

Franchising Code of Conduct Exposure Draft

Release for consultation, of an exposure draft instrument to remake the Franchising Code of Conduct

Background

In 2023, Dr Michael Schaper undertook a comprehensive review of the Competition and Consumer (Industry Codes-Franchising) Regulations 2014 (the Code), which resulted in 23 recommendations. In May 2024, the Minister for Small Business, the Hon Julie Collins MP, released the Government response to the Review, agreeing or agreeing in principle to all 23 recommendations.

The Government response outlines 11 changes to be implemented in remaking the Code.

Consultation on exposure draft legislation is not about revisiting policy decisions but is an opportunity for interested stakeholders to provide input on how those decisions are implemented through changes to the law. This paper provides information about the proposed approach to implementing the changes (including the formulation of relevant legislative provisions) and stakeholders should use it to inform their consideration of the exposure draft instrument.

Ensuring the Code remains fit for purpose

The Code has existed in one form or another since 1993 and has been amended multiple times over the years. The Code will sunset on 1 April 2025 if not remade.

This section addresses the following aspects of the Government response:

- Recommendation 2: The Code should be remade, largely in its current form.
- Recommendation 3: A clear statement of purpose should be inserted into the Code.
- Recommendation 4: Service and repair work conducted by motor vehicle dealerships should be explicitly captured by the Code.
- Recommendation 5: Reviews of the Code should be conducted in five yearly cycles in the future.

Remaking and updating the Code

The Competition and Consumer (Industry Code–Franchising) Regulations 2024 will provide for the new Franchising Code (the new Code). The new Code is expected to come into force on 1 April 2025.

The new Code aligns with contemporary drafting standards and expresses obligations through principles-based drafting where possible. While former iterations of the Code existed as a schedule to the Regulations, the new Code will exist as a chapter within the Regulations. This change also means ‘clauses’ will become ‘sections’, which follows contemporary drafting standards. Annexure 1 to the existing Code will now be contained in a schedule to the new Code. The different formatting approach does not change the substance or the effect of the Code provisions.

Remaking the Code has meant that the numbering of provisions has had to change. However, the numbering for the disclosure document – contained in Annexure 1 to the existing Code and in Schedule 1 of the new Code – has been maintained. This will make it easier for franchisors to assess the compliance of their disclosure documents.

Over the last 10 years there have been 8 amendments to the Code. To ensure the Code is operating as effectively as possible, this refresh of the legislation provides the opportunity to address drafting and operational issues that have arisen due to ‘tinkering’ and to better clarify existing obligations. This includes, for example:

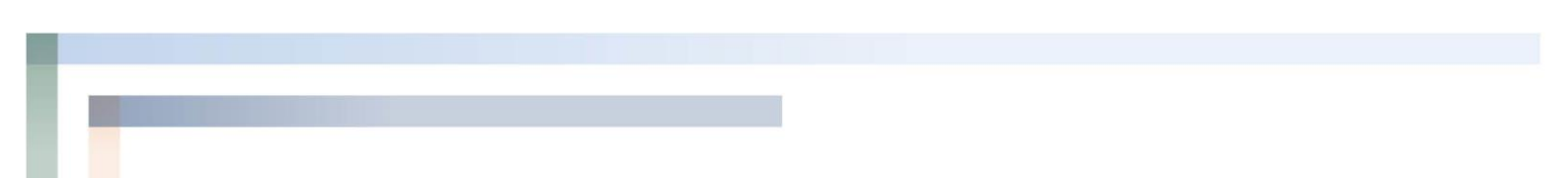
- A move away from the use of the concepts of ‘marketing’ and ‘cooperative funds’ to the use of a single concept - ‘specific purpose funds’ under section [6] and Schedule 1 [item 15]. This is intended to capture all relevant specific purpose funds, apply consistent requirements across these funds and reduce confusion arising from the use of multiple legislative concepts.
- Reframing the rule about restraint of trade clauses at section [41]. The circumstances in which a restraint of trade clause does not apply are largely maintained as they appear in clause 23 of the existing Code, except that the circumstances now include where a franchisee has sought to renew an agreement. However, where the current approach provides that a relevant restraint of trade clause has no effect – the new approach is to expressly prohibit a franchisor from entering into an agreement that includes a relevant restraint of trade clause (see section [41]) or from relying on such a clause in the relevant circumstances (see section [64]).
- Certain drafting improvements set out in Appendix A to the Review have also been included in the new Code.

