairs of individuals and companies in the course of its deliberations, to the extent not inconsistent with its legal or accountability obligations.

The Committee was required to report by 30 September 2006.

NOTE: The Minister for Small Business and Tourism extended the report date for the review to 31 October 2006 to allow the Committee sufficient time to consider the 75 submissions received, to consult with stakeholders, and to frame its recommendations.

¹ The Franchising Code of Conduct is a mandatory code and it is contained in the Trade Practices (Industry Codes – Franchising) Regulations 1998 made under the Commonwealth's *Trade Practices Act 1974*.

Membership of the Franchising Code Review Committee

Period of the Review – 28 June 2006 to 31 October 2006

Chairman:

Mr Graeme Matthews National Managing Partner, KPMG Middle Market
Advisory

Advisers to the Committee:

A Corrs Chambers Westgarth team, led by Ms Alexandra Wedutenko, Partner

Secretariat:

Provided by the Office of Small Business and led by Dr Peter Tucker, General
Manager

Foreword

Franchising is a major part of the Australian economy and day to day life.

The mandatory Franchising Code of Conduct was introduced under the Commonwealth's *Trade Practices Act 1974* in 1998 by the Australian Government.

A review of the Code was commenced in 1999 with the report and recommendations being delivered to the Australian Government in 2000.

This present Review was announced on 28 June 2006 by the Minister for Small Business and Tourism, the Hon Fran Bailey MP. I am grateful for all the time and careful thought contributed to the Review by industry, academia, and the Government.

While the Committee's Terms of Reference were, *inter alia* to review the current operation of *Part 2 - Disclosure* of the Franchising Code of Conduct it is clear that Annexures 1 and 2 of the Code are integral to the operation of disclosure and Parts 1 and 3 are also important and relevant. Many submissions to the Review dealt with Parts 1, 2 and 3 and Annexures 1 and 2 of the Code. In order to provide a comprehensive review of disclosure the Committee has chosen to comment on and make recommendations that relate principally to Part 2 and Annexures 1 and 2. Additionally, where considered appropriate the committee has included comment and recommendations that relate to Parts 1 and 3 of the Code.

The Committee was greatly assisted by the high quality of written submissions.

Strong support for the Code has been registered throughout the review process. It is widely seen as pivotal to the continued success of the franchising industry.

I am also thankful for the strong support provided by Corrs Chambers Westgarth and the secretariat from the Office of Small Business within the Department of Industry, Tourism and Resources.

I am pleased to bring this report and its recommendations to the Government.

Mr Graeme Matthews - Chairman
National Managing Partner, KPMG Middle Market Advisory,
31 October 2006

Abbreviations

2001 Regulations	<i>Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001</i>
ACCC	Australian Competition and Consumer Commission
AWA	<i>Arthur Wishart Act (Franchise Disclosure) 2000</i>
CCC	California Commercial Code
ECE	European Code of Ethics for Franchising
FCC	Franchise Code Council,
FCP	Franchising Code of Practice
FPC	Franchising Policy Council
FTC Rule	Code of Federal Regulations
Cth	Commonwealth
ECE	European Code of Ethics for Franchising
FPC	Franchising Policy Council
UNIDROIT	International Institute for the Unification of Private Law
OMA	Office of the Mediation Adviser
TPA	<i>Trade Practices Act 1974</i>
The Code	<i>Trade Practices (Industry Codes – Franchising) Regulations 1998</i>
UFOC	Uniform Franchise Offering Circular
UCC	<i>Uniform Commercial Code</i>

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EXECUTIVE SUMMARY – THE RECOMMENDATIONS

NOTE:

- When applicable changes to Annexure 1 also relate to Annexure 2.
- At least some of the recommendations will have consequential changes to other provisions.
- The Committee recommends that sufficient time be allocated for franchisors to update disclosure documents to meet these recommendations.
- Recommendations included in the Appendix which relate to inconsistencies and areas for clarification in the Code, have not been reproduced in this executive summary.

Recommendations directly pertinent to Part 2 and Annexure 1

1. Requirement to include a complete franchise agreement

Clause 10 and item 17 of Annexure 1 of the Code be amended to require the franchisor to provide the franchise agreement in the form it is intended to be executed with the disclosure document.

2. Requirement to include copies of all associated agreements and contracts

Item 18 of Annexure 1 of the Code be modified to require the franchisor to provide copies of all related documents required by the franchise agreement to be signed by the franchisee, in the form they are intended to be signed with the disclosure document, or earlier, which would be at least 14 days before the franchise agreement is expected to be signed.

3. Requirement to include a Risk Statement

The Code be amended to include a requirement for the franchisor to include a Risk Statement with the disclosure document.

The ACCC be tasked with developing a prescribed Risk Statement document with disclosure requirements.

4. Disclosure of section 87B TPA undertakings

Part 3 clause 18(2) of the Code and item 4 of Annexure 1 to the Code be amended to include the requirement to disclose details of section 87B

TPA undertakings within a reasonable time (but not more than 14 days) after the undertaking is given.

5. Rebates and other financial benefits

That item 9.1(j) of Annexure 1 to the Code be extended to include disclosure of the amounts or method of calculation of rebates or other financial benefits to the franchisor or an associate of the franchisor from the supply of goods or services to franchisees.

6. Auditing of marketing and other co-operative funds

The annual financial statement of marketing or other co-operative funds, receipts and expenses prepared pursuant to clause 17 of the Code be subject to compulsory annual audit by a registered company auditor.

7. Provision of audited financial information for the franchisor and the consolidated entity

The ACCC, as part of the registration process (Recommendation 23), collect information on the extent to which franchisors' financial statements are currently audited and provided pursuant to item 20.3 of Annexure 1 of the Code.

The ACCC determine the extent to which any lack of audited financial statements is causing unsatisfactory outcomes for the industry particularly in respect to franchisor solvency disclosures.

The ACCC report to the Government on its findings and provide recommendations by 30 April 2007.

8. More information about past franchises

Subject to compliance by the franchisor with Privacy Laws and the obtaining of relevant consents to disclosure, the Code be amended to require not just the numbers but also names, location and contact details relating to the franchisees corresponding to events listed in item 6.4 of Annexure 1. This could be included as an addendum to the disclosure document.

9. Qualifications of advisors

The Government ask relevant peak industry bodies to raise the level of understanding of their members of the particular requirements connected with advising potential franchisees prior to them entering into franchisee agreements.

10. Disclosure of the business experience of all who have or may have management responsibilities.

That item 3.1 of Annexure 1 be amended to remove the executive officer exemption from the class of persons about which a summary of relevant business experience in the last 10 years must be provided.

That Item 2.6 of Annexure 1 be amended to substitute for the term “executive officer” (which is not defined in the *Corporations Act 2001*), the concept of a person who is concerned in, or takes part in, the management of the franchisor (regardless of the person’s designation and whether or not the person is a director of the franchisor).”

11. Opt out clause from providing information requested from Annexure 1

The opt out provision in Part 2 clause 6C be deleted.

Recommendations directly pertinent to Parts 1 and 3

12. Disclosure of materially relevant facts

Part 3 clause 18(1) of the Code be amended to require franchisors to disclose materially relevant facts within 14 days after the franchisor becomes aware of the facts rather than the present 60 days.

13. Exemption from application of the Code

The exemption to the application of the Code referred to in Part 1 clause 5(3)(a)(i) and (ii) be removed from the Code.

14. Franchises currently excluded from the Code

Delete clause 5(3)(c).

15. Directors to disclose their convictions

Part 3 clause 18(2)(b) and (2)(d) and *Annexure 1 item 4* of the Code be amended to include franchisor directors in the class of persons about which materially relevant facts must be disclosed and the scope of disclosure be extended to criminal convictions for non serious offences.

16. The right of unilateral termination to a franchise agreement

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor termination rights contained in Part 3 clause 22 of the Code.

Consideration also be given to removing or modifying the right of a franchisor to include in a franchise agreement the right to unilaterally terminate a franchise agreement. In the event that the right to unilaterally terminate the agreement is maintained, adequate franchisee compensation should be provided for in the franchise agreement and referred to in the disclosure document.

17. The right of unilateral change to a Franchise Agreement

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor changes to franchise arrangements.

Consideration also be given to prohibiting unilateral changes by franchisors to arrangements with franchisees which have materially adverse effects on the franchisee without franchisee consent. In the event that the right to unilaterally amend financial arrangements with franchisees is maintained, adequate franchisee compensation should be provided for in franchise agreements and referred to in the disclosure document.

18. Prospective franchisees communication with existing franchisees

Part 3 clause 15 of the Code be amended to include a reference to prospective franchisees after the references to franchisees.

Other recommendations and observations relevant to disclosure

19. General waivers of written representations

Consideration be given as to whether or not franchise agreements and disclosure documents should be prohibited by the Code from including any general waivers of written representations made to potential

franchisees or franchisees seeking to extend their franchise agreements.

20. Clarity at the termination, expiry or non-renewal of an agreement

The Risk Statement should, if significant, refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement.

21. Clarity in the event of franchisor failure

The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with franchisor failure.

22. Financial Details

The requirement under item 20 of Annexure 1, to disclose financial details be extended, where applicable, to include the consolidated entity to which the franchisor belongs.

23. Registration and Review of Disclosure Documents.

The Government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate enforcement of the Code. The process would be administered by the ACCC.

24. The current level of ACCC action relating to franchising

The Government appraise the ACCC of concerns expressed to the Committee about the level and extent of action by the ACCC in dealing with claims of breaches of the Code by franchisors.

25. Implementation of the principle of good faith and fair dealing

A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part1 of the Code.

26. Standardisation of the audit period

The audit period referred to in Part 2 clause 6(1) of the Code be aligned with the *Corporations Act 2001* audit period.

27. Avoidance of providing the details and history of the territory or site to be franchised together with the disclosure documents

Item 11.3 of Annexure 1 of the Code be amended to require the details mentioned in item 11.2 to be in a separate document which is provided with the disclosure document.

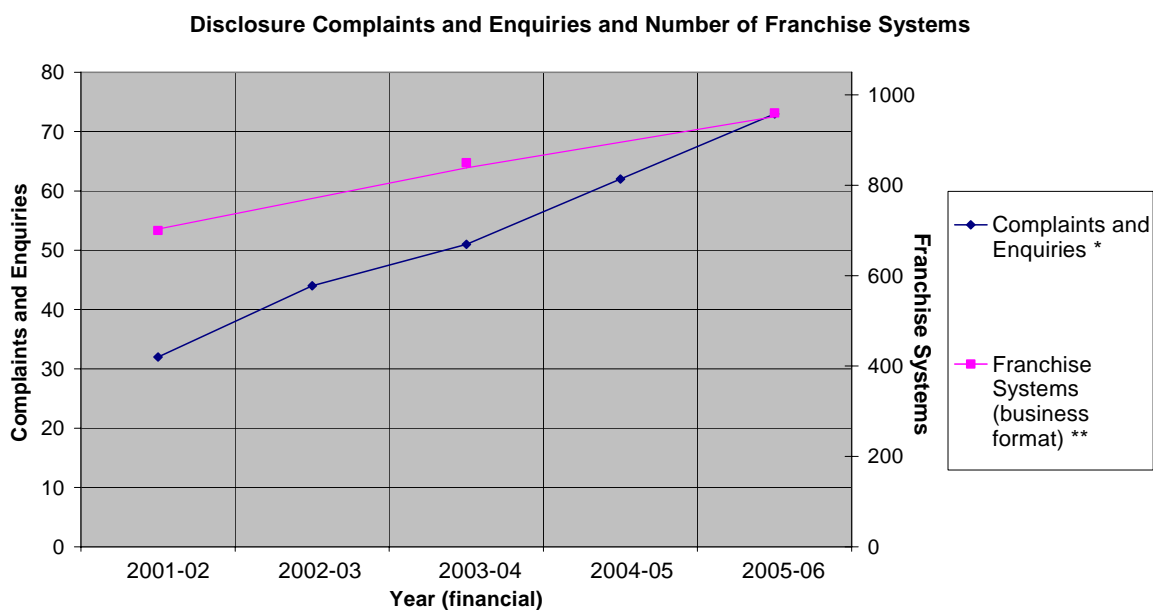
THE EXTENT OF THE PROBLEM

The Committee noted the analysis by the Australian Competition and Consumer Commission (ACCC), in their submission, of complaints data and trends in relation to the Code since July 2001.

The ACCC reported that 252 complaints related to disclosure issues, which represents 19 percent of the total number of complaints and inquiries in the period from July 2001 to June 2006. Further analysis reveals that the *failure to provide the disclosure document* category accounted for 11 percent of matters, or 141 complaints and inquiries, four percent (56) were complaints about *misleading or deceptive* disclosure documents and three percent (42) of complaints alleged that *disclosure documents were inadequate*.

According to ACCC data, disclosure related complaints received by the ACCC were dominated by the *failure to provide* category. The number of complaints relating to *misleading or deceptive* or *inadequate disclosure documents* were somewhat less.

The ACCC's trend analysis of the number of disclosure document complaints shows a steady increase in complaints and inquiries. The number has more than doubled over the past 5 years. Two factors should be noted: that the ACCC's education initiatives have most likely contributed to an increase in the number of inquiries; that there has also been an increase in the number of franchise systems over this same period. These two factors have the effect of inflating the combined number of complaints and inquiries. Nevertheless, the Committee sees this trend as justifying its view that improvements to the disclosure provisions and their operation should be recommended to the Government.



* Data from ACCC Submission to this Review

**Data from Franchising Australia 2006 Survey, Griffith University

The ACCC also noted that according to the *Franchising Australia 2004 Survey*², the number of franchise systems operating in Australia was estimated to be 850 with 50 000 franchising units in operation. It was their contention that the receipt of only 252 disclosure related complaints and inquiries in the last five years indicates that the disclosure regime prescribed by the Code is, overall, highly effective. It provided potential and existing franchisees with a protection mechanism and a means to access relevant information about a franchisor and franchise system.

Figures provided by the Office of the Mediation Advisor (OMA) on the number and results of mediations from August 2004 to June 2006 suggest that approximately 10 per cent of these mediations (293) were related to disclosure issues. Data from the first half of 2006 is provided below.

