

Submission

To: Committee Secretary, Parliamentary Joint Committee on Corporations and Financial Services

From: Derek Sutherland Lawyer

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Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Franchising Code of Conduct

1. My experience in franchising

- 1.1 I am a commercial lawyer who practices exclusively in franchising, retail and distribution and have been involved in the sector for over 25 years representing participants in industries regulated by both the Franchising Code and Oil Code sectors.
- 1.2 My clients have included many iconic brands including national and international franchisors, franchisees, master franchisees and suppliers (such as banks), motor vehicle dealers, motor vehicle manufacturers and distributors (car, truck, heavy machinery and marine), and petroleum companies.
- 1.3 I regularly provide advice on the application and interpretation of technical aspects of the Code. I draft documents to assist franchisors to comply with the Code, deal with transactions such as leasing, grants, renewals, transfers, disputes and terminations and assist with strategies for change, resolving disputes including mediation and litigation and compliance with regulatory compliance such as competition law including assisting clients with their dealings with the ACCC.
- 1.4 My experience includes acting as an independent reviewer to review and provide annual compliance reports for a franchisor that provided a S87B enforceable undertaking to the ACCC.
- 1.5 I was for many years a long standing member of the ACCC Franchising Consultative Committee and relevantly was a member at the time the independent review undertaken by Alan Wein and the prescription of the new Code occurred. I still have regular contact with the ACCC and Treasury on matters affecting the franchise sector including issues concerning the interpretation and application of the Code. I am also a member of various industry based committees.

- 1.6 I am also currently an Adjunct Professor in Franchising for Griffith University and was involved in content for modules in their online Franchise education course. I do not consider myself to be an academic because my practice involves direct application of the Franchising Code and Oil Code to clients I represent.
- 1.7 This submission reflects my personal views and is not prepared on behalf of any client that I represent or client of the firm I work for) nor any organisation of which I am a member. It does not reflect and is not intended to reflect the official views of the law firm I work for.

2. Are the Disclosure Document and Information Statement effective to ensure full disclosure to prospective franchisees of "all information" necessary to make a "fully informed decision" whether to enter a franchise agreement

Effective reforms

- 2.1 The independent review by Alan Wein into the Franchising Code of Conduct (**Code**) was extensive. It has been widely considered by many to have resulted in significant improvements to the version introduced in 1998. It is far more effective than the original code because it includes civil remedy provisions and has resulted in greater enforcement powers (fines and penalties) to the regulator.
- 2.2 In my view the franchising business model and the current regime of regulation through a prescribed mandatory industry code is not 'broken'. Calls by a few that there is to an urgent review of the current regulatory regime or to impose additional more burdensome regulations on franchisors are unwarranted.
- 2.3 Despite that the Code should be regularly reviewed to identify where disclosure under particular items needs improvement, clarification or expansion, whether particular types of conduct should be prohibited or restricted and whether particular terms of franchise agreements should or should not be included. This should improve the quality of the information required to be disclosed and the overall effectiveness of the Code.
- 2.4 Improvements in information to be disclosed to a prospective franchisee will not completely prevent franchisee insolvency or business failure. However reckless or deliberate misrepresentation or false, misleading and deceptive conduct or unconscionable conduct can cause it. There are already existing remedies and powers that available which should be used to hold those to account where their conduct is void of morality and unconscionable. Those remedies and powers should be actioned before trying to determine if other remedies should be given.
- 2.5 The franchise sector is being tarnished by, and does not want to provide refuge to, the actions of a small few who operate under a distorted 'moral compass' that may regularly or systemically engage in opportunistic, dishonest, immoral or unconscionable behaviour. Like any industry it is currently possible to identify and target those engaging in that opportunistic conduct. It is already possible to take steps to prevent them being a risk to

prospective franchisees. In exceptional cases individuals working in the sector who deliberately or recklessly engage on a regular or systemic basis in that opportunistic conduct should face the prospect of being shunned and banned from being involved in a franchise system in Australia. ASIC has powers to ban people from being managing a corporation - in extreme cases this may be required. That prospect should not even be contentious.

