

Franchise Disclosure Registry Exposure Draft

Regarding: Department of Treasury Request for submission concerning exposure draft. **From:** Australian Association of Franchisees (AAF) response

Introduction

AAF welcomes the opportunity to make comment on the Franchise Disclosure Register Exposure Draft as presented. Our response is informed by the many issues with which the franchisees ask us to assist. Additionally, our members were major contributors to the PJC Inquiry into franchising, and we were encouraged by the thorough, accurate and comprehensive picture that was embodied in the PJC report to Parliament in March 2019. The key statement from that report was that there is a massive and unacceptable imbalance of power as between franchisor and franchisees.

AAF has a clear policy position that the regulation of the sector via the Franchising Code is both inappropriate and inadequate. Franchising is first and foremost a mechanism for capital raising. It needs to be legislated for in the same way as the Corporations Act is designed to protect minority shareholders from exploitation. However, AAF accepts that the path to legislation will require a change of mindset at Government level. We provide our comments on the disclosure registry approach with this understanding in mind and with a desire to be constructive.

Broad commentary

Since the PJC Inquiry, government action has been largely based on the *caveat emptor* or *buyer beware* maxim. There have been significant improvements in the content requirements for disclosure documentation to prospective franchisees. The proposed creation of the Disclosure Register is the next step in that process.

As the key Franchisee representative Association, we accept that the *buyer beware* maxim, has a role to play in the success of franchising as an investment and business model. However, it is also true that being prepared at the outset has limited value when the other party to the relationship has sweeping rights to change the rules after the game has commenced. The disclosure documents provided to franchisees cannot address this issue and that greatly limits the value of the proposed registry, if its content is limited to disclosure documentation.

The most important documents in the franchisor/ franchisee relationship are firstly the standard form franchise agreement which all franchisees in a system are required to sign up to as the contract between the parties, and, secondly, the franchisor's policy, or operations, manual.

As a general rule, the franchise agreement creates very onerous obligations on franchisees, but obligates the franchisor to do virtually nothing except maintain a brand, exercise a limited degree of good faith and perform its tepid obligations with best endeavours. Additionally, the franchise agreement, in almost all instances, reserves the right for the franchisor, but not franchisees, to make changes to the arrangement between the parties, mainly via unilateral changes to the policy manual.

A well thought through decision to invest in a franchise system with all its costs and obligations requires a thorough assessment of all of the documents, the disclosure document, the franchise agreement and the policy or operations, manuals. Of these documents, in our experience, the franchise agreement is by far the most important in a buyer beware environment. However, the operations manual enables running changes to the rights and obligations of the parties and should also be on the record.

The argument against this proposition, which is continually trotted out by the franchisor lobby is that these documents are “commercial in confidence”. This argument is cliched and self-serving. It does not stand up to scrutiny. Franchisors are in the business of recruiting franchisee investors. Franchisee investors have every right to know the full extent of what they are getting themselves into. Franchise deals are being sold in the market. Franchise agreements are not required to contain the secrets to the franchisor’s corporate or competitive strategy. The Corporations Act enshrines comprehensive disclosure rights for share purchasers; why is franchising different?

Finally, in a multi-party mediation attended by AAF members, one of the major law firms resisted changing terms in an agreement because, as they stated, “there are more than 200 franchise agreements across the whole sector that are in lock step with this one, and we are not prepared to change all of them”. The mediation referred to included a QC’s opinion that there were more than 50 unfair contract terms in that system-wide agreement.

As well as the content of the register, there is the question of how it will be used. The exposure draft explanatory document talks about franchisees only. The massive problem here is that the information provided is often very hard to interpret. There is considerable evidence that franchisees need help in understanding what is in front of them. This is even more so, if they are trying to compare options. Is this opportunity better or worse than that opportunity?

In the corporate world there is an industry devoted to making these comparisons for investors. The disclosure registry needs to set the ball rolling for franchisees to be able to access similar levels of analysis and comparison. Government cannot get involved in this endeavour, but through the registry, can make a good part of the non-financial data available.

The AAF view is that it is time the franchising sector stopped being cloaked in secrecy borne of franchisor self-interest. The history of dysfunction and damage to franchisees, the involvement of private equity and publicly listed companies, and the sheer scale of the sector, demands a more transparent approach.

Detailed comments

The proposal as presented will require that franchisors upload their disclosure documents in current form and do this on an annual basis. Our experience is that franchisor disclosure documentation varies greatly in quality, form and structure. This will make the job of potential franchisees, their advisors and analysts quite difficult. We believe thought should be given to developing a standard template for the provision of disclosure information.

There is also discussion of user's identifying themselves. This is not necessary in a public register and will be a disincentive to users.

The Register should provide prospective franchisees with all materially relevant information to enable them to make an informed decision. A key, but underlying factor, in that decision is about the franchise culture.

Information pertaining to any previous disputes with suppliers, other franchisees and records of civil court action should also be on the register.

Finally, there is an issue of quality assurance. We support the government's position not to be responsible for the accuracy and quality of the data provided. However, this is a compulsory system with penalties attached, and it will need a level of oversight. Will the ACCC take on this role? And, if so, how? Will there be guidance as to minimum standards? And, will the input be subject to ACCC audit?

In the context of quality assurance, there is also no reference to franchisor licencing. This could be an issue in terms of achieving universal compliance.

Summary

AAF supports the idea of a register. We are recommending the scope of the documentation provided be expanded to franchise agreements and policy manuals. The government is right not to get directly involved in quality assurance, but this issue needs to be addressed. We also recommend that disclosure documentation be in a standardized format, with a view to better access and understanding for potential franchisee and, in the interests of better analysis and advice being made available to franchisees.