Mediations by basis of dispute 1 January to 30 June 2006 Data gathered by the OMA from their own activities.	
Alleged Misrepresentations by Franchisor as to Profit/Performance	6
Failure to Provide a Disclosure Document	2
Alleged Multiple Misrepresentations by Franchisor (site/profit/support etc.)	13
Amounts Unpaid by Franchisor	3
Competing with Franchisor	0
Franchisee's failure to Pay Franchise Fees / Other Amounts and Make Financial Reports	4
Franchisee's failure to Comply with Agreement Terms	9
Franchisor's failure to Comply with Agreement Terms	3
Inadequate Support, Training, Assistance	4
Materials/Intellectual Property Rights	1
Poor Franchisor Management / Communication	5
Poor Franchisee Communication	0
Premises and/or Premises Refurbishment	2
Sale of Franchise	3
Territory	1
Terms of Termination/Exit Arrangements	1
Unfair Agreement Terms	0
Unprofitability of Franchise	1
Total	58
NOTE: Mediations usually involve more than 1 issue and since the data was collected prior to mediation, and not necessarily accurately define all the issues these statistics are indicative only.	

² *Franchising Australia 2004 Survey*, Griffith University, Service Industry Research Centre, L. Fraser & S. Weaven.

The Committee noted the finding of the Franchising Australia 2006 Survey that fewer than 2 percent of franchised units ceased to operate in 2005. This, according to Professor Lorelle Frazer, supports the notion that franchising failure rates are low³.

The Committee was made aware of a number of cases where the impact of the failure of a franchise or a franchisor had a major effect on the financial and emotional well being of those involved.

³ Frazer, Lorelle, Weaven, Scott, and Wright, Owen, *Franchising Australia 2006 Survey* (draft) Service Industry Research Centre, Griffith University

CHARACTERISTICS OF FRANCHISING

A franchise agreement is an agreement in which a person (the franchisor) grants to another person (the franchisee) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor. Under the arrangement the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol and before starting business or continuing the business, the franchisee must pay or agree to pay to the franchisor or an associate of the franchisor an amount.⁴ This fee may relate to the initial capital investment, goods or services, training or royalties of the business. The amount of any franchise fee can be specified in the franchise agreement, or incorporated into the price for goods sold to the business.⁵

Franchises generally share the following elements:

- a contractual business agreement which can be written, oral or implied;
- the franchisor granting to the franchisee the right to carry on a business under a system or marketing plan that is provided and controlled by the franchisor;
- the business is conducted under a trade mark, advertising or symbol owned or licensed (or specified) by the franchisor; and
- the franchisee pays the franchisor, often by way of an initial license fee and in ongoing royalties.

There are different types of franchises: product plus tradename franchises, where franchisees are granted the right to distribute a manufacturer's product within a specified territory or at a specific location, usually under the manufacturer's trademark (examples are fuel depots and new car sales yards); and the business format franchise, which is the most common type, and generally involves each individual outlet operating under a common trademark according to a standard system of management, appearance and quality of goods (for example food outlets). Franchising is most intensive in the retail non-food industry followed by the property and business services sector.⁶

About two thirds of franchisors have adopted master franchising (also known as sub-franchising) arrangements in their Australian operations.⁷

Franchisees operate from diverse locations, including home, retail site or mobile operations.⁸

Slightly more than one quarter of Australian based systems are currently franchising internationally.⁹

⁴ Trade Practices (Industry Codes – Franchising) Regulations 1998

⁵ ACCC The franchisees guide November 2001

⁶ Lorelle Frazer, *Franchising Australia 2006 Survey*, p10

⁷ Lorelle Frazer, *Franchising Australia 2006 Survey*, p11

⁸ Lorelle Frazer, *Franchising Australia 2006 Survey*, p11

⁹ Lorelle Frazer, *Franchising Australia 2006 Survey*, p11

INTRODUCTION

The Franchising Code of Conduct – Historical information

Draft Franchise Agreements Bills were developed in 1986 but subsequently lapsed. In response to continuing calls for Government intervention, a voluntary Franchising Code of Practice (FCP) was developed in 1993. The FCP was designed to improve standards of behaviour in the franchising industry by providing standards of disclosure, cooling off periods and access to dispute resolution mechanisms. It was administered by a company limited by guarantee, the Franchise Code Council (FCC), which was also responsible for developing modifications to the FCP.

The FCP was widely viewed as ineffective. Even where franchisors did register as agreeing to comply with the FCP, there was no assurance that they complied with all of its provisions. Government funding for the FCC was removed and the FCP lapsed in 1996 as a result.

In May 1997 the House of Representatives Committee on Industry, Science and Technology delivered a report on fair trading in Australia. The report, *Finding a Balance*, dealt with franchising problems in detail.

The Committee identified numerous problems experienced by small business. Problems in the franchising sector related to:

- unfair contract terms arising from a refusal of big business to negotiate the terms and conditions of contracts;
- complexity of documentation;
- lack of pre-contract disclosure, resulting in an inability to make informed decisions about the viability of an enterprise;
- the inadequacy of advice and education for small business; and
- the prohibitive costs of, and the long delays involved in, legal action, inhibiting small business access to justice.

The Committee recommended the development of specific franchising legislation, and argued that the legislation should provide for adequate disclosure documentation, the establishment of appropriate independent code administration bodies, and dispute resolution procedures.

The task of preparing and advising on the content of the new Code was given to the Franchising Policy Council (FPC) comprising three franchisors, three franchisees, two advisers and an independent Chair. In its September 1997 *New Deal: Fair Deal* statement the Government announced a mandatory Franchising Code of Conduct, prescribed under the *Trade Practices Act 1974* (TPA).

The Code was prescribed on 1 July 1998 under the TPA and as such has the force of law. It became fully operative from 1 October 1998. It is administered by the Australian Competition and Consumer Commission (ACCC) with the Minister for Small Business and Tourism, the Hon Fran Bailey MP, having Ministerial responsibility for the Code.

The Code is designed to ensure that franchisees are given information that is material to the running of the franchised business, and provide access to a fast and relatively inexpensive way to resolve any disputes. Broadly, it achieves this by requiring franchisors to disclose specific facts to franchisees and to follow set procedures in their dealings with franchisees. For instance, if a dispute arises, either party can require the other to attend mediation.

To support the dispute resolution aspects of the Code the Government established the Office of the Mediation Adviser (OMA) in 1998 to assist with the mediation of disputes between franchisees and franchisors. The OMA appoints qualified and experienced mediators to help franchisors and franchisees resolve their problems and disputes without going to court. While the OMA provides an initial free and confidential discussion, the parties to the mediation are responsible for their own costs.

The First Review – December 1999 to May 2000

In the Budget Statements for 1999-2000, the Government announced that it would conduct a review of the Code. On 26 August 1999, the then Minister for Employment, Workplace Relations and Small Business, the Hon Peter Reith MP, announced that the FPC had accepted the task to review the Code. This review was conducted during the period 1 December 1999 to 31 May 2000.

The FPC was required to report on:

- the effectiveness of the Code in meeting its objectives;
- the success of the Code in raising standards of conduct within the franchising sector; and
- the costs of compliance with the Code and how these costs might be minimised.

The FPC made a number of recommendations for amendments to the Code.¹⁰ In relation to the disclosure provisions of the Code, the recommendations included:

- that the original Annexure 2 (mainly used for disclosure of information by a vendor franchisee to a prospective purchaser franchisee) be repealed;
- that a short form disclosure document for franchisees with an annual turnover of less than \$50,000 per annum be prescribed; and
- that international franchisors should be exempt from the disclosure requirements of the Code (only in situations where the franchisor has appointed an Australian master franchisee to make the necessary disclosures on its behalf).

The Government responded to the FPC's Report in October 2000. It agreed with the recommendations outlined above in relation to repealing Annexure 2 and introducing a short form disclosure document for small franchises. These amendments were effected by the *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001* (the 2001 Regulations). The short form disclosure document is now contained in a new Annexure 2.

¹⁰ See *Review of the Franchising Code of Conduct*, Report by the Franchising Policy Council (May 2000).

The 2001 Regulations also clarified the position of master franchisees in relation to disclosure requirements: before a master franchisee grants a sub franchise, both the franchisor and master franchisee must disclose the information required by the Code. A joint disclosure document is permitted.

Other amendments made by the 2001 Regulations in relation to disclosure include:

- the requirement for the franchisor to maintain a current disclosure document;
- an extension of the stated purpose of disclosure documents – the purpose of such documents is now not only to provide information about the franchise to prospective franchisees, but to give the franchisee “current information that is material to the running of the franchised business” (clause 6A of the Code); and
- the inclusion of additional “materially relevant facts” that must be disclosed by franchisors to franchisees (see clause 18 in Part 3 of the Code).

The operations of the Franchising Policy Council ceased over the period June to August 2002. The Office of Small Business established arrangements to accommodate any necessary industry consultative meetings. Consultation was held under these arrangements in the lead up to the current review.

THE CURRENT REVIEW

Establishment

It is important that businesses at both ends of the franchising system are able to operate with confidence and certainty. While the franchising industry is generally satisfied with the operation of the Franchising Code of Conduct (the Code), concerns have been raised with the Government about whether the disclosure provisions covered in Part 2 of the Code are working effectively. The Government has also received representations, particularly from franchisees, about the enforcement of the Code by the ACCC.

On 28 June 2006 the Minister for Small Business and Tourism, the Hon Fran Bailey MP, announced that the Australian Government would review the current operation of *Part 2 - Disclosure* of the Code. Mr Graeme Matthews, National Managing Partner, KPMG Middle Market Advisory, agreed to lead the review which was required to focus on the disclosure provision of the Code and to identify, where justified, possible amendments that could improve the disclosure provisions of the Code. Mr Matthews was supported by a team from Corrs Chambers Westgarth and a secretariat from the Office of Small Business within the Department of Industry, Tourism and Resources.

Terms of Reference for the Review

The Terms of Reference for the review were:

1. The Committee is to review the current operation of *Part 2 - Disclosure* of the Franchising Code of Conduct.
2. The Committee is to identify, where justified, possible amendments that could improve the disclosure provisions of the Franchising Code of Conduct.

In performing its functions, the Committee is to advertise nationally, consult with key stakeholders, receive public submissions, take into account overseas experiences, and seek the views of State and Territory Governments.

The Committee is to protect the confidentiality of the affairs of individuals and companies in the course of its deliberations, to the extent not inconsistent with its legal or accountability obligations.

The Committee was required to report by 30 September 2006. The Minister subsequently extended the reporting date to 31 October 2006.

Methodology

The Committee advertised the Review nationally, (**Attachment A**), consulted with a range of stakeholders, including the ACCC and the OMA, representative organisations and individual franchisees and franchisors, (**Attachment B**), considered overseas experience and regulatory regimes and sought the views of State and Territory government agencies.

Respondents were asked to confine their comments to issues relevant to the terms of reference and focus on providing:

- factual information regarding the operation of the disclosure section of the Code;
- views about the current form of the disclosure section of the Code.

Submissions closed on Tuesday 15 August 2006 with final submissions accepted up to Tuesday, 22 August 2006. To assist in obtaining the most relevant information authors of submissions were asked to clearly mark any material that they wished to be treated as confidential.

Seventy five submissions were received. Details of those submissions, except for those who requested that their submissions be treated in confidence, are at **Attachment C**.

THE CODE - CONTENT

The *Part 2 – Disclosure* provisions are an integral part of the Franchising Code of Conduct. Although this review is focused on Part 2, it is important to understand the role of each part of the Code and their relationship to Part 2. The following sections seek to explain the purpose of each of the four parts of the Code.

Part 1 – Preliminary

This Part sets out the name and purpose of the Code as well as its application. It also sets out all definitions, including the meaning of a "franchise agreement".

Part 2 – Disclosure

Franchisors are obliged to create and maintain a disclosure document (see clause 6 of the Code), in accordance with either Annexure 1 (long form) or Annexure 2 (short form). The short form disclosure document contains only 11 categories of prescribed information that must be disclosed to franchisees, rather than the 23 categories listed in the long form document (see **Attachment D**).

However, a franchisor who is entitled to provide a short form disclosure document in accordance with Annexure 2 may be asked by a prospective franchisee to provide any information from the remaining Annexure 1 items.

The Committee was provided with anecdotal evidence that suggests that the short form disclosure document is very rarely used.

Some of the matters required to be disclosed, pursuant to Annexure 1, include:

- current and past proceedings (including litigation and arbitration) against the franchisor and directors of the franchisor;
- information about the franchise site or territory;
- information about the supply of goods or services to and from a franchisee;
- information about marketing or cooperative funds to which the franchisee may be required to contribute;

- payments that will have to be made by the franchisee in relation to the franchise;
- a summary of some of the significant provisions of the franchise agreement (or references to those provisions if the franchise agreement is attached); and
- financial details of the franchisor.

The appropriate disclosure document and a copy of the Code must be provided to prospective franchisees and to franchisees proposing to renew or extend an existing franchise agreement at least 14 days before the prospective franchisee enters into, renews or extends the relevant franchise agreement or makes a non-refundable payment to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement. A new disclosure document must be produced within three months after the end of each financial year after entering a franchise agreement.

The franchisor is not permitted to enter into, renew or extend a franchise agreement unless the franchisee or prospective franchisee gives the franchisor a statement to the effect that they have received, read and had the opportunity to understand the disclosure document and the Code. Further, before a new franchise agreement is entered into, the prospective franchisee must provide the franchisor with a signed statement that it has received independent advice about the proposed franchise agreement or franchise business, or alternatively that they acknowledge that such advice should be sought but have decided not to seek it.

Part 3 – Conditions of Franchise Agreement

This part of the Code provides for a number of other measures to be followed. Those that relate to the disclosure of information by franchisors include:

- the prohibition of a general release of the franchisor from liability to the franchisee;
- the imposition of obligations on the franchisor in relation to money paid for marketing or to another cooperative fund;
- the requirement for the franchisor to provide copies of lease documents to the franchisee (if relevant);
- the requirement for the franchisor to disclose “materially relevant facts” not mentioned in the disclosure document; and
- the requirement for the franchisor to give a franchisee a current disclosure document within 14 days of receiving a request from the franchisee.