- 2.6 Having said that, Parliament cannot and should not legislate to protect someone from their own stupidity or conduct. At a certain stage they also need to take a significant degree of responsibility and accountability for their actions and decisions. That may mean that they need to be compelled to take steps to protect themselves and seek independent advice particularly to help them identify if the franchisor is engaging in such conduct and to get advice on whether the opportunity 'stacks up'. In many cases experienced advisors do know of the reputation of systems and those which operate under sound business models and those that don't.

Opportunistic conduct

- 2.7 Previous inquiries and reviews have reflected on the conduct of franchisors to identify examples of opportunistic conduct that would require Government intervention to protect franchisees. As a consequence of those inquiries improvements to the Code were made including the obligation to act in good faith and empowering the ACCC with greater investigative and enforcement powers and remedies.
- 2.8 The vast majority of franchisors do act responsibly in recruiting and assessing the suitability of prospective franchisees. . Responsible franchisors can use diagnostic tools and professional advisors¹ to assist to recruit and evaluate the suitability of a prospective franchisee to join their networks. A franchisor should not recruit a prospective franchisee simply based on the fact that they have a heart beat and cheque book or because they want to 'off load' a failed business to stop their losses. Franchisors know that if they chose the wrong franchisee it can ultimately cost them significantly more in wasted time and money as well as frustration and stress than if they properly vetted them. However like the process of recruitment of employees, sometimes what looks like a great prospect in an interview can turn out to be someone entirely different.
- 2.9 On their own, improvements to disclosure obligations will not protect a franchisee from those that deliberately or recklessly fail to comply with their code obligations (including disclosure obligations) or acts opportunistically to encourage a prospective franchisee to enter into a transaction in circumstances where good conscience and morality would dictate that it should never have been allowed to do so.
- 2.10 Occasionally an example of opportunistic conduct by a franchisor alleged to be devoid of morality will surface. That opportunistic conduct flows predominantly from a deliberate or reckless decision motivated primarily to offload a failed site or business in circumstances where they know that there is no reasonable or foreseeable prospect that the business (using the franchisors business model) could ever succeed at that site. The motivation is to stop losses rather than to help a franchisee succeed using their model. The motivation for the franchisor re-granting that franchise is not based

¹ Greg Nathan - Franchise Relationships Institute - Profiler

predominantly on the business model but on an overriding commercial imperative to stop the bleeding of losses they are incurring when morality would dictate that the decision should have been based on many factors including a proper evaluation of the operator, a reasonable belief that the site is suitable and the business with good operators at the helm is likely to be turned around and successful based on the normal application and current parameters of their business model. It becomes opportunistic if their decision is deliberately or recklessly motivated predominantly on getting out of residual lease liabilities and reduce the losses they are incurring in continuing to operate the business.

- 2.11 In simple terms the motivation to 'offload the business and site' at any cost to an unsuspecting franchisee would be opportunistic when in good conscience they know the franchise business model won't work there and what they should have done was close what is otherwise clearly a failed site and incur that loss themselves.
- 2.12 That type of opportunistic conduct can unfortunately have a common theme. A prospective franchisee (and even an existing franchisee of another store) is actively encouraged to takeover a failed or failing business operated by a previous franchisee (or the franchisor), pressure to move quickly is applied, often significant incentives are promised (waived, suspended or reduced royalties, rent or marketing support, a low purchase price etc) under tight time pressures to take up the opportunity on promises of the likelihood of a significant turnaround in business performance because they are great potential operators. Invariably inadequate disclosure of the poor past trading information is given. Important information is withheld that would be vital to make an informed decision. A representation about the ability to significantly improve the financial performance of that business is made. A prospective franchisee then takes on the opportunity (sometimes against or without legal and accounting advice) and they quickly discover that the promises of support of the franchisor evaporate and the franchisor moves on expecting the franchisee to perform a miracle and make the business suddenly successful and in line with other businesses using the model. With the benefit of hindsight the franchisee quickly discovers they have been duped, the rent is too high and unsustainable, the business model just doesn't work at that site and more importantly the business at that location could never be turned around even if they were the best operator in the network. Their losses continue until they close, become insolvent or offload the business again to another unsuspecting prospective transferee. In some cases lives are destroyed and marriages ended.
- 2.13 In my view that type of opportunistic conduct could clearly breach the existing express obligation not to engage in unconscionable conduct and not to mislead or deceive. It could also breach the obligation to act in good faith. A franchisor could also by that conduct already expose itself to a claim founded on the tort of negligence that it deliberately or recklessly breached a duty of care it owed to the prospective franchisee. In my view that type of conduct also goes against the questions of the legitimacy and effectiveness of their business model.
- 2.14 It is also fair to say that many franchised businesses fail predominantly simply because the operators are not suitable. The site or territory may be within business model parameters and the underlying business can be turned around with support and good management. If matters such as site selection, rent and outgoings are within normal business parameters of the business model it should be able to be turned around and a decision made to re-grant the franchise could be reasonable and justifiable.