Clarifying the Code’s purpose

The Government response agreed to insert a clear statement of the purpose into the Code which provides clarity to the franchising community and assists in future reviews of the effectiveness of the Code.

Considering stakeholder feedback from consultations, the Schaper Review found that the current purpose in the Code:

- Is too narrow and lacking in meaning.
- Could better articulate the intent to address the power imbalance between franchisors and franchisees and prospective franchisees, and
- Should convey that the Code is intended to raise standards of conduct and encourage best practice.



The proposed new purpose at section [14] in the exposure draft identifies specific objectives, including addressing the power imbalance between franchisors and franchisees and prospective franchisees. It also calls attention to improving standards of conduct in the sector through better transparency in disclosure obligations, setting out requirements for franchise agreements, and providing fair and equitable dispute resolution processes.

In considering the purpose of the Code, it is important to note that industry codes exist to complement other legal and legislative frameworks that set broad, economy-wide standards and expectations, such as the Australian competition and consumer law, unfair contract terms regime and common law contract rules.

Capturing service and repair work conducted by motor vehicle dealerships

The Government response requires that the new Code clarify that service and repair work performed by motor vehicle dealerships is within the scope of the Code.

The Schaper Review observed that the definition of ‘motor vehicle dealership’ is assumed to cover all aspects of the franchisees’ business that have been required to be conducted by the franchisor, as was confirmed in the *Mercedes Benz* case.¹ However, it also highlighted concerns from stakeholders about the structuring of arrangements or agreements so as to exclude service and repair work from regulation under the Code.

The revised definition of ‘motor vehicle dealership’ contained in section [6] explicitly captures any servicing or repairing of motor vehicles conducted by dealers or associated with a dealership agreement that buy, sell, exchange or lease motor vehicles.

Including service and repair work as an element of the ‘motor vehicle dealership’ definition ensures that service and repair businesses that are a franchise, but do not engage in the other aspects of the ‘motor vehicle dealership’ (i.e. do not buy, sell, exchange or lease motor vehicles) will not be subject to Part 6 and the additional requirements that it imposes.

Explicit statutory review provision

The Government response requires 5 yearly reviews of the Code to ensure it is delivering on its updated purpose and is operating efficiently and effectively.

Section [11] requires that the first review of the new Code commences before 1 April 2030. Note: this section does not specify requirements for a ten-year review as there is already an obligation under the *Legislation Act 2003* for instruments to be reviewed prior to being remade to avoid sunseting 10 years after they commence.

Simplifying and Streamlining

Multiple changes to the Code over the last 10 years have responded to emerging trends and challenges affecting the sector. However, some changes have created unnecessary complexity or introduced a lack of clarity. There is an opportunity now, while making more holistic changes, to improve the operation of the Code.

This section addresses the elements of the Government response for simplifying existing processes:

¹ *AHG WA (2015) Pty Ltd v Mercedes-Benz Australia/Pacific Pty Ltd* [2023] FCA 1022.

- Recommendation 6: Simplify and consolidate the pre-entry information given to prospective franchisees.
- Recommendation 7: Franchisor obligations under the Code in relation to existing franchisees should be simplified.
- Recommendation 13: Provisions relating to termination for serious breaches should be simplified. Changes made in 2021 relating to termination under clause 29 of the Code should be revisited.

Merging the Key Facts Sheet and Disclosure Documents

Disclosure should be comprehensive and in an appropriate form to ensure franchisees have access to the information they need to make an informed decision. However, this should not add unnecessary compliance burden.

The Government response committed to effectively merge the key facts sheet into the disclosure document.

As the Schaper Review observed, the key facts sheet repeated information that is now available on the Franchise Disclosure Register, without improving the readability of that information or addressing any further information gaps.

The requirement to provide a key facts sheet will be removed from the new Code entirely. Franchisors will no longer have to create, maintain or provide a key facts sheet. To ensure consistency between the information previously required and the obligations for disclosure in the new Code, any requirements from the key facts sheet which were not already required by the Disclosure Document have been added into the required fields for the Disclosure Document, at Schedule 1 – see item [9].

Opt-out provisions

Obligations in the Code that require cooling off periods and pre-entry disclosure information protect new franchisees from the potential harm that flows from information asymmetry between franchisors and prospective franchisees.

The Government response agreed to simplify disclosure obligations in relation to existing franchisees, noting that the risk of information asymmetry is significantly reduced when parties have an existing relationship and franchisees have experience with the franchise.