Other non-disclosure aspects of **Part 3** of the Code include:

- a 7 day cooling off period following the signing of a franchise agreement;
- a prohibition of franchisor behaviour that would induce a franchisee not to form an association or not to associate with other franchisees for a lawful purpose;
- the regulation of the circumstances in which a franchisor may withhold consent to a franchise transfer; and
- the regulation of how and when termination of the franchise agreement is permitted. If the franchisee breaches the franchise agreement and the franchisor intends to terminate the agreement as a result, the franchisor must

notify the franchisee and allow a reasonable time for the franchisee to remedy the breach.

Part 4 – Resolving Disputes

This part of the Code mandates various aspects of the disputes resolution process including definitions, the appointment of a mediation adviser and procedures to be followed, including the inclusion of particular dispute resolution processes in franchise agreements.

THE CODE – CONSEQUENCES OF BREACHING PART 2

The Franchising Code of Conduct is a mandatory industry code prescribed under the *Trade Practices Act 1974* (TPA) and thus has the force of law. The ACCC is responsible for:

- investigating possible breaches of the competition and consumer protection provisions of the and, where appropriate, bringing proceedings against those suspected of breaching the Act;
- considering applications for immunity from the Act on a range of public interest grounds;
- arbitrating on disputes over access to essential facilities and in the telecommunications industry;
- assisting consumers who have suffered as a result of breaches of the Act to obtain compensation or redress;
- generally ensuring a culture of compliance with the Act through education and research.¹¹

This part of the report explains the consequences of breaching Part 2.

General

A breach of Part 2 of the Franchising Code of Conduct constitutes a breach of section 51AD of the *Trade Practices Act 1974* (Cth) (TPA) which reads:

“A corporation must not, in trade or commerce, contravene an applicable industry code.”

This section prohibits corporations from contravening mandatory industry codes, and voluntary codes where a corporation has bound itself to accepting that code, provided that such codes are prescribed under regulations made under section 51AE of the TPA.

Consequences of Breaches

Any person who suffers loss or damage as a consequence of a breach of section 51AD may:

- seek injunctions under section 80 of the TPA;
- seek remedial orders under section 87 of the TPA; and /or
- recover damages under section 82 of the TPA

There are no criminal sanctions for a breach of section 51AD.

Injunctions – section 80

1 ¹¹ Miller, Russel V. Miller's Annotated Trade Practices Act. 2001/22nd Edition, 2001

On application from the ACCC or any other person, the Court may grant an injunction on such terms as the Court determines to be appropriate where it is satisfied that a person has engaged in, or proposes to engage in, conduct that contravenes, among others, section 51AD or where a person has:

- aided, abetted, counselled or procured such a contravention;
- induced, or attempted to induce, whether by threats, promises or otherwise, such a contravention;
- conspired with others to engage in conduct that would constitute such a contravention; or
- been in any way, directly or indirectly, knowingly concerned in, or party to such a contravention.

Damages – section 82

A person who suffers loss or damage by the conduct of another person that was done in contravention of section 51AD, may recover the amount of the loss or damage by action against that other person or any person involved in the contravention. The ACCC cannot bring an action for damages under section 82 on its own behalf, as it is not a person who suffers loss and damage by reason of a contravention of the TPA. Actions for damages pursuant to section 82, for breach of section 51AD must be brought within six years of the date on which the applicant suffered loss or damage.

Compensatory Orders – section 87

Where the Court finds that a person who is a party to proceedings for breach of section 51AD has suffered, or is likely to suffer loss or damage by conduct of the person being sued for that breach, the Court may make such orders as it thinks appropriate to compensate the first mentioned person in whole or in part for the loss or to otherwise prevent or reduce the loss or damage. The ACCC can make an application pursuant to section 87 for orders on behalf of individuals who have suffered loss or damage as a consequence of another person's breach of section 51AD. Actions for compensatory orders pursuant to section 87, for breach of section 51AD must be brought within six years of the date on which the cause of action accrues.

ACCC Enforcement Action

In its submission the ACCC indicated that, in its view, there were significant benefits to resolving franchisor/franchisee issues through alternative dispute resolution mechanisms. This approach facilitates ongoing business relationships and is not likely to damage the franchise in the way that court proceedings may.

The next stage if this option does not result in a resolution to the problem, is the appointment of an ACCC Investigation Officer. This officer's task is to seek further information from the complainant to substantiate their allegations. If adequate substantiation is received, the view of the other party involved in the dispute is sought.

Once information from both parties is received the ACCC considers if there may have been a breach of the Code. The ACCC then carefully considers the detriment caused by the conduct, whether:

- the conduct involves a blatant disregard of the law;
- the person, business or industry has a history of previous contraventions of competition or consumer laws;
- the conduct is of major public interest or concern;
- the conduct is 'industry wide' or is likely to become widespread if the ACCC does not intervene; and/or
- there is potential for action to educate and deter future conduct.

The ACCC can resolve enforcement matters through agreeing to an administrative resolution, accepting a court enforceable undertaking and/or litigation. See "Consequences of Breaches" above.

Since the introduction of the Code, the ACCC has commenced and successfully concluded litigation in 15 cases. All cases were found to be in breach of the TPA and the Code, and a variety of remedies were ordered by the courts including injunctions, court orders and the implementation of a trade practices compliance program.

Of these 15 cases, 14 involved a failure by the franchisor to fully comply with the disclosure provisions of the Code. Most cases involved situations where the franchisor did not provide disclosure documents to potential franchisees or, if the disclosure documents were provided, they were misleading or inadequate. Some of these cases also involved franchise systems that wrongly represented themselves as distributorships or licence agreements, to avoid the stringent requirements of the Code.

RELATED AUSTRALIAN LAW

In addition to any rights that may exist under the Code, franchisees' available legal remedies for a franchisor's inadequate or inaccurate disclosure may include:

- the prohibitions on misleading and deceptive conduct and on false and misleading representations in sections 52 and 53, respectively, of the TPA and in the equivalent State and Territory *Fair Trading Acts*;
- the common law and, in the Australian Capital Territory and South Australia, the legislation relating to innocent misrepresentations;
- the common law of tortious misrepresentation;
- the common law of fraudulent misrepresentation;
- the prohibition on unconscionable conduct at law and as contained in sections 51AA and 51AC of the TPA;
- the doctrine of equitable estoppel;
- the equitable doctrine of undue influence; and
- the express written terms and any pre-contractual statement by the franchisor in the nature of a term.

The rights and remedies described above are not necessarily mutually exclusive and there will be instances where a franchisee may be entitled to rely on several rights of action.

AN INTERNATIONAL PERSPECTIVE

By way of background, the Committee considered the regulation of the franchising industry in a number of overseas jurisdictions. Jurisdictions considered by way of example included the USA (Federal, State and the Uniform Franchise Offering Circular), a number of European systems including France, Italy and voluntary codes of conduct prescribed by the British Franchise Association and the European Franchise Federation. Vietnam and Malaysia were considered as a sample from South East Asia. The Canadian province of Ontario and a model franchising law proposed by the International Institute for the Unification of Private Law (UNIDROIT) were also considered. These examples were considered to be an adequate sample of current regulation of the franchise industry.

Disclosure is a key issue in all of the examples reviewed, as it is in Australia. However, the approaches taken and the degree of regulation and compliance monitoring vary considerably between jurisdictions.

By way of comparative example, US jurisdictions generally require quarterly revisions, fully audited financial statements and more information on franchisees that have been terminated, cancelled or not renewed. In Europe, under the European Code of Ethics for Franchising (ECE), the disclosure requirements are much less stringent while in Italy, failure to disclose by either party can result in annulment of the franchise agreement.

Malaysia prohibits unfair discrimination between franchisees, including when supplying goods to different franchises. Both Malaysia and Vietnam provide for a system of registration.

Under the model law proposed by UNIDROIT the franchisee only has to acknowledge receipt of the disclosure documentation if the franchisor asks for it and in Ontario (Canada) the franchisor has to certify that they have provided all the information required by the legislation.

Further details of the features of each of the jurisdictions reviewed by the Committee is provided at **Attachment E**. This attachment compares how each jurisdiction treats disclosure and issues such as registration requirements, good faith and fair dealing, requirements to obtain advice, termination and renewal, payments to franchisors and advertising of franchises and promotional funds.

DISCLOSURE – OPERATION AND RECOMMENDATIONS

Introduction

Many respondents considered that there was a high level of awareness of the Code in the franchising industry and that the Code has had a positive impact on that industry. However suggestions ranged from recommendations for no alterations to those for significant changes.

A number of submissions related to incomplete or inaccurate information in disclosure documents. It was also suggested that there did not appear to be any process for the administrator of the Code to ensure that disclosure documents complied with the Code until after a complaint was lodged. There was some suggestion that even when problems with the disclosure process were identified and either went to mediation or were referred to the ACCC, limited follow up action was taken to address the concerns of the franchisee. In the case of mediation conducted by the OMA, due to confidentiality issues, there is no system in place to monitor or review the implementation of the results of the mediation. However in the majority of resolutions the two parties sign an agreement.

The Committee considers that a number of changes could be implemented to augment the level and extent of disclosure and oversight of this aspect of the Code. These options and subsequent recommendations are provided below. Where possible specific recommendations are provided for amendments to the Code to achieve these recommendations.

The recommendations are divided into three parts:

- Recommendations directly pertinent to Part 2 and Annexure 1;
- Recommendations directly pertinent to Parts 1 and 3; and
- Other recommendations and observations pertinent to disclosure.

An appendix contains recommendations that the Committee made regarding some inconsistencies that it observes in the Code.

NOTE:

- When applicable changes to Annexure 1 also relate to Annexure 2.
- At least some of the recommendations will have consequential changes to other provisions.
- The Committee recommends that sufficient time be allocated for franchisors to update disclosure documents to meet these recommendations.

Recommendations directly pertinent to Part 2 and Annexure 1

1. Requirement to include a complete franchise agreement

The Code requires a franchisor to give a current disclosure document to a prospective franchisee. According to Annexure 1 of the Code this must include summary conditions of the franchise agreement (see items 15,16 and 17). Some submissions reported that franchisors provided incomplete franchise agreements at the time the disclosure document was provided. In some instances the franchisee was given the complete document at the time of signing the franchise agreement and consequently insufficient time was allowed for them to consider the document. It was reported that in some cases the document provided for signing may have included additional provisions or changed provisions from those in the original draft. The Committee considers that whilst the 7 day cooling off period does provide some protection, the protection afforded is not adequate.

The Committee considers that it is appropriate for prospective franchisees to receive the franchise agreement in the form in which it is intended to be executed at the same time as they receive the disclosure document. The franchise agreement could be provided on the basis that it is commercial and in confidence.

The Committee noted that such a requirement is consistent with a number of the foreign franchising disclosure laws reviewed (Italy, France and United States – Federal being examples).

Recommendation 1

Clause 10 and item 17 of Annexure 1 of the Code be amended to require the franchisor to provide the franchise agreement in the form it is intended to be executed with the disclosure document.

2. Requirement to include copies of all associated agreements and contracts

Item 18 of Annexure 1 requires the franchisor to provide a summary of any requirements under the franchise agreement for the franchisee to enter into other agreements as a result of signing the franchise agreement. These include leases and sub-leases for premises, chattel leases or hire purchase agreements, guarantees, mortgage security deposits, confidentiality agreements and agreements not to carry out business in the area for a time after the franchise agreement is terminated.

The Committee was advised that the final form of such documents is sometimes not provided until after the franchise agreement is signed and their existence is only alluded to briefly during preliminary meetings or brushed off as not being of any significance. However, such agreements often have a major impact on the viability of the franchise and therefore need to be treated appropriately.

The Committee noted that the 7 day cooling off period does not provide adequate protection as the signing of these documents in their final form, under the current arrangement, may take place some time beyond the expiration of cooling off period.

In the interest of full disclosure and to allow the franchisee to seek advice on these agreements and their ramifications, the Committee considers that complete copies of such documents should be provided to the franchisee at least fourteen days before they are expected to sign the franchise agreement. This would provide the franchisee sufficient time to assess these documents before making a commitment.

It is noted that a similar provision is a requirement of the *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*¹² in the USA.

Recommendation 2

Item 18 of Annexure 1 of the Code be modified to require the franchisor to provide copies of all related documents required by the franchise agreement to be signed by the franchisee, in the form they are intended to be signed with the disclosure document, or earlier, which would be at least 14 days before the franchise agreement is expected to be signed.

3. Requirement to include a Risk Statement

The Committee noted that some of the problems identified by the submissions may have been avoided if the prospective franchisee had a clearer understanding of the significant risks that were involved in becoming a franchisee. Significant risks may include decisions made by third parties relevant to the business (such as landlords, franchisor and franchisee associates), earnings projections, changing competition, franchisor rights to unilaterally amend the franchise agreement, franchisee rights and obligations on termination or expiration of the franchise agreement, economic cycles, legislative change, franchisor solvency, franchisor rights to unilaterally terminate the franchise agreement and a decision by the prospective franchisee not to take advice before entering into a franchise agreement.

The Committee considers that, if prospective franchisees are made aware of significant risks, such as those identified above, then they should be better informed in making their decision about entering a franchise agreement and will be better equipped to manage the risks.

In the Risk Statement the franchisor should identify known significant risks that could have a material impact on the franchisee. In recognition of the Committee's desire to keep the disclosure focused, relevant and concise, it is recommended that the ACCC be tasked with developing a prescribed Risk Statement format with disclosure requirements.

¹² *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (FTC Rule) §436.*

In addition the committee notes that Clause 11 of the Code enables prospective franchisees to opt out of taking advice from an independent legal advisor, an independent business advisor or an independent accountant. The Committee is of the view that prospective franchisees are well advised to obtain as much information and advice as possible before entering a franchise agreement. Many submissions supported this view and noted the disadvantages to prospective franchisees who opted not to take such advice.

Whilst the Committee agreed that the taking of advice would, generally, be in the best interest of the prospective franchisee, it did not consider that the taking of advice should be mandated by the Code. Some franchisees, for example, have existing knowledge about franchises and franchising. The Committee recognised the importance of education in this regard and recommends that the risks of not taking advice be included in the Risk Statement and augmented in ACCC educational material.

Recommendation 3

The Code be amended to include a requirement for the franchisor to include a Risk Statement with the disclosure document.

The ACCC be tasked with developing a prescribed Risk Statement document with disclosure requirements.