- 2.15 The reality is that it may be impossible for a prospective franchisee to get relief through the Courts due to cost, time and expense or because they have lost everything. In that kind of case the ACCC already has the powers and remedies available to it to step in and assist a franchisee and also to take steps to stop a franchisor continuing to engage in that kind of conduct.
- 2.16 If the ACCC had the power to ban a person from being involved (ownership, management or employed (or even a contractor) with a franchisor it may help lower the risk and prevent exposure to that sort of opportunistic conduct. It may also allow those to search and identify those with whom they should not be dealing if those details are published on a register. It may be a strong deterrent to prevent that conduct occurring particularly if criminal penalties applied to the person subject to that banning order if they chose to ignore that banning order.
- 2.17 Allegations of opportunistic conduct where a party unconscionably induces a party to take on an overvalued or failing business are not limited to franchisors. In some cases allegations arise in relation to former franchisees as well.
- 2.18 Occasionally we also see examples of opportunistic conduct by a franchisee when they sell their franchised business. The business is promoted for sale at an overinflated sale price based more on a personal '*what it owes me*' valuation rather than on a true market value comparative with other businesses in the network. The existing franchisee (vendor) makes a representation to a prospective transferee to induce them to pay much more for the business than the business is really worth. The transferee (usually heavily leveraged) soon realises after they buy it that they paid much more than it was worth. In some cases the business broker does not include an enforceable restraint of trade to protect the buyer for the goodwill it has paid. The buyer or the broker may assume the franchisor will enforce its contractual restraint against the former franchisee to protect the buyer, rather than giving the buyer a direct contractual right to protect its investment. In some cases a former franchisee may start to compete against the buyer and breach the restraint covenant that the franchisor has with the former owner. That can lead to a dispute where the buyer demands the franchisor take steps to protect them and their investment when they have NO contractual restraint to enforce themselves. In that case the buyer paid the seller (not the franchisor) for goodwill, but cannot protect it because a franchisor cannot afford to enforce the restraint.
- 2.19 Similarly opportunistic behaviour by a franchisee can occur where it wants to sell to get out at any cost and make the business 'someone else's' problem. I have advised a master franchisee who found themselves in this situation. They unfortunately acted for themselves in the sale to 'save costs' and didn't seek legal advice in a transaction where this happened. The vendor didn't disclose problems within a system or with their franchisor (or in this case questions as to the enforceability of agreements the buyer was taking over, simply because they didn't want to lose a sale. They just want to get out. The buyer blames the franchisor (or if he had been advised - his advisor) for its position and for not telling them it was overvalued or there were significant things not disclosed to them that would have affected their decision to proceed. The former franchisee walks away after misleading the prospective transferee.
- 2.20 Currently Clause 25 of the Code outlines the circumstances where it is reasonable for a franchisor to withhold (or revoke) its consent to a transfer. It does not cover circumstances where the franchisor should be entitled to withhold or revoke its consent if it reasonably believes a vendor franchisee is

engaging in opportunistic conduct. Clause 25 should expressly allow a franchisor to withhold its consent to prevent that sort of opportunistic conduct by transferees. In many cases a franchisor may reasonably believe the price is overinflated and unsupportable and the vendor is misleading the buyer. I have seen more than one example where the outgoing franchisee had threatened the franchisor with litigation if it did anything to interfere with the sale and cause them to lose the buyer when in fact the moral thing to do is to protect the buyer from an opportunistic seller.

