

The Future of Franchising

April 2014



Small Business is a vital part of Australia's economy. The franchise industry is extremely important to the small business community, employing hundreds of thousands of Australians. It gives the public access to successful Australian enterprises as well as some of the most recognisable international brands.

This Government will ensure this important industry has the support it needs to flourish. That is why, before the election, we said we would refine the national Franchising Code. We want to promote growth in the sector, reduce red tape and make sure that all participants in the industry follow best practice principles. The Government is also committed to guard against separate and additional state regulation to maintain a consistent national framework.

Following the recommendations from the 2013 Wein Review and ongoing consultation with the franchising sector, the Government is committed to:

- ensuring franchisees and franchisors act in good faith in their dealings with each other;
- introducing penalties for a breach of certain provisions of the Franchising Code;
- improving the transparency of marketing funds; and
- improving disclosure including short form, easy to understand information for prospective franchisees.

In addition, we will cut red tape by clarifying and streamlining the Franchising Code of Conduct, reducing unnecessary and sometimes unclear provisions. The Government's changes strike the right balance between the needs of franchisors and franchisees that reflects the unique nature of the franchise relationship.

I look forward to working with the sector to implement these important reforms.

The Hon Bruce Billson MP
Minister for Small Business

Background

Franchising has experienced steady growth in the Australian market. According to research conducted by Griffith University, the franchising sector has 73,000 franchisees, 1,180 franchisors and employs a total of 407,000 people. In 1998, the mandatory Franchising Code of Conduct was introduced to regulate behaviour in the sector. The Code was specifically introduced to address issues such as access to justice, assisting small business in understanding complex documentation, harsh business conduct and transparency of information before entering a business venture. Since then, the Code has been regularly reviewed with changes to the Code following each review.

The franchising industry is also regulated by laws relating to fair trading and business operations, chiefly the *Competition and Consumer Act 2010* (the CCA), the Australian Consumer Law (ACL), the *Australian Securities and Investments Commission Act 2001* and the *Corporations Act 2001*; and the unwritten law (also known as the common law).

The 2013 Review

Mr Alan Wein conducted a review of the Code in 2013. A copy of the review report is available on the Treasury website.¹

During the review, and through consultation following the review, submissions were received from all sectors of the franchising industry. This included input from franchisees, franchisors, lawyers, academics and industry associations. Mr Wein made 18 recommendations which were broadly categorised under headings of disclosure, franchisor failure, transparency of financial information in a franchise, good faith, transfer, renewal or end of a franchise agreement, dispute resolution and enforcement.

The Government has considered the review recommendations and conducted further consultation with the sector. The Government would like to thank the franchising sector for its high level of engagement in this review process and its patience while the regulatory impact of these changes was fully explored by the Government. The wide spectrum of views which informed the review and consultation process has meant that the impacts of the reforms have been thoroughly explored.

The draft regulations and draft bill contain the entirety of the Government's changes to the Code following the review. Broadly, the Government's changes address the issues identified in the review report. Additionally, the Government has made a concerted effort to reduce the compliance burden on franchisors and franchisees.

The Process

The Government has completed a regulation impact statement, which can be accessed from the website of the Office of Best Regulation² and from the Treasury website. This thoroughly examines the costs and benefits of the changes to the Code and has been informed by ongoing consultation with the franchising sector.

The draft regulations and bill have been released for a three week period of public comment. This is to ensure that the Government's proposed changes are effectively implemented.

¹ See: www.treasury.gov.au/Policy-Topics/Business/Small-Business/Codes-of-conduct/Franchising

² See: ris.dpmc.gov.au/

Key Changes

Reducing red tape

- The Government will amend the Franchising Code of Conduct ('the Code') to clarify the meaning of provisions, and simplify the language to reduce the time business needs to take to comply with the regulations. Changes will include:
 - The removal of the 'double disclosure' currently imposed on master and foreign franchisors. This will reduce the unnecessary compliance burden which exists in multi-tiered systems.
 - The removal of disclosure obligations in relation to summarising provisions of the franchise agreement in the disclosure document. The disclosure document is not meant to be a substitute for closely reading the franchise agreement, and these provisions make the disclosure document unnecessarily lengthy and complex.
 - Removing the redundant short form disclosure document from Annexure 2 of the Franchising Code given that it is not used by the sector.
 - Making a range of other drafting improvements to the Franchising Code to address ambiguity and improve consistency of practice among the industry. This will streamline the Code, saving the time of franchisors and franchisees and reducing compliance costs.