4. Disclosure of section 87B TPA undertakings

Undertakings given by a party under TPA section 87B are voluntary and legally enforceable undertakings that the party may give to the ACCC in many different circumstances, including to settle or avoid proceedings alleging that the party has breached the TPA.

The Code in item 4.3 Annexure 1 requires the franchisor to disclose, in their disclosure document, the date of order or undertaking under section 87B of the TPA. However the franchisor is not required to advise franchisees of subsequent undertakings as they are for other proceedings by way of Part 3 clause 18(2) requirements. Since timely knowledge of the existence and content of 87B undertakings may be material to the ability of the franchisees to make informed decisions (whether prior to or after the franchise agreement is entered into), the Committee considers that such information should be included in the disclosure document and should also be disclosed within a reasonable time (but not more than 14 days) after the undertaking is given.

Recommendation 4

Part 3 clause 18(2) of the Code and item 4 of Annexure 1 to the Code be amended to include the requirement to disclose details of section 87B TPA undertakings within a reasonable time (but not more than 14 days) after the undertaking is given.

5. Rebates and other financial benefits

Item 9.1(j) of Annexure 1 of the Code requires franchisors to disclose whether the franchisor or an associate of the franchisor, will receive a rebate or other financial benefit from the supply of goods or services to franchisees, and whether any rebate or financial benefit is shared, directly or indirectly, with franchisees.

The Committee received submissions requesting that this clause be extended to include details of the amounts of the rebate or other financial benefit. The Committee considers that this extension should be made, as disclosure of this information would provide greater transparency to the relationships between the franchisor, franchisee and suppliers to the franchisee.

Recommendation 5

That item 9.1(j) of Annexure 1 to the Code be extended to include disclosure of the amounts or method of calculation of rebates or other financial benefits to the franchisor or an associate of the franchisor from the supply of goods or services to franchisees.

6. Auditing of marketing and other co-operative funds

The Committee noted concerns expressed in submissions about the operation and management of marketing and other co-operative funds. The concerns related to the lack of transparency in the management and application of such funds and the fate of the franchisees' contributions in the event of franchisor failure.

The Committee noted that franchisors have an option to seek approval from 75 per cent of their franchisees to avoid the requirement to have such funds audited. It was considered that this option sent the wrong messages to industry participants and that this option should be removed by deleting clause 17(2) of the Code. This would also require a consequent amendment to item 12.1(e) of Annexure 1.

Some submissions suggested that these funds should be placed in a trust account. This would ensure that these funds were not subsumed into the working capital of a franchisor and not lost in the case of franchisor failure. However requiring these funds to be placed in a trust account would potentially result in increased expense and require increased administration. This may adversely impact on funds available for marketing and other purposes.

As a compromise, the Committee proposes that the audit of marketing and other co-operative funds should be mandatory.

Recommendation 6

The annual financial statement of marketing or other co-operative funds, receipts and expenses prepared pursuant to clause 17 of the

Code be subject to compulsory annual audit by a registered company auditor.

7. Provision of audited financial information for the franchisor and the consolidated entity

The Committee considers that the provision of audited financial information for the franchisor, and if applicable, the consolidated entity to which it belongs could be important for a prospective franchisee in assessing the structure and financial viability of the franchisor (See also Recommendation 24). The Committee noted that several overseas jurisdictions mandate audited financial statements; these jurisdictions include the United States, Malaysia and the Province of Ontario in Canada. However the Committee also recognised that an obligation to provide audited financial information would impose additional cost burdens on franchisors and consequently, on franchisees and consumers through cost recovery.

There is currently insufficient evidence to fully evaluate the costs and benefits of mandating audits for the franchise sector. To better understand the extent to which financial statements are currently being audited and the degree to which this affects outcomes in the franchising sector, the Committee recommends that the ACCC collect and analyse further information, and reports and provides its recommendations in this area.

Recommendation 7

The ACCC, as part of the registration process (Recommendation 23), collect information on the extent to which franchisors' financial statements are currently audited and provided pursuant to item 20.3 of Annexure 1 of the Code.

The ACCC determine the extent to which any lack of audited financial statements is causing unsatisfactory outcomes for the industry particularly in respect to franchisor solvency disclosures.

The ACCC report to the Government on its findings and provide recommendations by 30 April 2007.

8. More information about past franchises

Concern about the availability of information regarding past franchises was expressed in a number of submissions.

The Committee considers that such information is an important element in the disclosure process because it may assist a prospective franchisee to obtain information regarding the viability of the franchise, practical issues in running the franchise business, and assistance provided by the franchisor. Further, the level of movement in and out of the franchise system and the reason for that movement is also likely to be relevant to a prospective franchisee.

In disclosing past franchisee details it is vital that the privacy of those franchisees who did not want their details disclosed be protected. The disclosure of information about past franchisees will need to comply with the *Privacy Act 1988* and confidentiality obligations.

The Committee considers that the onus should be on the franchisor to seek the approval of past franchisees to release their contact details to prospective franchisees. Where consent was not forthcoming, the franchisor would disclose the number of franchisees that declined to give consent.

Recommendation 8

Subject to compliance by the franchisor with Privacy Laws and the obtaining of relevant consents to disclosure, the Code be amended to require not just the numbers but also names, location and contact details relating to the franchisees corresponding to events listed in item 6.4 of Annexure 1. This could be included as an addendum to the disclosure document.

9. Qualifications of advisors

It was submitted to the Committee that the independent advisors referred to in clause 11 of the Code should be subject to a certification process about their franchising qualifications. The Committee recognises the importance of taking advice from a suitably qualified and competent person but did not form the view that this should necessarily require a certification process at this time.

The ACCC and peak industry associations undertake an important role in providing education and information resources for franchisees and franchisors. These resources should strengthen the message to prospective franchisees in particular that they should seek advice from suitable and independent franchise sector advisors.

Recommendation 9

The Government ask relevant peak industry bodies to raise the level of understanding of their members of the particular requirements connected with advising potential franchisees prior to them entering into franchisee agreements.

10. Disclosure of the business experience of all who have or may have management responsibilities.

Item 3.1 of Annexure 1 of the Code specifically excludes an executive officer from the class of persons about which a summary of relevant business experience in the last 10 years must be provided. The Committee is of the view that knowledge about the business experience of an executive officer is relevant to prospective and

existing franchisees and consequently that the executive officer exemption should be deleted from item 3.1 of Annexure 1.

The *Corporations Act 2001* does not define the term “executive officer” but the previous definition of that term (as used in the Corporations Law) referred to the concept of a person who is concerned in, or takes part in, the management of a body (regardless of the person’s designation and whether or not the person is a director of the body). Notwithstanding the omission of the definition of “executive officer” from the *Corporations Act 2001*, the previous definition as was used in the Corporations Law is appropriate.

Recommendation 10

That item 3.1 of Annexure 1 be amended to remove the executive officer exemption from the class of persons about which a summary of relevant business experience in the last 10 years must be provided.

That Item 2.6 of Annexure 1 be amended to substitute for the term “executive officer” (which is not defined in the *Corporations Act 2001*), the concept of a person who is concerned in, or takes part in, the management of the franchisor (regardless of the person’s designation and whether or not the person is a director of the franchisor).”

11. Opt out clause from providing information requested from Annexure 1

In accordance with item 11.1(a) of Annexure 2 of the Code, franchisors are required to give a statement to the effect that the prospective franchisee may ask for information referred to in various sections of Annexure 1.

Clause 6C of Part 2 obliges franchisors to provide this information "unless, in the circumstances, it is reasonable to withhold the information". It is the Committee’s view that if any of the additional information required under Annexure 1 is requested in accordance with clause 6C, then it should be provided.

The Committee’s view is that the opt out provision in clause 6C, as described above, should be deleted.

Recommendation 11

The opt out provision in Part 2 clause 6C be deleted.

Recommendations directly pertinent to Parts 1 and 3

There are clauses in Part 1 and Part 3 and that have a strong bearing on the disclosure provisions. The Committee considers it appropriate to submit its recommendations concerning these disclosure related sections.

12. Disclosure of materially relevant facts

The Committee received a number of submissions in relation to the time given to a franchisor to disclose "materially relevant facts" under the provisions of Part 3 clause 18(1) of the Code. The Committee understood that a change from 60 days to 14 days had been recommended by the first review in 2000. The Committee agrees with that recommendation.

Recommendation 12

Part 3 clause 18(1) of the Code be amended to require franchisors to disclose materially relevant facts within 14 days after the franchisor becomes aware of the facts rather than the present 60 days.

13. Exemption from application of the Code

The following exemption to the application of the Code is provided at clause 5(3)(a)(i) and (ii) of the Code:

"5 (3) However, this code does not apply to the franchise agreement:

(a) if the franchisor:

- (i) is resident, domiciled or incorporated outside Australia; and*
- (ii) grants only 1 franchise or master franchise to be operated in Australia".*

It was suggested to the Committee that this exemption should be removed from the Code because of problems that have arisen from foreign franchisors reselling the one franchise. As the Committee is of the opinion that franchise arrangements referred to in clause 5(3)(a)(i) and (ii) should be subject to the same disclosure requirements as other franchise arrangements, the Committee agrees with the suggestion.

Recommendation 13

The exemption to the application of the Code referred to in Part 1 clause 5(3)(a)(i) and (ii) be removed from the Code.

14. Franchises currently excluded from the Code

The following exemption to the application of the Code is provided at clause 5(3)(c) of the Code:

“5 (3) However, this code does not apply to the franchise agreement:

...

(c) if:

(i) the franchise agreement is for goods or services that are substantially the same as those supplied by the franchisee before entering into the franchise agreement; and

(ii) the franchisee has supplied those goods or services for at least 2 years immediately before entering into the franchise agreement; and

(iii) sales under the franchise are likely to provide no more than 20% of the franchisee's gross turnover for goods or services of that kind for the first year of the franchise.

The Committee's view is that the protection provided by the disclosure provisions should be afforded to all prospective and existing franchisees. The Committee sees no sufficient reason to exclude franchise agreements within the description of clause 5(3)(c).

Recommendation 14

Delete clause 5(3)(c).

15. Directors to disclose their convictions

The Committee was made aware of a recent ACCC investigation that indicated a need to consider a greater level of disclosure of prior criminal convictions for offences under the *Corporations Act 2001*. The relevant matter involved allegations of unconscionable conduct and complaints concerning the non-disclosure of the director's prior conviction for a criminal offence under the *Corporations Act 2001*.

As awareness that a director of a franchisor company has been convicted of an offence under corporate law may be relevant to existing and potential franchisees making informed business decisions, the Committee considers that the Code should be amended to require disclosure of this information.

Recommendation 15

Part 3 clause 18(2)(b) and (2)(d) and Annexure 1 item 4 of the Code be amended to include franchisor directors in the class of persons about which materially relevant facts must be disclosed and the scope of disclosure be extended to criminal convictions for non serious offences.

16. The right of unilateral termination to a franchise agreement

A number of submissions expressed concern about the unequal nature of a business relationship that allows a franchisor to unilaterally terminate a franchise agreement without any breach by the franchisee (a unilateral termination). Amongst the submissions there were calls for a guaranteed buy-back of franchise or other compensation or a prohibition on the right of unilateral termination.

Part 3 clause 22 contemplates franchise agreements that permit the unilateral termination of an agreement by a franchisor.

The Committee's view is that in many circumstances it would be unreasonable for a franchisor to unilaterally terminate a franchise agreement where there has been no breach by the franchisee.

If unilateral termination rights are to be held by a franchisor, the Committee considers that the franchisee's risks associated with these rights should be covered in the Risk Statement. In addition, it is important that the ACCC ensure that such risks are clearly spelt out in the educational material that they provide to prospective franchisees.

The Committee also sees merit in the franchise agreement providing for adequate franchisee compensation if unilateral termination rights are exercised, and in referring to such compensation in the disclosure document.

Recommendation 16

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor termination rights contained in Part 3 clause 22 of the Code.

Consideration also be given to removing or modifying the right of a franchisor to include in a franchise agreement the right to unilaterally terminate a franchise agreement. In the event that the right to unilaterally terminate the agreement is maintained, adequate franchisee compensation should be provided for in the franchise agreement and referred to in the disclosure document.

17. The right of unilateral change to a Franchise Agreement

Franchisors are currently able to include in the franchise agreement the right to unilaterally amend arrangements between themselves and franchisees.

The original Franchise Bills proposed that such clauses in a franchise agreement should be null and void.¹³

¹³Clause 22 of the original *Franchise Agreements Bill 1986* (Cth) declared void any provision in a franchise agreement or related agreement which permits a party to unilaterally vary provision in the franchise agreement or related agreement. See, Business Affairs Division of the Commonwealth Attorney-General's Department, *Consultative Paper and Franchise Agreements Bill 1986* (Cth), 62.

Franchise agreements which contain clauses enabling a franchisor to unilaterally amend arrangements with franchisees have the potential to adversely impact a franchisee. If rights of unilateral change are to be held by a franchisor, the Committee considers that the franchisee's risks associated with these rights should be covered in the Risk Statement. In addition, it is important that the ACCC ensure that such risks are clearly spelt out in the educational material they provide to prospective franchisees.

The Committee received submissions supporting the view that changes to a franchise agreement that have a materially adverse effect on a franchisee should not be allowed without the consent of the franchisee or at the least not without some form of appropriate compensation being paid to the franchisee. The terms and conditions of any such payment of compensation would necessarily have to be clearly spelt out in the disclosure document and the franchise agreement.

Recommendation 17

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor changes to franchise arrangements.

Consideration also be given to prohibiting unilateral changes by franchisors to arrangements with franchisees which have materially adverse effects on the franchisee without franchisee consent. In the event that the right to unilaterally amend financial arrangements with franchisees is maintained, adequate franchisee compensation should be provided for in franchise agreements and referred to in the disclosure document.

18. Prospective franchisees communication with existing franchisees

A number of submissions indicated that there are occasions when franchisors exert pressure on prospective franchisees not to communicate with past franchisees.

Clause 15 of the Code prohibits franchisors from inducing franchisees not to associate with other franchisees for a lawful purpose. However this clause does not expressly prohibit franchisors from inducing prospective franchisees not to associate with current or past franchisees. Thus the interests of prospective franchisees are not currently protected by clause 15.

The Committee considers that as the interests of current or past franchisees cannot be distinguished from those of prospective franchisees in this respect, clause 15 should also protect prospective franchisees.