- 2.21 Currently the obligation to act in good faith in a sale can put a franchisor in direct conflict between its obligation to an existing franchisee and its obligation to a prospective transferee. In my view morality should expect a franchisor (without breaching its obligations to the existing franchisee) to advise the prospective transferee that in its reasonable view the purchase price is 'overinflated' compared to other businesses in its network and that the purchase price should be independently verified by a registered business valuer experienced in valuing franchised businesses.
- 2.22 A franchisor should have the right (exercised in good faith) to withhold consent to a sale where it reasonably believes the price is 'overinflated' and a prospective transferee could be misled.
- 2.23 Some prospective franchisees may be on boarded to a franchise when they are clearly unsuitable or not in a financial position to allow them to prudently take on a franchise. Ethical recruitment practices should oblige a franchisor to inform the recruit that they are just not suitable as a franchisee in their franchise network.

Poor borrowing practices

- 2.24 In many cases a prospective franchisee may be less than honest with a franchisor about their skills and financial position. They can engage in irresponsible borrowing practices and have excessive debt burdens.
- 2.25 In some cases franchisees deliberately do not pay down business debt, they may borrow from family and friends (and not disclose this to a franchisor) or prefer to use their money from the business to reduce non deductible house mortgage debt and other non deductible debt before repaying business debt. As a consequence it may still have a significant business debt to repay at end of term for the business. This can mean that they are not in a financial position to be able to fund a fit out or refurbishment at the time of renewal. It can often lead to disputation and non renewal.
- 2.26 Excessive borrowings and poor repayment practices can also lead to a higher risk of failure and insolvency. A prospective franchisee should obtain proper advice on financing the business and working capital required. In many cases a franchise business model may be pre vetted by a bank who lends to franchisees in that network. Using a lender who has accredited the franchisor business model could give a degree of comfort to a franchisee that the lender is confident to lend to a business in the network and that the business model operated properly should work.

Improvement in items of disclosure document

- 2.27 I have attached to this submission some Schedules addressing particular provisions of the Code and some suggested changes I think need to be made to the Code to improve the quality of Items of disclosure and enhance the quality and meaningfulness of a disclosure document (and continuing disclosure) to prospective franchisees. They include suggestions to improve clauses of the Code as well.
- 2.28 They should lead to better quality of information being given and as a consequence a more effective decision being able to be made by a prospective franchisee.
- 2.29 Clarification and improvement of ambiguous or ineffective provisions where there is drafting irregularities improves the transparency and effectiveness and enforcement of the Code.
- 2.30 Some items in Annexure 1 are poorly drafted. As a consequence, deficiencies in the information provided can occur simply because the wording of the item is open to interpretation². An incorrect interpretation of an item can mean an item is not properly answered and disclosure is useless because the answer provided is "not applicable".
- 2.31 Some items of information deal with similar matters and are scattered across more than 1 item so it may make disclosure less clear to a prospective franchisee. For example issues about exclusivity are covered in various items such as Item 9.1 and 9.2, 11.1(b) Item 12 (Online sales) - item 12.4(a) and item 13.2 (History of the Site or territory) which may include disclosure of whether a franchisee who operated in the territory has left the system and currently operates independently of the franchise network within the territory.
- 2.32 A careful review by Treasury and the ACCC in consultation with Stakeholders at the next review of the Code can assist to identify those items that could be improved or even a better guide to completion prepared that gives practical examples and tips for completing them.

Effectiveness of risk statement

- 2.33 All small businesses face some risk of personal and corporate insolvency. Warnings of the risk of insolvency are useless if the business model is flawed and the prospective franchisee is not able to properly evaluate that model when it makes the decision to purchase a franchise.