Improving information available to franchisees

- The Government understands that while the Code has improved the imbalance of information between franchisors and franchisees, there are areas which can be improved. Based on the recommendations of the review, the Government will:
 - Require franchisors to provide prospective franchisees with a short information sheet which gives them an overview of the risks and rewards of franchising. This will include information on unforeseen capital expenditure, the importance of education and conducting due diligence, and the prospect of franchisor failure. This will encourage franchisees to conduct more thorough investigations to ensure the agreement is right for them.
 - Improve the disclosure of the online trading activities of franchisors, accounting for the growth in online trading and the potential impact of this on traditional stores. This is relevant to a franchisee's assessment of the viability of the business they are proposing to operate and will lead to more informed decisions by franchisees.
 - Ensure that franchisors remind franchisees that they are entitled to a current disclosure document when the franchisor indicates it intends to renew the franchise agreement.
 - Introduce greater transparency for the way in which marketing funds are used and accounted for. This will include:
 - : requiring additional disclosure on the types of expenses marketing funds are being used for;
 - : giving franchisees the option to vote for an annual audit of the marketing fund; and
 - : requiring franchisors to keep marketing funds in a separate account to the rest of their monies.

Strengthening the balance in franchise agreements

- Nearly all commercial transactions will have some level of imbalance. However, there are some practices which go beyond the protection of the reasonable interests of one party. The review identified a number of areas in the Code which could be amended to improve the balance in franchise agreements. To address these issues, the Government will amend the Code to:
 - Enhance protections for franchisees against significant capital expenditure imposed by a franchisor. The reforms will prevent franchisors from imposing significant capital expenditure unless:
 - : the expenditure is disclosed in the franchise agreement;
 - : a majority of franchisees in a system agree to the expenditure; or
 - : the expense is considered necessary by the franchisor and can be justified by a statement which provides the rationale, costs and anticipated benefits associated with making the investment.
 - Prevent parties to a franchise agreement from attributing their costs in dispute resolution to the other party. The review found that some franchisors currently require franchisees to bear the costs associated with dispute resolution, which can act as a disincentive for franchisees to raise genuine concerns with franchisors.
 - The Code will also be updated to ensure that franchisors cannot require franchisees to conduct dispute resolution outside the State where the franchisee’s business is located, unless otherwise agreed at the time of the dispute. These changes will encourage a speedy resolution of disputes and make the process more accessible.
 - Prevent franchisors from unreasonably imposing restraints of trade on former franchisees. Currently, a franchisee may be unable to benefit directly from the goodwill they have generated in their business by continuing to operate it or being compensated for it. This change will mean that, in appropriate cases, franchisees will be able to utilise the skills they have developed in franchising to operate a similar business, which will promote competition.
 - Ensure franchises owned by the franchisor contribute to the system’s marketing and other cooperative funds. Currently, a franchisor’s own store or unit could be benefiting from outlays from a marketing fund even though they are not contributing on the same basis as other stores. This change will mean all stores will benefit equally from equivalent contributions to any marketing fund.

Improving conduct in the sector and the overall effectiveness of the Code

- Consultation during the review presented consistent anecdotal evidence of questionable behaviours in franchising. As franchisors are usually in a more powerful economic and contractual position than the franchisee, poor conduct by franchisors can have a disproportionate effect on franchisees. On the other hand, due to the network nature of franchising, poor conduct by isolated franchisees can affect the reputation of the system as a whole. To address this the Government proposes to:
 - Introduce an obligation to act in good faith into the Code. This obligation will apply to all aspects of the franchising agreement including during negotiations, throughout the agreement, in dispute resolution and as part of renewal discussions. This will improve conduct in the franchise sector, ensuring that both parties to a franchise agreement act honestly, cooperatively and not arbitrarily.

- Improve compliance and enforcement outcomes through a range of flexible tools for use by the regulator, the Australian Competition and Consumer Commission ('ACCC'). The Government will introduce penalties of up to \$51,000 for serious breaches of the Code. This will mean stronger consequences for breaching the Code and will further deter parties from breaching the Code. The ACCC will also be given powers to issue infringement notices.
- Allow the ACCC to use its audit powers to obtain documents that the franchisor has relied upon to support statements and claims made in their disclosure document. This will facilitate more effective and robust franchising audits by giving the ACCC the ability to test the accuracy of the information behind a franchisor's disclosure document.
- Prevent franchisors from improperly interfering with prospective franchisees' ability to speak with ex-franchisees. This will mean that prospective franchisees will have more information available to them before they take the decision to invest in a franchise business.

Franchising is a significant and growing part of our small business community and has displayed a great capacity for nurturing innovation and entrepreneurship in Australia. The Government's commitment to these important franchising reforms will ensure that our regulatory settings remain responsive to the needs of the sector to promote confidence, competitiveness and productivity. Streamlining the Code by clarifying the policy intent behind the provisions and removing unnecessary red tape will allow franchising to continue to make a valuable contribution to our national economy and local communities.