Recommendation 18

Part 3 clause 15 of the Code be amended to include a reference to prospective franchisees after the references to franchisees.

Other recommendations and observations relevant to disclosure

In addition to the core recommendations appearing in the sections "Recommendations directly pertinent to Part 2, Annexure 1" and "Recommendations directly pertinent to Parts 1 and 3", the Committee considers it appropriate to submit other recommendations and observations which are relevant to disclosure under the Code.

19. General waivers of written representations

In its submission the ACCC referred the Committee to a recent Full Federal Court decision¹⁴ where the disclaimers, exclusion clauses and requirement to seek independent advice were sufficient to place the franchisees on notice that further investigation and qualification was required of representations regarding sales, profitability, site quality and other matters.

The ACCC was of the view that this determination may place franchisees in a vulnerable and disadvantageous position, as it was in the ACCC's experience that the decision of many prospective franchisees to purchase a franchise is influenced by prior written representations.

In its submission the ACCC suggested that this decision may encourage franchisors to use broad disclaimers in franchise sales literature to seek avoiding liability under the Code and the TPA, while placing a stronger onus and obligation on franchisees to verify information provided. The ACCC stated that this onus appears disproportionate considering that franchisors should be able to provide accurate and detailed information about a potential and existing franchise.

Accordingly, the ACCC recommended that the Committee consider a possible amendment to the Code to provide that franchise agreements contain no general waiver of written representations made to potential franchisees.

The Committee notes that it is not uncommon in business-to-consumer and business-to-business transactions for one or both parties to seek waivers, disclaimers and limitations or exclusions of liability in order to allocate risks. Moreover, it is possible that such a change may discourage franchisors who would normally make written representations as to sales, profitability, site quality and other matters (albeit with disclaimers) from providing any such written representations at all.

Recommendation 19

Consideration be given as to whether or not franchise agreements and disclosure documents should be prohibited by the Code from including any general waivers of written representations made to potential franchisees or franchisees seeking to extend their franchise agreements.

¹⁴ *Poulet Frais Pty Ltd v The Silver Fox Company Pty Ltd* (2005)ATPR 42-075

20. Clarity at the termination, expiry or non-renewal of an agreement

A number of submissions from franchisees and ex-franchisees expressed concern about the consequences to them on termination, expiry or non-renewal of the franchise agreement. Other stakeholders also suggested that further clarity on this matter would be beneficial. Clause 17 of the Code requires a summary of the conditions of the franchise agreement (or a reference to the relevant conditions of the franchise agreement) that deal with franchisee obligations when a franchise agreement is terminated, expires or is not renewed. Recommendation 1, if adopted, will require the franchisor to provide the franchise agreement in the form it is intended to be signed with the disclosure document.

Consequently, compliance by the franchisor, in the franchise agreement, to the requirements of clause 17 of the Code, will provide franchisees with the conditions dealing with termination, expiration or non-renewal of the franchise agreement. To further highlight the importance of this issue the Risk Statement should, if significant, also refer to the risks to the franchisee on termination, expiring or non-renewal.

Recommendation 20

The Risk Statement should, if significant, refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement.

21. Clarity in the event of franchisor failure

Concerns were expressed about the sufficiency of franchisor disclosure regarding franchisee rights and obligations if the franchisor fails. The Committee considers that these concerns can be addressed through the Risk Statement and ACCC educational material.

Recommendation 21

The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with franchisor failure.

22. Financial Details

In some instances the franchisor belongs to a consolidated entity comprising a number of legal entities. Clause 20 requires disclosure of financial details in respect of the franchisor but not, where applicable, the financial details of the consolidated entity to which it belongs.

The Committee considers that as financial information in respect of both the franchisor and, where applicable, the consolidated entity is relevant to prospective

and existing franchisees, this information should be disclosed as part of the requirements under item 20 of Annexure 1.

Recommendation 22

The requirement under item 20 of Annexure 1, to disclose financial details be extended, where applicable, to include the consolidated entity to which the franchisor belongs.

23. Registration and Review of Disclosure Documents.

A number of franchisees advised the Committee that they had not been given disclosure documents at all whilst some others advised that the disclosure document they had received was not in accordance with the Code. Additionally many of the concerns raised in the submissions may have been overcome if the degree of compliance with the disclosure provisions of the Code was improved. The Committee formed the view that to address this issue, the registration of franchisors and review of a sample of disclosure documents should be introduced. The committee noted that recommendations for Registration and review of disclosure documents were received from a cross section of stakeholders. By comparison, in the USA the UFOC¹⁵ does not require registration but 14 states, which include California, require the disclosure document to be registered with their regulatory body. Registration is required before entering into a franchise agreement in Vietnam¹⁶ and before making an offer to sell a franchise in Malaysia.¹⁷

The Committee considers that franchisors should be required to register with the ACCC and annually provide the most current disclosure document and other minimum prescribed information (to be determined by the ACCC). The ACCC should be tasked with performing representative sample audits of disclosure documents each year and addressing any failures to comply with the disclosure provisions of the Code. The Code should be amended to allow the ACCC to ask for a copy of a disclosure document for assessment outside the provisions of Section 155(1) of the TPA.¹⁸

The ACCC should also be tasked to perform an active enforcement role including vetting disclosure documents and addressing failure to comply with the Code.

Recommendation 23

The Government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate

¹⁵ United Franchise Offering Circular (UFOC).

¹⁶ Investment and Trade Promotion Centre, *Trade Ministry Circular n° 9-2006-TT-BTM dated May 25, Article 17-23.*

¹⁷ Malaysian Parliament, *Act 590 - Franchise Act 1998 (section 6(1)).*

¹⁸ Clause 155(1) Grants power to the ACCC to obtain information documents and evidence if they believe that there has been a contravention of the TPA.

enforcement of the Code. The process would be administered by the ACCC.

24. The current level of ACCC action relating to franchising

The administration of the Code by the ACCC is a key element in ensuring that franchisors are complying with the disclosure provisions of the Code.

A number of submissions from franchisees expressed concern about the level and extent of action by the ACCC to deal with claims of breaches of the Code by franchisors. Some submissions, from franchisees and ex-franchisees expressed disappointment that the ACCC did not launch investigations into their cases.

Notwithstanding the concerns expressed by a number of franchisees who made submissions, the Committee notes that the ACCC demonstrated that it has been active in promoting the Code. In its submission, the ACCC advised that their Small Business Team provides regular information to national and state industry bodies and business service providers about trade practices issues. In addition to general liaison the ACCC has established a Franchising Consultative Panel which meets twice a year and provides a forum to identify emerging industry issues, and a mechanism for developing specific compliance tools to assist franchisors and franchisees in understanding their rights and obligations under the TPA and the Code. Since 2001-02 the ACCC has received approximately 1300 complaints and inquiries relating to the Code; approximately 260 of these have concerned disclosure documents. Since the introduction of the Code, the ACCC has commenced and successfully concluded litigation in 15 cases, where 14 related to the disclosure provisions of the Code.

Recommendation 24

The Government appraise the ACCC of concerns expressed to the Committee about the level and extent of action by the ACCC in dealing with claims of breaches of the Code by franchisors.

25. Implementation of the principle of good faith and fair dealing

A number of the reviewed foreign jurisdictions have either a general concept of good faith in commercial contracts or a specific concept of good faith which applies to franchise agreements, e.g. in the context of pre-contractual negotiations and in mediation of disputes. (See Attachment E)

In Australia, some courts have accepted, to some degree, the implication of obligations of good faith in contractual dealings, For instance, it has been suggested that good faith embraces three notions: an obligation on the parties to cooperate in achieving their contractual objects, compliance with honest standards of conduct and compliance with standards of conduct which are reasonable having regard to the interests of the parties. However, uniform acceptance and

understanding of concepts, content and implications of good faith obligations has not emerged in the Australian jurisdictions.¹⁹ (See Attachment F)

The concept has been included in the voluntary Motor Vehicle Insurance and Repair Industry Code of Conduct 2006. In this case insurers and repairers have agreed to "*observe high standards of honesty, integrity and good faith in conducting their business with each other and in the provision of services to claimants*".²⁰

The interdependency between franchisors and franchisees is fundamental to the franchise sector. Notwithstanding the various legal remedies already available to both franchisors and franchisees under various laws including the *Trade Practices Act 1974* (see Attachment F), the Committee considers that recognition in the Code of a concept of good faith and fair dealing would provide positive reinforcement to the development of improved relationships and dealings between franchisors, franchisees and prospective franchisees.

Recommendation 25

A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part1 of the Code.

26. Standardisation of the audit period

The Committee is of the view that the audit period referred to in clause 6(1) should align with *Corporations Act 2001* audit period. This will improve consistency with other statutory requirements.

Recommendation 26

The audit period referred to in Part 2 clause 6(1) of the Code be aligned with the *Corporations Act 2001* audit period.

27. Avoidance of providing the details and history of the territory or site to be franchised together with the disclosure documents

Annexure 1 item 11.2 requires details and history of the territory or site to be franchised to be provided in the disclosure document. Annexure 1 item 11.3 states that "The details mentioned in item 11.2 may be in a separate document and may be made available for inspection at a time and place mentioned in the disclosure document."

¹⁹ The Hon Justice James Douglas "Exploring the Recent Uncertainty Surrounding the Implied Duty of Good Faith in Australian Contract Law: the Duty to Act Reasonably - Its Existence, Ambit and Operation" <http://www.cisq.law.pace.edu/cisq/biblio/douglas1.html> (accessed 12 October 2006)

²⁰ *Motor Vehicle Insurance and Repair Industry Code of Conduct (June 2006)*; page 7.

Whilst accepting that the required information may be provided by way of a separate document the Committee's view is that the information should be provided with the disclosure document.

Recommendation 27

Item 11.3 of Annexure 1 of the Code be amended to require the details mentioned in item 11.2 to be in a separate document which is provided with the disclosure document.

Appendix

During the review of the disclosure provision of the Code, the Committee made the following additional observations regarding inconsistencies and areas for clarification.

28. Clarification of "other payments"

Property payments can be major expenses to franchisees. A number of submissions commented on the failure to provide adequate information about rental and other property expenses.

The Committee therefore sees the need to clarify that the "other payments", which must be disclosed pursuant to Annexure 1 item 13.6, include lease related payments. This should be done by stating that the definition of "associate" in clause 3(1)(b) also applies to persons who supply real property to franchisees.

Recommendation 28

Part 1 clause 3(1)(b) include the words "real property" so that it reads:

**"associate, for a franchisor, means a person...
(b) whose relationship with the franchisor is relevant to the franchise system, including supplying goods, real property or services to a franchisee."**

29. Consistency with regard to attaching a copy of the Code to the disclosure document

As a result of its study of the Code, the Committee noted an inconsistency with regard to instructions for a copy of the Code to be supplied together with the disclosure document. Item 22.2 of Annexure 1 currently reads "Copy of the Code may be attached." This is inconsistent with clause 10 of the Code, which requires that a copy of the Code "must" be attached.

Recommendation 29

That Item 22.2 of Annexure 1 be deleted.

30. Clarification of "extend"

A number of submissions sought clarification as to whether the word "extend" in this clause refers to an extension in "term" only or term and "scope". Part 2 clause 6B (1) currently uses the phrase "a franchisee proposing to renew or extend a franchise agreement." The Committee formed the view that this should be clarified because "extend" is used in a number of clauses, eg, clauses 10 and 11. The Committee favours the inclusion of "scope" in order to define the provision in a

broader sense than “term”, however, suspects that the original intention was that clause 6B is limited to “term”.

Recommendation 30

Part 2 clause 6B (1) be amended to read:

"(1) A franchisor must give a current disclosure document to:

- (a) a prospective franchisee; or**
- (b) a franchisee proposing to renew a franchise agreement or extend the scope or term of a franchise agreement".**

31. Clarification of the time frame for the measure used to determine the use of the Annexure 1 or Annexure 2 disclosure documents

Concern was raised about the meaning of the time frame in Part 2 clause 6(2) of the Code. The Committee saw the need to make clear the time frame that is used to determine the scale of franchised business according to which the required disclosure document is determined.

Recommendation 31

That in Part 2 clause 6(2) of the Code “at any time during the term of the franchise agreement” be added after “turnover” to clarify the time frame.

32. Definitions of "executive officer" and "officer"

Part 1 clause 3(2) directs the reader to consult "the *Corporations Law*" for a definition of the term "executive officer" and other terms is dated since the *Corporations Law* has been repealed and replaced by the *Corporations Act 2001*. The *Corporations Act 2001* does not use or consider the term "executive officer" nor does it provide a definition for this term.

Recommendation 32

That, in view of the repeal of the definition of “executive officer under the *Corporations Law*:

- (a) clause 6(2)(c) of the Code be amended to replace the term “executive officer” with the term “officer”;**
- (b) Item 2.6 of Annexure 1 be amended in accordance with Recommendation 10; and**
- (c) clause 3(2) of the Code be amended to delete the term “executive officer”, and the usage of that term in the rest of the Code and the Annexures be reviewed.**

33. Termination of the agreement and costs within the 'cooling off' period.

The Code is inconsistent regarding the cost to a prospective franchisee who terminates the agreement within the 'cooling off' period. Item 1.1 (d) of Annexure 1 and item 1.1 (e) of Annexure 2 both allow for the prospective franchisee to "terminate the agreement without cost" if this is within the "7 day 'cooling off' period after signing the agreement" while Part 3 clause 13 (4) states that "the franchisor may deduct from the amount paid under subclause (3) the franchisor's reasonable expenses if the expenses or their method of calculation have been set out in the agreement".

Recommendation 33

Add the intention of Part 3 clause 13 (4) to items 1.1 (d) of Annexure 1 and item 1.1 (e) of Annexure 2.

34. Relevance of "site" and "premises"

Some confusion has arisen in relation to inconsistent language in the Code. The Committee is of the view that the scope and clarity in Annexure 1 item 16.1(a) and 1.61 (j) should be improved in relation to the terms "site" and "premises".