As such, subsections [22(4)] and [23(4)] will give existing franchisees the ability to opt-out of receiving disclosure documents and subsections [47(7)] and [49(4)] grant existing franchisees the ability to opt-out of the 14-day cooling off period, allowing them to operate the business immediately.

These changes reduce the regulatory burden for both parties and create a more efficient commercial transaction. To ensure adequate protections for franchisees remain, the opt-out has to be in writing, and franchisees will still have the ability to request a disclosure document at any point under sections [31] and [32] (existing obligation).

Termination for serious breach

The Government response requires the new Code to adopt an approach that simplifies termination provisions relating to serious breaches by franchisees. The Schaper Review observed that the 2021 changes relating to clause 29 of the existing Code made it difficult for a franchisor to terminate the agreement within a timely fashion where there is a franchisee breach.

Key messages from the Schaper Review about the early termination provisions were that:

- The Code must strike a balance between early termination provisions and protection of franchisee interests.
- Franchisors must be able to take decisive action to address serious misconduct, where the circumstances are sufficiently severe.
- There is a need to retain checks and balances to guard against misuse of early termination provisions by franchisors.

The new arrangements for termination for serious breaches include the following characteristics:

- On the grounds outlined in section [54], a franchisor may terminate with 7 days' notice and the franchisee may not progress the matter to alternative dispute resolution (ADR). The relevant grounds are circumstances where there has been a finding against the franchisee by a competent authority in relation to matters that represent serious misconduct by the franchisee. For example, where:
 - the franchisee no longer holds a licence that the franchisee must hold to carry on the franchised business (finding by a regulatory body)
 - the franchisee is a company that is deregistered by the Australian Securities and Investments Commission (finding by the Australian Securities and Investments Commission), and
 - the franchisee is convicted of a serious offence (finding by a court).

In these circumstances, the Code would provide that it is not necessary to enable access to ADR because the franchisee has already been afforded a chance to dispute the relevant conduct through the process of the competent authority. In these situations, the provision of access to ADR may delay the franchisor from taking decisive action.

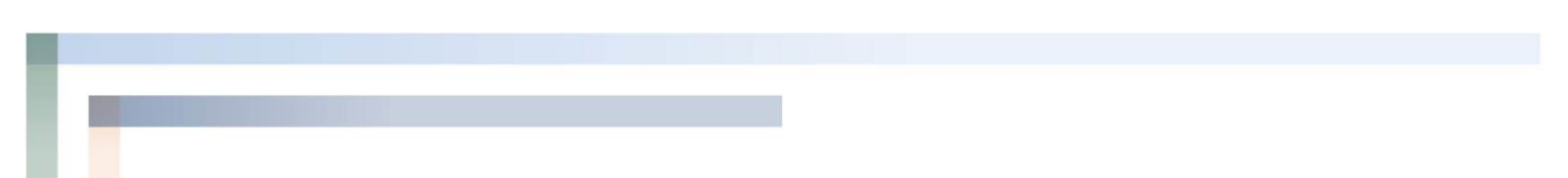
- On the grounds set out in section [55], a franchisee maintains the right to give notice of a dispute and access expedited ADR processes. This is available for situations where there has not been a relevant finding by a competent authority, but the circumstances involve a subjective view about the franchisee's breach of the agreement (e.g., that the franchisee has voluntarily abandoned the business). In these situations, the franchisee retains the right to test the establishment of the relevant ground through the dispute and ADR processes.

The existing arrangements for termination for non-serious breaches (section [52] (existing clause 27)) and termination where there is no breach (section [53] (existing clause 28)) are maintained.

The operation of termination provisions under the Code does not preclude franchisors from exercising other contractual rights under their franchise agreements. For example, the contract may end by convenience where there has been agreement by both parties and consent to terminate following a negotiation where the franchisor has agreed to provide the franchisee with adequate compensation.

Extending key protections

The Government has committed to extending certain key protections that currently apply to new motor vehicle dealerships to all franchisees. As the Schaper Review observed, properly functioning markets require accurate and transparent valuations and informed buyers.



This section addresses the elements of the Government response on compensation for early termination and reasonable opportunity for return on investment:

- Recommendation 8: The existing requirement that new vehicle dealership agreements must provide a reasonable opportunity to make a return on investment should be extended to all franchise agreements.
- Recommendation 9: The existing requirement that new vehicle dealership agreements must include provisions for compensation for franchisees in the event of early termination should be extended to all franchise agreements.

