



29 September 2023

Franchising Review Secretariat Unit
Small and Family Business Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email only: franchisingreview@treasury.gov.au

Dear Sir/Madam

Review of the Franchising Code of Conduct

Guzman y Gomez (GYG) is an Australian multinational casual-dining restaurant chain which commenced operations in Australia in 2006. Since this time, GYG has expanded into 202 stores, most of which operate as franchisees.

As an active participant in the Australian franchise network, GYG welcomes the opportunity to provide our insights and recommendations in respect of the current regulatory framework. Our responses are aligned to the questions and numbering within the Review of the Franchising Code of Conduct consultation paper August 2023.

(2) Is the Franchising Code fit for purpose? Should it be retained? If so, should it be remade prior to sunseting?

The Code plays a vital role as a regulatory framework, offering essential guidance and safeguards for both franchisors and franchisees within the industry. It has been instrumental in upholding principles of transparency, equity, and accountability. Nevertheless, like any regulatory structure, there may be areas that require enhancement to align with the evolving business landscape.

Regarding its retention, GYG submit that the Code should, subject to the balance of our submission, be retained due to its foundational role within the franchising industry's regulatory framework.

That said, while maintaining the Code is imperative, it could benefit from periodic reviews and updates. Given the dynamic nature of the business environment, evolving consumer expectations, and changing industry practices, the Code should adapt accordingly.

(4) Does the general scope of coverage of the Franchising Code remain appropriate? Is the scope of coverage flexible enough having regard to the diversity of the franchising industry?

Whilst we believe that the current scope of the Code is appropriate, an important update to the scope of the Code could be to specifically refer to the importance of brand alignment between the franchisee and franchisor. This refers to the standards, processes, and procedures that are put in place to ensure the integrity and consistency of products and services across the relevant franchise networks. The Code could include an obligation on Franchisees to act in accordance with and uphold the brand standards. Regardless of industry, brand alignment and reputation are significant themes that can drive positive outcomes for franchisees and franchisors.

(9) How effective are the requirements of the Franchising Code that ensure franchisors make information available to franchisees prior to entry into a franchise agreement? If possible, please comment on the effectiveness and content required for inclusion in each of the Franchise Disclosure Register, Information Statement, Key Facts Sheet and Disclosure Document.

We believe that the Code is effective in ensuring that franchisors share essential information with franchisees. However, we would like to express our viewpoint that some aspects of the information and content demanded for inclusion in the relevant documents can be overly burdensome for franchisors. We think that more balance could be achieved to address the burden of disclosure on franchisors if the Code was more explicit that franchisees also have a responsibility to get comfortable by performing their own due diligence investigations.

While we fully support the Code's intention to promote accuracy and transparency in the information shared with franchisees, we believe that certain requirements are excessively detailed, repetitive, and, at times, not essential. We acknowledge the need for comprehensive information, but we also believe that a more streamlined approach could achieve the same goals without imposing undue challenges on franchisors.

In this regard, we encourage a constructive dialogue to review and potentially refine the specific requirements to strike a better balance between transparency and the practicality of compliance.

(10) How have changes to unfair contract terms laws impacted franchise agreements? Is the approach in the Franchising Code to regulating certain types of contract terms still appropriate?

While the UCT regulation is currently in its early stages, we anticipate a substantial impact on franchise agreements after 10 November 2023, when the UCT regime takes effect. Despite franchisors being obligated to act in good faith, we expect that the introduction of the UCT will bring about more comprehensive regulation of contract terms. Consequently, franchisors, if they haven't already, are likely to undertake revisions of their franchise agreements to ensure they align with the heightened requirements imposed by the UCT regime. Furthermore, we foresee that franchisors will be more inclined to engage in negotiations concerning key terms, leading to a more equitable balance in franchise agreements for all parties involved.

In terms of appropriate regulation, it is crucial to ensure that the regulatory framework strikes a balance with the commercial objectives of franchisors. It's worth noting that many regulatory reforms (including the Code and the UCT) tend to heavily favour franchisees, aiming to protect their interests comprehensively. While this protection is important, it is equally important to acknowledge the legitimate business interests of franchisors. Achieving a harmonious equilibrium between protecting franchisees and allowing franchisors to maintain their commercial viability will be essential for the long-term sustainability of the franchising industry.

(11) Do you have any other comments on how the Franchise Code regulates the relationship between franchisors and franchisees at the point of entry into a franchise agreement?

There are several ways that the Code regulates the relationship between franchisors and franchisees at the point of entry into a franchise agreement, the most notable being the 14-day cooling-off period.