Recommendation 34


Add a reference to "and premises" after "site" in Annexure 1 item 16.1(a), so that it reads:

"site and premises selection and acquisition"

Add a reference to "site and" before "premises" in Annexure 1 item 16.1(j), so that it reads:

"maintenance and appearance of site and premises, vehicles and equipment"

ATTACHMENT A – ADVERTISING



Australian Government
Department of Industry
Tourism and Resources

Review of the Disclosure Provisions of the Franchising Code of Conduct Call for Submissions

The Franchising Code of Conduct began operation in October 1998. It is a mandatory code under the *Trade Practices Act 1974*. The Australian Government is undertaking a review of *Part 2 - Disclosure* of the Code which covers the information that franchisors must disclose to franchisees and prospective franchisees.

Industry participants and interested parties are invited to provide submissions to the review by close of business on Tuesday, 15 August 2006. Submissions should be confined to issues relevant to the terms of reference and should focus on providing factual information regarding the operation of the disclosure section of the Code and views about the current form of the disclosure section. Further information about the review, including the terms of reference may be obtained by following the small business link on the Department of Industry, Tourism and Resources' web site at www.industry.gov.au.

Submissions can be sent to:

Secretary
Review of the Franchising Code of Conduct
Office of Small Business
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2600

Or by email to Franchise.Review@industry.gov.au

hwaCD4951

WWW.INDUSTRY.GOV.AU

Publications Used

26 July 2006

Australian Financial Review
The Australian
Adelaide Advertiser
Brisbane Courier Mail
Sydney Morning Herald
The Melbourne Age
West Australian
Hobart Mercury
NT News
Canberra Times

ATTACHMENT B – LIST OF STAKEHOLDERS CONSULTED

List of stakeholders with whom the Committee held direct consultation

ACCC (Mr John Martin, Commissioner)

Office of the Mediation Adviser (Mr David Newton (OMA) and Ms Bianca Keys)

Franchise Council of Australia (Mr Richard Evans, Chief Executive Officer)

Baker & McKenzie (Ms Penny Ward)

National Retail Association (Mr Gary Black)

Yum group (Ms Michelle Davies, Legal Counsel and Craig Kaywood)

Michael and Benjamin Morris (ex-Danoz franchisees)

National Federation of Independent Business (Mr John Farrell and Ms Pamela Ayson)

University of New South Wales (Professor Andrew Terry)

Mr Tony Melham (Gloria Jeans franchisee)

BCI Business Brokers (Mr Tony Arena, Managing Director)

ATTACHMENT C – LIST OF SUBMISSIONS

No.	Company
1	Spectrum Analysis
2	Former Donut King franchisee
3	Former franchisee
4	Former Midas franchisee
5	Permac Pty Ltd (Lenard's master franchisor)
6	Baker's Delight
7	Baskin Robbins franchisee
8	Former Midas franchisee
9	Former franchisee (chicken industry)
10	Former Michel's <u>Patisserie</u>
11	Northvue
12	Just Cuts
13	Lenard's
14	Aussie Pooch Mobile
15	United Franchisees Inc. (Victorian 7-Eleven Franchisees Association)
16	Jim's Group
17	Bill Winter Business Development
18	Franchisees Association of Australia
19	Former Baker's Delight franchisee
20	Foodco Group Pty Ltd
21	Midas franchisee
22	Federal Chamber of Automotive Industries
23	Baskin Robbins franchisee
24	Australian Retailers Association
25	Spinner's Building Services franchisees
26	Former Power Loan franchisee
27	Former franchisees
28	Former Thrifty franchisee
29	Australian Couriers
30	Bond University
31	Youth and Enterprise Legal Centre
32	IF International Group
33	Franchisee (chicken industry)
34	Former Lenard's franchisee
35	Mortgage Choice
36	Former Michel's <u>Patisserie</u> franchisee (additional to submission no. 10)
37	Former Lenard's franchisee
38	Former franchisee
39	The Iceberg Corporation Pty Ltd
40	Confidential
41	Baker's Delight franchisee
42	Franchisee (travel industry)
43	Doxa International
44	Cartridge World

No.	Company
45	University of NSW (Faculty of Commerce and Economics)
46	Motor Trades Association of Australia
47	Former franchisees
48	Former franchisee
49	Robert James Lawyers
50	Hertz Licensee Council
51	Confidential
52	National Retail Association
53	GHB Property Services
54	Franchise Council of Australia
55	Post Office Agents Association Limited
56	Acheson Franchise Advisors
57	Former franchisees Danoz Directions Pty Ltd
58	Baker McKenzie
59	Queensland Law Society
60	Former Midas franchisee
61	Former Jani-King franchisee
62	US Attorney at Law
63	Former Lenard's franchisee
64	CPA Australia
65	ACCC
66	National Federation of Independent Business Inc
67	Phillips Fox
68	Small Business Development Corporation (Western Australia)
69	Department of State Development, Trade and Innovation, (Queensland)
70	Department of Trade and Economic Development(South Australia)
71	Chairman, Farm & Industrial Dealers Association (Victoria)
72	Northcoats Pty Ltd
73	Quindar Pty Ltd formally trading as Jim's Antennas Central Coast.
74	Il Gianfornaio, franchisee
75	Il Gianfornaio, former franchisee

ATTACHMENT D – LONG AND SHORT DISCLOSURE

Differences between the Long Form and Short Form Disclosure Documents are evident from the following table.

Long Form	Short Form
1. First Page	1. First Page
2. Franchisor's Details	2. Franchisor's Details
3. Business Experience	
4. Litigation	3. Litigation
5. Payment to agents	
6. Existing franchises	
7. Intellectual property	4. Intellectual property
8. Franchise site or territory	5. Franchise site or territory
9. Supply of goods or services to a franchisee	
10. Supply of goods or services by a franchisee	
11. Sites or Territories	
12. Marketing or other cooperative funds	6. Marketing or other cooperative funds
13. Payments	7. Payments
14. Financing	
15. Franchisor's obligations	8. Franchisor's obligations
16. Franchisee's obligations	9. Franchisee's obligations
17. Summary of other conditions of agreement	
18. Obligation to sign related agreements	
19. Earnings information	
20. Financial details	10. Financial details
21. Updates	
22. Other relevant disclosure information	
23. Receipt	11. Receipt

The prospective franchisee may ask the franchisor for all of the information in the Long Form that is not listed in the Short Form (i.e. items 3, 5, 6, 9, 10, 11, 14, 17, 18, 19, 21 and 22)

ATTACHMENT E – FOREIGN FRANCHISING LAWS

The Committee considered publicly available material for a number of foreign jurisdictions (including model laws established by particular organisations) as background information:

- The USA (Federal);
- The USA (Uniform Franchise Offering Circular);
- The USA (California);
- European Franchising Federation;
- The United Kingdom;
- Italy;
- France;
- Malaysia;
- Vietnam; and
- UNIDROIT (Model Franchise Disclosure Law)

The summary of these jurisdictions provided below is not intended to be a comprehensive analysis or description of the franchising laws for each jurisdiction. Rather, it seeks to highlight some similarities and differences between the selected jurisdictions in relation to disclosure and associated requirements for franchises. The experiences of the reviewed jurisdictions and their varying approaches to franchise regulation provide a helpful guide to considering issues relevant to the review.

Disclosure in the Reviewed Jurisdictions

Disclosure is a key issue in all of the jurisdictions reviewed; however, it has been approached in a number of different ways, ranging from minimal disclosure regulation through to the requirement that a disclosure document be registered and vetted before a franchise can be offered for sale. The summary set out below highlights some of the key disclosure requirements in the reviewed jurisdictions.

The USA has both Federal and State franchising laws, the State laws can either be unique to a State or as is the case with the Uniform Franchise Offering Circular (UFOC) adopted by a group of States.

USA (Federal)

In 1979 the USA introduced the *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (Title 16, Part 436 of the Code of Federal Regulations)* (**FTC Rule**).²¹

The FTC requires that a franchisor provide a prospective franchisee with a disclosure statement either at the first personal meeting²², or 10 business days

²¹ Federal Trade Commission, *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures* (1979) <<http://www.ftc.gov/bcp/franchise/16cfr436.htm>> last accessed 7 September 2006.

prior to the execution of the franchise agreement or any other agreement imposing a binding legal obligation on the prospective franchisee, or the payment by the prospective franchisee, about which the franchisor²³ knows or should know, of any consideration in connection with the proposed sale of a franchise (which ever occurs first). The franchisor is also to prepare quarterly revisions to reflect any material change in the franchisor or relating to the franchise business which are to be attached to the disclosure document.

It is also noted that the *Uniform Commercial Code (UCC)* imposes an obligation of good faith on the performance and enforcement of all contracts.²⁴

The FTC Rule requires franchisors to include a wide range of items in the disclosure statement. Some items worth highlighting include:

- details of which, if any, directors and executive officers are subject to any currently effective injunctive or restrictive orders or are parties to currently pending proceedings where such orders are sought, relating to franchise activities, the franchisor-franchisee relationship or involving fraud, embezzlement, fraudulent conversion, misappropriation of property or restraint of trade;
- the names, addresses and phone numbers of the 10 nearest franchised outlets of the same franchise;
- general categorisation of the reasons for franchisor re-acquisition, refusal to renew or termination of franchises in the relevant franchise network;
- the business experience of the franchisor and the franchisor's parent firm (if any) in relation to the franchise;
- a statement of the total funds which must be paid by the franchisee to the franchisor or to a person affiliated with the franchisor or collected by a franchisor or affiliate for a third party;
- financial statements which have been examined in accordance with generally accepted accounting standards by an independent certified or licensed public accountant. Further, the FTC Rule only allows for the disclosure of unaudited financial statements in limited circumstances. Where unaudited statements are used they must be accompanied by a clear and conspicuous disclosure that they are unaudited and that final statements prepared on an audited basis will be made available as soon as practicable.

Along with the disclosure document, the FTC Rule requires that a franchisor must also provide a prospective franchisee with a copy of the franchise agreement and all related agreements to be executed by the parties at least 5 business days prior to the expected date of execution.

²² A "personal meeting" is a face to face meeting between a franchisor or franchise broker (or any agent, representative, or employee thereof) and a prospective franchisee which is held for the purpose of discussing the sale or possible sale of a franchise.

²³ This will include any franchise broker, or agent, representative or employee of the franchisor.

²⁴ See §1-304 of the UCC. Further, §1-201(b)20 defines good faith as "honesty in fact and observance of reasonable commercial standards of fair dealing." Also note, the UCC only has the force of law if enacted by States. See Cornell Law School, *Uniform Commercial Code* (2003) < www.law.cornell.edu/ucc/ucc.table.html > last accessed on 27 September 2006.

USA (Uniform Franchise Offering Circular (UFOC)).²⁵

Franchisors in the USA have a choice of formats for making the disclosures required by the FTC Rule. They may use either the format provided by the FTC Rule or the UFOC format. State franchising laws may also require disclosure documents to be in the form of the UFOC (see comments on California below).

The UFOC is a model disclosure document. The circumstances under which it is necessary to create a disclosure document in the form of the UFOC will vary depending on whether the FTC Rule or a particular state law is being applied. The UFOC also provides example clauses for agreements. The UFOC provides for a copy of all agreements regarding the offering of a franchise to be attached. This includes the franchise agreement and related agreements such as any leases, options and/or purchase agreements. However as is the case in Australia the UFOC does not require franchisors to include an earnings claim.

USA (California)

Corporations Code §§31100-31516²⁶ and *California Code of Regulations, Title 10 Chapter 3, Subchapter 2.6* (Regulations)²⁷

The *Corporations Code* provides for a franchise registration system in California. It is unlawful for any person to offer or sell any franchise in California unless the offer is registered with the California Corporations Commissioner or alternatively deems to fall into one of the categories of exemption set out in the *Corporations Code*.²⁸ Where registration is required a franchisor must create a disclosure document consistent with the UFOC. Thus, the content of a disclosure document will be the 23 items required by the UFOC.²⁹ A franchise which is exempt from registration on the other hand is only required to disclose 16 items set out in §31101(c)(3)(1) of the *Corporations Code*.

Set out below are a number of noteworthy features of the Californian disclosure regime:

- If there is a failure to comply with the *Corporations Code*, registration can be revoked or suspended;
- It is unlawful for any person wilfully to make any untrue statements or omissions of a material fact in any application, notice or report filed with the Commissioner;³⁰
- Franchisees are not required to seek legal and financial advice regarding the disclosure document;

²⁵ The UFOC was created and adopted by the North American Securities Administration Association (NASAA). NASAA is an association of 67 state, provincial and territorial securities administrations in the 50 states of the United States of America, the District of Columbia, the U.S. Virgin Islands, Puerto Rico, Canada and Mexico. See North American Securities Administrators Association, *Uniform Franchise Offering Circular Guidelines* (1993) <http://www.nasaa.org/Industry___Regulatory_Resources/Uniform_Forms/3697.cfm> last accessed on 7 September 2006.

²⁶ Official California Legislation Information, *California Corporations Code* <<http://www.leginfo.ca.gov/>> last accessed on 6 September 2006.

²⁷ California Office of Administrative Law, *California Code of Regulations* <<http://www.calregs.com>> last accessed on 7 September 2006.

²⁸ Various exemption categories are set out in Chapter 1 of the Corporations Code (see §§31110-31109.1).

²⁹ State specific regulations may amend the UFOC to require further disclosures or allow for exemptions. The Californian Regulations, for example amend the UFOC in a number ways.

³⁰ See California Corporations Code, §§31200 -31203.

- Franchisees can sue for damages or rescission of the franchise agreement in cases when franchisors violate specified parts of the *Corporations Code*.
- Except for in a number of defined circumstances³¹, it is unlawful to solicit the agreement of a franchisee to a proposed material modification of an existing franchise without first delivering to the franchisee a disclosure document in a form and containing information required by the Commissioner;
- Annual disclosures are not required; however, notification of any material change is required;
- Financial statements should be audited except where the particular form (i.e., UFOC) permits the use of unaudited statements for interim periods or generally. In extraordinary cases the Commissioner may waive the requirement for audited statements if the statements have been prepared by an independent certified public accountant or independent public accountant and the Commissioner is otherwise satisfied as to the reliability of such statements and as to the ability of the franchisor to perform future commitments. It is unlawful to sell a franchise which is subject to registration without first providing a prospective franchisee at least 10 business days prior to the execution of a binding franchise agreement, or payment of any consideration by the prospective franchisee, with a copy of the disclosure document and a copy of all proposed agreements relating to the sale of the franchise;
- Registration of a franchise offering is to occur annually; and
- Franchisor must promptly notify the commissioner of any material change in the disclosure document.