² A retail store that has no 'territory' may not get information answered in Item 9.2 about the nature of their rights and exclusivity simply because the question appears limited to franchises where a territory is granted. Many law firms have voluntarily advised their clients of the overarching obligation not to mislead and deceive. We expect that some firms would recommend their clients provide more (not less) disclosure about the nature of rights and competition for fixed sites than what the item suggests. The item should be reviewed carefully to ensure it reflects the intent of parliament as to exclusivity or not.

- 2.34 In the absence of a public survey or collection of data from prospective franchisees by the regulator, it is difficult to make any statement as to the effectiveness of the Information Statement contained in Annexure 2 or if it has influenced or assisted a prospective franchisee to make a more 'informed decision' about entering into the agreement. That can only be gauged from prospective franchisees.
- 2.35 It does appropriately warn them of some of the relevant potential risks of franchising and operating a small business including failure and insolvency by them as well as the franchisor which I understand was its intent.
- 2.36 I believe the sector has embraced its use and implemented it in their negotiation processes. The obligation under clause 11 to give it is currently not expressed as a civil remedy provision for which a fine or penalty for contravention applies. If there is evidence of widespread breach of that obligation then enforcement may require clause 11 to be made a civil remedy provision.
- 2.37 The Information Statement cannot express every risk associated with establishing or operating a small business or acquiring a franchise including the circumstances when it will fail. It appropriately encourages and directs a prospective franchisee to participate in certain pre-franchising education initiatives and to seek independent advice which are of themselves important and timely at that stage of the decision making process.

Effectiveness of a disclosure document

- 2.38 There is a wide disparity between the length, quality of content and approach to answering items of disclosure in disclosure documents. The quality of content and disclosure depends on who prepare or settles the document. The quality and approach to disclosure does vary between franchisors and between law firms and in some cases even between lawyers within law firms.
- 2.39 In some cases Items of disclosure are very clear whereas others are less 'clear'. A lack of any pre-vetting opportunity or ability for a franchisor to obtain a binding ruling or opinion may mean that less effective disclosure is given.
- 2.40 There are only a few cases which have provided judicial guidance on the interpretation of provisions of the Code. As a consequence this requires the franchisor to seek advice or make a decision about and determine the information it is expected to provide to meet its disclosure obligation.
- 2.41 I have prepared and reviewed many disclosure documents across a number of systems. In my experience inadequate disclosure is more common where a franchisor prepares the document themselves without seeking legal advice or in circumstances where they have not used an experienced franchising lawyer to assist in preparation, vetting or verification of information contained in their disclosure document.
- 2.42 I think even some in-house counsel (without franchising experience) can struggle to understand clearly what each item requires in terms of disclosure and need to seek advice to be sure what is intended.

- 2.43 Overloading a prospective franchisee with excessive amounts of information can also have the opposite effect to giving them enough information to allow them to make an informed decision. It may simply mean they do not read and interpret the information and because of cost issues they do not seek advice on it.
- 2.44 There is no necessity for Government to change the current standard of the purpose of disclosure to a prospective franchisee set out in clause 8(2)(a) of the Code from a "reasonable informed" to a more onerous 'fully informed' standard. This is consistent with other standards of conduct that require a director to act reasonably.
- 2.45 There is no need to change the existing risk statement or disclosure obligation of a franchisor to a higher standard or test simply to attempt to make a prospective franchisee "fully informed" of every risk. The government controls the content of the 'risks' in the Information Statement and any changes to warnings about those risks are best dealt with generically in the drafting of that statement.
- 2.46 Any review of the current disclosure test for a disclosure document for a prospective franchisee should not seek to impose a standard so high that it makes compliance too difficult (if not impossible) for the majority of franchisors to understand or achieve.
- 2.47 It may be more appropriate to implement initiatives to ensure a franchisee takes reasonable steps to conduct its own due diligence and compel them to seek independent legal or accounting advice from experienced advisors with demonstrable franchising experience.
- 2.48 The existing disclosure obligations imposed on a franchisor under the Code including continuous disclosure under clause 17 are significant. In addition there is an overarching obligation under the ACL not to mislead or deceive a prospective franchisee. That obligation extends to representations made in negotiations and the disclosure given to a prospective franchisee.
- 2.49 The deliberate or reckless omission of information (silence) can amount to misleading and deceptive conduct but it can also amount to a contravention of the Code³. A franchisor also has an express obligation to act in good faith in negotiations with a prospective franchisee which includes an obligation to act honestly.
- 2.50 If a franchisor breaches those obligations there are already extensive remedies available to a prospective franchisee and the ACCC (including fines and penalties and court enforceable undertakings) arising from contraventions. The ACCC has taken action for contraventions of the Code and issued infringement notices and obtained Court ordered penalties as well as other orders including S87B enforceable undertakings. The more this occurs, the