Reasonable opportunity for return on investment

The Government response provides for there to be a requirement that all franchise agreements provide the franchisee with a reasonable opportunity to make a return on their investment during the term of the agreement.

This requirement which is currently set out under Part 5 as applying to new vehicle dealership agreements, will appear in Part 4 of the new Code and apply to all franchise agreements.

Under this provision, at section [43], what is considered a reasonable opportunity will be specific to the terms of each agreement, the costs paid by the franchisee and the length of the agreement. Franchisors are not expected to provide a contractual guarantee of a profit or the success of the franchisee's business. It is not intended to remove the inherent risks of running a business but is intended to ensure that the term of a franchise agreement is consistent with the level of capital investment required.

Compensation for early termination

The Government response requires that all franchise agreements include provisions for compensation for early termination of the franchise agreement in specific circumstances.

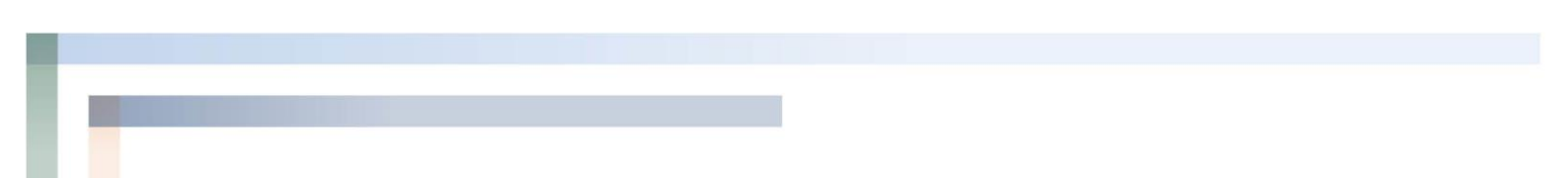
This requirement which is currently set out under Part 5 as applying to new motor vehicle dealership agreements, will appear in Part 4 of the new Code and apply to all franchise agreements.

Due to the extension of this provision to all franchise agreements at section [42], the items the franchisor is required to buy back or compensate the franchisee for has been extended to apply to the sector more generally.

This provision now covers outstanding stock of the franchise, where those things were specified by the franchisor, purchased by the franchisee and required in order to operate that franchise in line with the franchise agreement or the operations manual. This includes things like:

- all essential specialty equipment;
- branded products or merchandise purchased or maintained by the franchisee that could not be repurposed for a similar business; and
- any other thing that the franchisee was required to purchase or maintain for the purpose of the franchise.

To ensure that the existing protections for new vehicle dealerships continue to provide adequate coverage of the items unique to their businesses, subsection [42(3)(d)] retains the reference to 'new road vehicles, spare parts and special tools' set out in clause 46A(2) of the existing Code.



These provisions work in conjunction with section [43] as the opportunity to make a reasonable return on investment would be effectively ‘cut short’ if a franchisor decided to, for example, exit the market or reduce their market presence.

Promoting best behaviour

Effective dispute resolution and compliance mechanisms are essential aspects of facilitating a fit-for-purpose regulatory regime. By discouraging bad behaviour, these mechanisms encourage and support sector participants who do the right thing, maximising the benefit that franchising offers.

This section addresses the elements of the Government response which promote good behaviour:

- Recommendation 18: the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) should be given additional powers to name franchisors who have not participated meaningfully in alternative dispute resolution.
- Recommendation 22: The scope of penalties under the Code and associated investigation powers and infringement notice regime in Part IVB of the *Competition and Consumer Act 2010* (CCA) should be increased.

Giving the ASBFEO the power to name franchisors

The Government response requires relevant legislation to be amended to provide the ASBFEO with the power to publicly name franchisors that fail to participate meaningfully in ADR.

Under section [75], the ASBFEO will now have the power to name franchisors who are a party to a dispute and who have refused to engage in an ADR process or withdrawn from an ADR process. This extends an existing power the ASBFEO has for general business disputes.

The ASBFEO will have discretion as to whether and how it names franchisors.

Aligning the penalties in the Code with substantive obligations

The Government response requires all substantive obligations placed on parties under the Code to have a penalty provision set at 600 penalty units.

Provisions which include obligations but did not previously have penalties have been redrafted to accommodate a penalty.

An amount of 600 penalty units is the maximum amount a court can impose for a breach. The Court maintains its discretion to determine the value of the penalty depending on the circumstances of the breach.