France

*Law No. 89-100 of December 31, 1989 (the Loi Doubin) and Decree No 91-337 Implementing Law No. 89-100 of December 31, 1989 (1991) (the Decree)*³²

The Loi Doubin requires that any person who grants another person a licence to use a trade name, a trade mark or logo subject to exclusivity or quasi-exclusivity for the exercise of the latter's activities shall, prior to the execution of any agreement, furnish a document on the other party which gives honest information which would permit them to make an informed decision.

While a definition of "franchise" is not used, a franchisor/ franchisee relationship is covered by the type of licensing agreement contemplated by the Loi Doubin.

Disclosure must be made at least 20 days before the execution of the franchise agreement or before the payment of any monies.³³

Disclosure requirements under the Loi Doubin worth noting include:

- the number of franchisees who ceased to be members of the network during the preceding year; and

³¹ See above, §§31125(c) and 31125(d).

³² European Franchise Federation, *The Loi Doubin on Pre-contractual Disclosure* (1986) < http://www.eff-franchise.com/france_franchise_legislation_loi_oubin_english.pdf > last accessed on 7 September 2006.

³³ See above, Article 1.

- notification of presence in the same area of establishments which have the express permission of the franchisor to offer the same goods and services subject of the franchise agreement.

Italy³⁴

*Law on “commercial affiliation” (Franchising) Approved by the Senate of the Italian Republic on April 21, 2004 (the Law)*³⁵

Under the Law a franchisor is required to provide a complete copy of the franchise agreement and a series of annexures to a prospective franchisee at least 30 days before the signing of the franchise agreement. Some of disclosures are required to be in the body of the franchise agreement and others are required to be in the form of the annexures. Essentially, the franchise agreement and the annexures together form the disclosure document. Noteworthy disclosure provisions include:

- the requirement that the franchisor provide an indication of the variation in franchisees from year to year;
- the requirement that the franchisor provide information required by the franchisee or otherwise justify non disclosure;
- franchisees are obliged to disclose to the franchisor, promptly and in a complete and correct manner, any information necessary or appropriate for the signing of the franchise agreement;
- if one party provides false information, the other may ask for an annulment of the franchise agreement and damages (if due);
- If the franchise agreement (and required annexures) is not in writing it is null and void;
- In the pre-contract time-frame each party must behave towards the other “with loyalty, fairness and good faith” and disclose the information useful or necessary for the purposes of signing the franchise agreement.

Vietnam

*Decree of the Government No 35-2006-ND-CP dated March 31 2006 – Detailing the provision of the Commercial Law on commercial franchising (the Decree)*³⁶; and *Trade Ministry Circular n° 9-2006-TT-BTM dated May 25, 2006 Guiding the Commercial Franchising Registration (the Circular)*³⁷

The Decree provides for a system of registration of franchisors. Before a franchisor can grant commercial rights to a franchisee, the franchisor must lodge a dossier of application with a competent state agency. This dossier must include:

³⁴ Note that franchise businesses in European countries may also be bound by the *European Code of Ethics for Franchising* (ECE). The ECE applies to the member companies of the 17 national franchise associations that form the European Franchise Federation’s (EFF) membership. The EFF is a non-profit international organisation that represents, promotes and defends the interests and development of franchising in Europe. A condition of membership of the EFF is that the national franchise associations require their members to accept and comply with the ECE. The ECE does not regulate the form and content of franchisor disclosure in detail but rather requires “full and accurate written disclosure” of information material to the franchise relationship in order to allow a prospective franchisee to enter into any binding document with full knowledge. See European Franchise Federation, *European Code of Ethics* (last amended 2003) < <http://www.eff-franchise.com/codeofethics0.html>> last accessed on 7 September 2006.

³⁵ European Franchise Federation, *Law on Commercial Affiliation* (2004) < http://www.eff-franchise.com/Italy_%202004%2021%20April%20Commercial%20Affiliation_Franchsie%20Law%20_english.pdf> last accessed on 7 September 2006.

³⁶ Ministry of Trade, *Decree of the Government No 35-2006-ND-CP dated March 31 2006* <<http://www.mot.gov.vn>> last accessed on 7 September 2006.

³⁷ Investment and Trade Promotion Centre, *Trade Ministry Circular n° 9-2006-TT-BTM dated May 25, 2006* < http://www.itpc.hochiminhcity.gov.vn/en/search?SearchableText=circular+25+May+2006&image1.x=20&image1.y=10_> last accessed on 7 September 2006.

- an application for registration, made according to a set form;
- a written description of the franchise, made according to a set form;
- a notarized copy of the business registration certificate or investment certificate;
- papers proving the approval of the primary franchisor's permission of franchise in the case the trader applying for registration is the secondary franchisor; and
- a copy of the foreign trader's business registration certificate or paper of equivalent validity, certified by a competent agency of the place where the foreign trader is set up (in case of commercial franchises from overseas into Vietnam).

The Circular provides the set forms in its appendices. Once the competent authority has approved the application for registration, the franchisor must provide a prospective franchisee with Appendix III, a "written introduction" and the franchise agreement at least 15 working days before the signing of the franchise agreement. The Decree requires a prospective franchisee to disclose information to the franchisor when the franchisor reasonably requests information needed in order to decide whether or not to grant commercial rights to the franchisee. There are other conditions that must be met before a franchisor can grant commercial rights. For example, the business system intended for franchise must have been in operation for at least one year.

The franchisor is also required to promptly notify all franchisees of all important changes in the commercial franchise system which may affect franchisees' franchise business activities. The responsibility to supply information is also extended to the prospective franchisees where the franchisor reasonably requests information before deciding whether or not to grant commercial rights to the prospective franchisee.

Malaysia

Act 590 - Franchise Act 1998 (the Act)³⁸; and;
Franchise (Forms and Fees) Regulations 1999. (Regulation)³⁹.

The Malaysian Act also provides for a system of registration. Before a franchisor can make an offer to sell a franchise, the franchisor must apply to register its franchise with the Registrar of Franchises. The application must include, among other things, a complete disclosure document with all the necessary particulars filled in. The form and content of the disclosure document has been prescribed by regulation. The Regulation sets out 20 items which must be contained in the disclosure document. Items worth noting include:

- an organisational chart (of the franchisor company) to be included with the details of the franchisor's personnel;
- audited financial statements for the last three financial years;
- financial forecasts for three years; and
- the actual amount of franchise fees or royalty rates (if applicable);

Other noteworthy disclosure related issues considered by the Act and Regulation include:

³⁸ Malaysian Parliament, *Act 590 - Franchise Act 1998* < <http://www.parlimen.gov.my/actindexbi/pdf/ACT%20590.pdf>> last accessed on 8 September 2006.

³⁹ CCH, *Business Franchise Guide*, vol 1 (at 241-11-99) 10,111-10,014. Note, the Act did not come into force until the Regulations were finalised and published on 8 October 1999.

- The disclosure document provided to a prospective franchisee must be in the same form as the document submitted to the Registrar;
- The Registrar may allow the public inspection of any disclosure documents filed with the Registrar unless, in his or her opinion, the inspection may bring harm to a franchisor or franchisee or any person involved in the franchise business or that it is not in the public interest;
- If there is any material change to the disclosure document, the disclosure document must be amended to the form prescribed by the Act; and
- The franchisor is required to submit the disclosure document to a prospective franchisee at least 10 days before the franchise agreement is signed

UNIDROIT

The International Institute for the Unification of Private Law (UNIDROIT) is an independent intergovernmental organisation. Its purpose is to study needs and methods for modernising, harmonising and co-ordinating private and, in particular, commercial law as between States and groups of States.

The UNIDROIT's model law dealing with franchise disclosure law is the *Model Franchise Disclosure Law (2002)* (the MFDL)⁴⁰. The MFDL is a model law upon which jurisdictions that have decided to adopt franchise specific legislation may choose to base their national law.

The MFDL sets out 16 items that must be contained in a disclosure document. It sets out a further 12 items that must be disclosed, however, notes that these 12 items may be contained in the franchise agreement and therefore may only require a reference in the disclosure document. Items of note include:

- *Audited* financial statements are only required to be provided to the prospective franchisee "when available";
- A description of the state of the general market of the relevant goods and/ or services and the prospects for development in that market; and
- Information is required on franchisees that have ceased to be franchisees during the previous three fiscal years.

Further, a confirmation of receipt of the disclosure document is only required if the franchisor requests such confirmation.

Canada (Ontario)

*Arthur Wishart Act (Franchise Disclosure) 2000 (AWA)*⁴¹; and *Regulations made under the Arthur Wishart Act (Franchise Disclosure) 2000 Ontario Regulation 581/00. (Regulation)*⁴²

The AWA and the Regulation apply in the Canadian province of Ontario. It was reviewed as an example of the type of regulation that applies in Canadian Provinces.⁴³

⁴⁰ International Institute for the Unification of Private Law, *Model Franchise Disclosure Law* <<http://www.unidroit.org/english/modellaws/2002franchise/main.htm>> last accessed on 7 September 2006.

⁴¹ Canadian Legal Information Institute, *Arthur Wishart Act (Franchise Disclosure) 2000* <<http://www.canlii.org/on/laws/sta/2000c.3/20060614/whole.html>> last accessed on 7 September 2006.

⁴² Canadian Legal Information Institute, *Ontario Regulation 581/00* <<http://www.canlii.org/on/laws/regu/2000r.581/20060614/whole.html>> last accessed on 7 September 2006.

⁴³ Other Canadian provinces with franchise specific legislation include Alberta and Prince Edward Island.

The Act requires that a franchisor provide a prospective franchisee with a disclosure document not less than 14 days before the earlier of the signing of the franchise agreement and the payment of any consideration by or on behalf of the prospective franchisee.

The AWA requires that all material facts, including those prescribed by the Regulation, are contained in a disclosure document. The Regulation prescribes the items that must be disclosed. Items of note include:

- disclosure of all costs to the franchisee;
- the amount a franchisee is required to contribute to an advertising fund;
- a description of every licence, registration, authorisation or permission that a prospective franchisee will be required to obtain in order to operate the franchise business;
- the degree to which a prospective franchisee must participate personally and directly in the operation of the franchise or if the franchise is a corporation, whether its principals are so required;
- contact details for each franchisee in Ontario who operated franchise of the type being offered that has been terminated or cancelled in the preceding fiscal year;
- reasons for the closure of each franchise of the type being offered in the previous three fiscal years; and
- a financial statement and an audited financial statement for the most recently completed fiscal year, prepared in accordance with generally accepted auditing standards that are at least equivalent to those set out in the *Canadian Institute of Chartered Accountants Handbook*⁴⁴; and
- Disclosure of all material changes to a potential franchisee is required.

Other noteworthy disclosure related issues considered by the AWA and Regulation include:

- a certificate must be included in the disclosure document which certifies that every material fact required by the AWA and its regulations is included; and
- a franchisee may rescind the franchise agreement without penalty or obligation no later than 60 days after receiving the disclosure document if the franchisor failed to provide the disclosure document with the prescribed time or if the contents of the disclosure document did not meet the requirements.

Non Disclosure Related Issues in the Reviewed Jurisdictions

In each of the jurisdictions reviewed non-disclosure related issues such as the application of franchising laws, registration, good faith, the requirement to obtain advice, termination/ renewal of franchise agreements, payments to franchisors and advertising have been approached in a number of different ways.

The summary set out below is not an analysis of these issues but rather identifies notable approaches from the various jurisdictions.

⁴⁴ A regulation made under section 13(1) or (2) of the AWA may exempt a franchisor from providing either the financial statement or the unaudited financial statement as long as the disclosure document contains a declaration to that effect. See Ontario Regulation 581/00, section 3(1)(c).

Application of the law

USA (Federal)

The FTC Rule does not apply when:

- the total payments made by the franchisee to the franchisor as a condition of obtaining or commencing the franchise, in the period between any time before, to 6 months after commencing operation of the franchise, is less than US\$500, or
- when the agreement is not in writing.

USA (UFOC)

The UFOC is a model disclosure document. The circumstances under which it is necessary to create a disclosure document in the form of the UFOC will vary depending on the law that governs the particular franchise relationship. The FTC Rule allows for the use of the UFOC as well as state franchising laws.

France

The Loi Doubin applies to specific types of licensing activity such as the exclusive use of trade names and trademarks rather than strictly between franchisors and franchisees.

Vietnam

Where a Vietnamese trader is the primary franchisee of a foreign franchisor, the Vietnamese trader must conduct business by the mode of company operated franchising for at least one year in Vietnam before sub-franchising.

Malaysia

In Malaysia a foreign franchisor's application to the Registrar which is approved, may be subject to any conditions the Registrar may impose and the term of a franchise agreement shall not be less than five years.

Further, the Act requires the parties to a franchise agreement to act in an honest and lawful matter and also prohibits a franchisor from refusing to renew a franchise agreement without compensating the franchisee.

Registration requirements

USA (California)

Unless the franchise is deemed to be exempt from the registration requirements under the Corporations Code, it is unlawful to offer or sell a franchise unless the offer is registered with the Commissioner. A disclosure document in the form UFOC must be filed with the application for registration. Further, all applications, reports and other papers or documents filed with the Commissioner are open to public inspection unless the Commissioner withholds from the documents from public inspection on public interest grounds or for the protection of investors.

Malaysia

In Malaysia a franchisor must register the disclosure document, a sample franchise agreement and an operations manual with the Registrar of Franchises before a franchise can be offered or sold to any person. Any advertisement which offers to

sell or buy a franchise must also be filed with the Registrar and can be prohibited if it is deemed misleading or deceptive. Further, franchise brokers wishing to work in Malaysia are also required to be registered with the Registrar of Franchises.

Good faith and fair dealing.

A number of the reviewed jurisdictions have express good faith provisions in their franchising legislation. Alternatively, some have express good faith provisions in their civil codes which may apply to franchise agreements as a class of contract. The various approaches to good faith are set out below:

USA

§1-304 of the Uniform Commercial Code (**UCC**) states that “[e]very contract...imposes an obligation of good faith in its performance and enforcement.” The UCC only has force of law if enacted by the states.⁴⁵

USA (California)

The UCC has been enacted in California as the California Commercial Code (CCC). §1203 of the CCC states that “...[e]very contract or duty within this code imposes an obligation of good faith in its performance or enforcement.”⁴⁶

Italy

The Law requires the franchisor and prospective franchisee to behave towards each other with loyalty, fairness and good faith in pre-contractual negotiations.⁴⁷ Both parties must promptly provide each other with any information which is necessary for the purpose of signing the franchise agreement. The Law’s limitation of the good faith concept to pre-contractual behaviour and focus on the sharing of information means that the disclosure process must be undertaken in good faith.