³ For example the recent case brought by the *ACCC-v- Morild Pty Ltd* (Pasta Cup case) where the ACCC successfully prosecuted and obtained fines against a franchisor and its director for the failure to include disclosure of a director's involvement in 2 former failed franchisors breached the obligation to give disclosure of relevant business experience

stronger the message to the sector to 'lift its game". That approach should be primarily targeted at those who engage in deliberate and reckless conduct not to be overly pedantic with those who genuinely taking action to meet their compliance obligations but have made a genuine mistake.

- 2.51 Australia's franchising regulatory compliance regime is already considered to be one of the most onerous and heavily regulated in the world. We have extensive and effective competition and consumer laws which underpin the mandatory code regime and give extensive rights and remedies to those who may suffer loss or damage from conduct in breach of those laws. Those powers including significant investigative and enforcement powers (and remedies) conferred upon the ACCC and other regulators. There are also other State and Territory laws that work alongside the Code. Including dispute resolution initiatives by State Small Business Commissioners and OFT's.
- 2.52 The recommendation from the last independent review by Alan Wein was to allow a period of 5 year after the introduction of the new Code for the sector to 'settle' before a further review was to be conducted to allow those reforms to be absorbed and implemented. In my view there is no need for a total rewrite of the Code to occur.

Motor vehicle dealerships

- 2.53 I made extensive submissions to the Alan Wein independent review which included a submission recommending that a review of issues affecting motor vehicle distribution agreements was required. Mr Wein made a recommendation that the Government conduct that review before the next formal review of the Code. The terms of reference do not directly include any reference to motor dealerships although it is likely submissions will be made by those in that sector.
- 2.54 Any review involving motor dealer specific issues should be transparent particularly if changes proposed are to be made to the Code provisions or the disclosure document will affect others that are regulated by the Code but they outside of the dealership sector.
- 2.55 If industry specific changes to the Code for motor dealerships are warranted that impose additional obligations on a distributor or manufacturer or additional rights for a motor dealer they should be quarantined to motor vehicle dealership agreements in a separate Part or in a new Motor Dealer Code. In my view that discussion should be a separate review with relevant stakeholders represented.
- 2.56 Motor vehicle dealership agreements are the only form of agreement which is taken to be a franchise agreement that does not otherwise have to pass the 4 elements test in clause 5 of the Code. As a consequence they are to a degree 'different' to other franchise agreements and may be appropriate to have some Code provisions that apply only to them and parties to those agreements.