GYG are of the view that the cooling-off period could be shortened to 7 days. Typically, franchisees seek advice on the franchise agreement well in advance of its formal disclosure. Consequently, a 14-day cooling-off period is excessively long, providing franchisees with an abundance of flexibility and, conversely, creating prolonged uncertainty for franchisors.

Furthermore, GYG encounter challenges concerning advice certificates from prospective franchisees. As it stands, franchisees must decide whether they want approved legal, financial, or business advice regarding the franchise agreement. In our experience, franchisee lawyers/advisors are unable or unwilling to endorse these certificates. Moreover, if a franchisee does seek the relevant advice and obtains signed certificate, this places the franchisor in a stronger position if an issue was to arise. GYG suggests that these certificates either become mandatory or are eliminated altogether.

(14) How effective are the 2021 reforms which restricted the franchisors' capacity to require a franchisee to undertake significant capital expenditure?

The 2021 reforms that restrict franchisors' capacity to require franchisees to undertake significant capital expenditure have been a point of concern from the perspective of GYG. While these reforms were enacted with the goal of protecting franchisees from unexpected financial burdens, they have raised significant challenges for GYG (and the franchise business model as a whole).

One major challenge posed by these reforms lies in the difficulty of accurately estimating capital expenditure needs. Franchise businesses, like any other businesses, operate in dynamic markets where operational and technological advancements are constant. The rapid pace of change means that capital investment requirements can shift unexpectedly.

GYG (like many franchisors) make long-term commitments to their franchisees through agreements that span 5-10 years, or even longer. During this time frame, the business environment can change significantly - new technologies emerge, consumer preferences evolve, and competition intensifies. In addition to this, the Code does not currently differentiate between maintenance and capital expenditure. If facilities and equipment are not well maintained by a franchisee, the cost of refurbishment can increase significantly to accommodate the shortfall in maintenance. To remain competitive and deliver the level of service or product quality that customers expect, franchisors need the flexibility to adapt and innovate and the Code should permit franchisors to facilitate this.

These reforms have made it challenging for GYG to accurately predict future capital expenditure needs. To mitigate against exposure to unforeseen changes in the business landscape, franchisors may feel compelled to overestimate capital expenditure requirements. This cautious approach can have several negative consequences:

- Reduced growth and innovation - franchisors may be hesitant to invest in new technologies or business improvements due to the uncertainty of cost recovery within the confines of the franchise agreement. This can stifle innovation and hinder the growth of the franchise system.
- Higher costs for franchisees - overestimating capital expenditure requirements can lead to higher initial costs for franchisees. These costs may deter potential franchisees from entering into agreements, limiting the expansion of the franchise system.

- Franchisee profitability - while the reforms aim to protect franchisee profitability, they can inadvertently harm it by making franchise businesses less competitive and efficient.

GYG submit that while protecting franchisee interests is essential, striking the right balance to ensure franchisors can continue to innovate, adapt, and sustain the growth of franchise businesses is equally crucial.

(16) How effective are 2021 reforms to the Franchising Code which created a process for franchisees to formally request early exit from their franchise agreements?

The process established for franchisees to seek an early exit from their franchise agreements is, in our view, largely ineffective. Our observations indicate that early exit requests primarily come from underperforming franchisees facing challenges in selling their businesses. In such cases, franchisors may hesitate to accept an early exit or repurchase the business (usually due to disparities in the purchase price). Furthermore, when a franchisee is underperforming, franchisors often have more favourable contractual alternatives at their disposal for terminating the franchise agreement and/or repurchasing the business.

(19) How useful and effective are the educational resources provided by regulators (such as from the ACCC)? Do they ensure prospective entrants to the franchising sector are sufficiently aware of their rights and responsibilities? Is the level of industry engagement appropriate?

While educational resources cover franchising comprehensively and provide necessary disclaimers, when you consider the amount of information which is (1) available to franchisees, or (2) that franchisors must provide to franchisees, it can be quite overwhelming. In our view, this much information is counterproductive as it reduces a franchisee's overall awareness of key matters.

We suggest a more effective approach would involve reducing the volume of required documents, potentially eliminating the key fact sheet, and streamlining the disclosure document to only include critical information for franchisees.

(20) What has been the impact of 2022 reforms which increased certain penalties available under the Franchising Code? Particular comment is sought on penalties which were increased to the greater of \$10 million, three times the benefit obtained, or 10 per cent of annual turnover?

Franchisors are becoming increasingly attentive to the importance of compliance. Key decision-makers are now actively engaging in operational compliance and its implementation. That said, it's worth considering that the current penalties for franchisors are, in our view, disproportionately high. A review of these penalties may be warranted to strike a fair balance between enforcement and fostering a culture of compliance within the franchising industry.

Yours faithfully



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