Further, while not considered by the good faith clause in the Law, it is a contravention of the Law to act unreasonably or materially discriminate between franchisees operating a franchise business in terms of franchise fees, royalties, goods, services, equipments, rentals or advertising services if such discrimination will cause competitive harm to a franchisee.

European Franchise Federation

The European Code of Ethics for Franchising (ECE) is meant to be a practical ensemble of essential provisions of fair behaviour for franchise practitioners in Europe. Clause 2.4 of the ECE states that the parties to a franchise agreement shall exercise fairness in their dealings with each other. Further, it requires that the parties resolve complaints, grievances and disputes with good faith and good will through fair and reasonable direct communication and negotiation.

Malaysia

The Act does not make an express reference to the concept of “good faith” in respect to dealings between franchisors and franchisees but does prescribe a

⁴⁵ All states except for Louisiana have implemented the UCC. See Cornell Law School, *Uniform Laws* (2004) <<http://www.law.cornell.edu/uniform/ucc.html#a1>> last accessed on 28 September 2006.

⁴⁶ Official California Legislative Information, *Californian Commercial Code* <<http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=com&codebody=1203&hits=20>> last accessed on 28 September 2006.

⁴⁷ Article 1337 of the Italian Civil Code also states that “parties, in the conduct of negotiation and the formation of the contract, shall conduct themselves according to good faith...”

particular standard of conduct that the parties must adhere to in their dealings with one another.⁴⁸ The Act requires both franchisors and franchisees to act in an honest and lawful manner and shall endeavour to pursue the best franchise business practice of the time and place.

In particular the Act requires a franchisor and a franchisee in their dealings with one another to avoid the following conduct:

- substantial and unreasonable overvaluation of fees and prices;
- conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party; and
- conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

Canada (Ontario)

Section 3 of the AWA imposes on each party to a franchise agreement a duty of fair dealing in its performance and enforcement, where the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

European Union

Some EU member countries rely solely on good faith -fair dealing provisions to govern the relationship between franchisor and franchisee. In Germany, for example, section 242 of the *Civil Code* requires all agreements to be negotiated and conducted according to the principle of *Treu & Glauben* (good faith), together with section 9 of the *Law to Regulate General Terms of Trade* which voids any disproportionately disadvantageous contract provision between contracting parties. These provisions have been interpreted by the German Courts to require a franchisor “to give full advice to the franchisee and to protect him from business mistakes.”⁴⁹

Requirement to obtain advice.

USA

The FTC Rule (§436.1(a)(21)) requires that a recommendation to seek advice is included on the cover sheet of the disclosure document.

Canada (Ontario)

Section 5(4)(d) of the AWA and Regulations 4(2) and (3) require that the franchisor include at the beginning of every disclosure document a series of statements recommending that the prospective franchisee seek advice. Statements such as:

- Independent legal and financial advice in relation to the franchise agreement should be sought prior to entering into the franchise agreement; and
- A prospective franchisee is strongly recommended to contact any current or previous franchisee prior to entering into the franchise agreement.

Termination and renewal

⁴⁸ See above Act 590, section 29(1) and (2).

⁴⁹ Albrecht Schulz in *Franchising in Germany, Franchising in Europe* (Martin Mendelsohn, ed.) Cassell Plc 2000, 156-157.

Vietnam

Article 16(1) of the Decree gives the franchisee the right to unilaterally terminate the franchise agreement when the franchisor breaches its obligations set out in the Vietnamese Commercial Law.

Article 16(2) of the Decree considers the franchisor's right to unilaterally terminate a franchise agreement. This can occur in a number of circumstances. For example when the franchisee:

- no longer holds the necessary licences or authorisations to carry on the business;
- is dissolved;
- goes bankrupt;
- commits a serious violation of the law which may harm the reputation of the franchise system; and
- where the franchisee fails to remedy its immaterial breaches of the franchise agreement within a reasonable time after having been advised in writing to do so.

Malaysia

Section 31 of the Act prohibits a franchisor from terminating a franchise agreement before its expiry date without good cause. It is also an offence under section 32 of the Act for the franchisor to refuse to renew a franchise agreement without compensating the franchisee. Where the franchisee requests an extension to the terms of a previous franchise agreement, the franchisor must grant the extension unless the franchisee has breached the terms of the previous agreement.

Payments to franchisors

France

The Loi Doubin requires the details of any payment to be made by a franchisee prior to the execution of a franchise agreement to be in writing.

USA (California)

Where a franchisor applies for registration and the Commissioner finds that the disclosure document contains insufficient evidence that adequate financial arrangements have been made to fulfil the franchisor's obligations to provide real estate, improvements, equipment, inventory, training and other items set out in the disclosure document, then the Commissioner may require the escrow or impoundment of any payments made by the franchisee until such obligations have been satisfied;

Advertising of Franchises and Promotional Funds

USA (California)

The Corporations Code prohibits the publication of an advertisement concerning any franchise in California if the Commissioner finds that the advertisement contains any statement that is false or misleading or fails to make a necessary statement.⁵⁰

⁵⁰ See above California Corporations Code, §31157.

Malaysia

Section 57 of the Act requires that an advertisement to sell a franchise must be filed with the Registrar and may be prohibited if it is deemed to be false, fraudulent, misleading or deceptive. Further, sections 22 and 23 of the Act states that where a franchisee is required to make any payment for the purpose of promotion, the franchisor shall establish a promotion fund which is to be managed under a *separate* account and shall only be used to promote the franchise. If a franchisee is required to contribute to such a fund then the payment will be at the rate provided in the disclosure document.

ATTACHMENT F – GOOD FAITH AND FAIR DEALING

There is no express good faith provision in the *Franchising Code of Conduct*. A number of the submissions to the current review have suggested that franchisors and franchisees should be required to act in good faith in the execution of their agreements and in mediation. These requests arose in response to specific issues of concern about franchisor conduct.

A number of overseas jurisdictions particularly those based on Roman civil law have either a general concept of good faith in commercial contracts or a specific concept of good faith applying in franchise agreements, including in the context of pre-contractual negotiations and in mediation of disputes.

In Australia, some courts in some jurisdictions have accepted, to some degree, the implication of obligations of good faith in contractual dealings.⁵¹ Nonetheless, uniform acceptance has not emerged in the Australian jurisdictions of a coherent, separate legal concept of good faith or fair dealing in contract law.

Specifically with reference to franchising situations, several Australian decisions (in Victoria and NSW) have found that good faith obligations were implied into the franchise agreements in those cases.⁵² However, at least one Australian decision (in Queensland) has declined to imply good faith obligations into a franchise agreement.⁵³

Further, some eminent Australian academics and commentators continue to dispute that good faith exists as such a coherent, separate legal concept in Australian contract law.⁵⁴

To date, the High Court of Australia has not addressed the general issue of good faith in contracts, and several judges of the current High Court have previously expressed scepticism regarding the concept.⁵⁵

⁵¹ In the NSW decision in *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, Priestley JA made comments suggesting that Australian law was ready to recognise an implied duty of good faith under Australian contracts. Those comments were taken in several later cases in NSW and other Australian jurisdictions as indicating an acceptance of the existence of an implied obligation of good faith in commercial contracts. See The Honourable Justice Robert McDougall, *The Implied Duty of Good Faith in Australian Contract Law* (2006) <http://www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/pages/SCO_mcdougall210206> last accessed on 26 October 2006.

⁵² *Bamco Villa Pty Ltd v Montedeen Pty Ltd; Delta Car Rentals Aust Pty Ltd v Bamco Villa Pty Ltd* [2001] VSC 192; *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 and *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187 at paragraphs 477-480 and 534. See also *Luce Optical v Budget Specs (Franchising)* [2005] FCA 1486 (Federal Court acceptance, in interlocutory proceedings, of good faith obligations in a franchise agreement).

⁵³ *Laurelmont Pty Ltd v Stockdale & Leggo (QLD) Pty Ltd* [2001] QCA 212.

⁵⁴ For instance, Carter, J & Peden, E, 'Good Faith in Australian Contract Law' (2003) 19 *Journal of Contract Law* 155-172.

⁵⁵ See Gummow J's comments in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393 at 406 and Kirby J's comments in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 186 ALR 289 at 311-312.

In the Australian jurisdictions that have accepted the existence of the concept of good faith in contract law, there does not appear to be a clear consensus regarding:

(a) whether good faith obligations are to be imposed on franchise agreements:

(i) because good faith obligations are to be found in all commercial contracts, and franchise agreements are a species of commercial contracts;

(ii) because franchise agreements are a category of contracts in which good faith obligations are to be imposed; or

(iii) on a case by case basis, depending on the particular circumstances in which the franchise agreement was formed;

(b) what the precise content of good faith or fair dealing obligations might be in franchise agreements, and what might constitute a breach of such obligations; and

(c) what the consequences of a breach of good faith or fair dealing obligations are.

Recent cases in NSW and Victoria appear to indicate a trend towards limiting the application of good faith obligations to case by case instances arising under particular fact scenarios.⁵⁶ In any case, the recognition of good faith or fair dealing obligations in Australian law extends only to recognition of them arising when and after the contract is formed, and does not include any acceptance of pre-contractual obligations on negotiating parties to act in good faith towards each other in their pre-contractual dealings.

However, there are applicable legal principles under existing Australian law that apply to provide analogous remedies for injured parties even if principles of good faith and fair dealing are not accepted or recognized, whether in pre-contractual scenarios or post-contract formation scenarios.

Obligation to act in good faith pre-contractually

In Australia there is no obligation to act in good faith in pre-contractual stages per se. There has been some Australian consideration of whether an agreement to negotiate is enforceable (and whether such an agreement might include an obligation to negotiate in good faith), but no consensus has emerged as to either the enforceability of such an agreement or the implication of such an obligation.⁵⁷

The *Trade Practices Act 1974* (Cth) (TPA), contains comprehensive provisions of wide impact that prohibit misrepresentations or misleading and deceptive conduct during the formation of a contract. Section 52 of the TPA, for example, can be

⁵⁶ See e.g., The Honourable Justice James Douglas, *Exploring the Recent Uncertainty Surrounding the Implied Duty of Good Faith in Australian Contract Law: the Duty to Act Reasonably – Its Existence, Ambit and Operation* (paper presented at the LexisNexis Contract Law Master Class, 24 August 2006) <http://www.cisq.law.pace.edu/cisq/biblio/douglas1.html> - last accessed on 26 October 2006.

⁵⁷ See e.g. *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991)24 NSWLR 1.

applied to prohibit franchisors from making misleading statements with regard to, among other things, projected turnover or profitability. Relevantly:

(a) section 52 applies to all ordinary or reasonable people who come within the relevant section of the public alleged to have been misled or deceived by the conduct in question. In this case, the relevant section of the public will be actual and prospective franchisees and will include astute and gullible, intelligent and not so intelligent, and well-educated and poorly educated franchisees.⁵⁸ However, franchisees who are “extraordinarily stupid” or gullible, or whose reactions are “extreme or fanciful” are unlikely to be used as the standard against which a franchisor’s conduct will be judged;⁵⁹

(b) a franchisor’s statement which is literally true can still be held to be in breach of section 52 if it misleads or deceives or is likely to mislead or deceive; similarly, reasonable and honest conduct by a franchisor can still be misleading or deceptive conduct that contravenes section 52;⁶⁰

(c) although a franchisor is permitted by section 52 to bargain “hard”,⁶¹ silence by a franchisor may, in all of the circumstances constituted by its acts, omissions and representations, constitute conduct likely to mislead or deceive a franchisee within the meaning of section 52;⁶²

(d) section 52 applies to both statements made publicly and in private negotiations by the franchisor;⁶³ and

(e) by section 51A, representations and opinions by a franchisor, as to future matters, will be taken to be misleading for the purposes of section 52 unless the franchisor can prove that it had reasonable grounds for making the representation.

A failure to observe the standard of conduct required by section 52 has its consequences under Part VI of the TPA (enforcement and remedies), including both remedies available at common law (such as injunctions and damages) and other compensatory remedies under section 87 which apply when loss or damage is likely to be suffered by a franchisee (e.g., orders declaring the franchise agreement void or varied, for specific performance of the franchise agreement, accounting for profits made by the franchisor, payment of other compensation, or refunds or returns of property).

The above features of liability under section 52 make this section a powerful mechanism for dealing with issues relating to franchisor conduct both before and during the course of the franchise arrangement.

Similarly, the general law doctrine of unconscionability, as extended under Part IVA of the TPA, can also be readily applied to many franchise scenarios that may arise. We note that although the concept of unconscionable conduct is not defined in the TPA, section 51 AC (which applies the concept of unconscionable conduct to

⁵⁸ *Campomar Sociedad, Limitada v Nike International Ltd* (2000) 202 CLR 45.

⁵⁹ *Ibid.* See also *Telstra Corp Ltd v Cable & Wireless Optus Ltd* [2001] FCA 1478 and *Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177.

⁶⁰ *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216.

⁶¹ *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25.

⁶² *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31 and *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452.

⁶³ *Bevanere Pty Ltd v Lubidineuse* (1985) 7 FCR 325.

business transactions with small business consumers including franchisees) expressly requires the Court to have regard to (amongst other things) the extent to which the supplier and the small business consumer acted in good faith: section 51 AC(4)(k). Several Australian cases have since found that section 51AC has been breached by a franchisor's conduct that included a lack of good faith within the meaning of section 51 AC(4)(k).⁶⁴ In one of these cases, the judge suggested that conduct which is held to be unconscionable within the meaning of s 51AC of the *Trade Practices Act 1974* "will probably be sufficient" to constitute a breach of an express term providing for absolute good faith between the parties.⁶⁵

⁶⁴ For instance, *ACCC v Simply No-Knead (Franchising) Pty Ltd* [2000] FCA 1365 and *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286.

⁶⁵ *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286 at paragraph 388 (Hasluck J).