The justification for franchising business model and best practice

- 2.57 The deliberate or reckless actions of a few who engage in opportunistic conduct do tarnish the reputation, trust and confidence of others who use the business model. The sector may be facing a 'trust' and confidence issue at the moment which needs to be kept in perspective.
- 2.58 I have acted for both franchisees (and master franchisees) as well as franchisors. I represent those on both sides of the argument. It would be naïve to suggest that worse case examples suggested by some franchisees do not occur. They do and I am not suggesting that they do not, nor do I understate the significant affect it can have on a franchisee and its family where their franchise experience is at the other end of the spectrum and extremely bad.
- 2.59 They may have significant existing rights arising from that conduct but (like other small businesses) they just cannot exercise those rights in a cost effective or timely manner because the justice system for enforcement of those rights and to get a commercial outcome through litigation involves long delays, expensive litigation, and an immense personal toll on their financial position (including insolvency), their health and family relationships. This leads to frustration, insolvency family breakups and other unexpected outcomes. That however is not everyone's experience, there are also many franchisees and master franchisees operating successful businesses in franchise systems with sound business models.
- 2.60 However it is important to remember that the majority of franchisors are also small businesses worthy of support and protections (and not overregulation). Many operate with limited financial and human resources. Some are public companies or owned by private equity investors or may even be owned collectively by groups of franchisees. Ownership is diverse. Some systems are heavily regulated by other State and Commonwealth laws (Pharmacy's, real estate agencies etc).
- 2.61 Businesses using the franchising business model already make a significant contributor to GDP in Australia, they employ people and pay taxes and buy goods and services from other businesses which stimulates the economy. They are also usually innovators in technology and the delivery of goods and services which provide market penetration across wide areas that would not occur without the model.
- 2.62 You only have to drive down the road in a regional area to see how many businesses are franchised and offering goods and services. Those businesses and their contribution to the economy particularly in regional areas would not exist but for that business model.
- 2.63 They encourage a positive contribution to the economy, not dependence on welfare. Many also contribute network wide to the social fabric by establishing or contributing to charities and other local and national social initiatives which often go unrecognised.
- 2.64 There are always 2 sides to a story, unfortunately sometimes bad news stories can get more 'air time' than good news stories.
- 2.65 A franchise system is usually characterised by a number of factors including a consistent offering of goods or services, a sound business model that can be replicated in other locations, established systems and support, training and the right to use intellectual property all of which are glued together by a strong entrepreneurial spirit. It is not founded or held together by opportunism.

- 2.66 It is therefore important for the business model to work and adapt in an ever changing business environment. There have unfortunately been many businesses (including franchise systems) that no longer exist because the financial and operating aspects of their business model have been unable to adapt and change their model to meet changing regulation, technology and consumer demand. In some cases franchisees resist that change, in others they want it to change. Similarly the demand and relevancy of goods and services and how they are delivered regularly change.
- 2.67 The Australian disclosure document is already one of the most comprehensive in the world. It has items of disclosure that were originally derived from the USA including following the form and items of disclosure that came out of the UFOC⁴ at the time the Code was originally prescribed. It has evolved over time and provides more meaningful items of information to a prospective franchisee than required by other foreign jurisdictions.
- 2.68 All franchisors should be encouraged to strive to achieve best practice and to make effective, meaningful and transparent disclosure to prospective franchisees. However simply making disclosure more onerous or complicated does not of itself lead to a more informed decision being made by a prospective franchisee.
- 2.69 Similarly in their offering franchisors are not asking a prospective franchisee to invest in a fast moving consumer good or to subscribe for shares in the float of a public company. The fundamental offering of a franchise is not simply the opportunity to 'buy a job' but rather the opportunity to encourage and assist their entrepreneurial spirit to establish and operate their own business under a business model with an established franchise system.
- 2.70 There are protections already in place that reflect this. Unfortunately other businesses that offer licence opportunities or dealerships that are not franchises give far less information (if they give any information at all) of the business opportunity than a franchisor. I have seen business opportunities to operate businesses purportedly offered as licenses when in fact they are actually franchises. The ACCC quite rightly should investigate and take action against those who deliberately avoid their compliance obligations entirely.
- 2.71 Over my career I have reviewed and prepared and vetted a large number of disclosure documents. I am regularly asked for my opinion on how particular ambiguous provisions of the Code and Items of disclosure should be interpreted.
- 2.72 In my view the effectiveness of a disclosure document substantially depends on the quality, adequacy, transparency and usefulness of information disclosed to prospective franchisees. This includes the way in which some Items of disclosure are interpreted and answered by the person preparing the document. This quality varies significantly between systems depending on the experience of the person who has prepared the document and whether they get legal advice from experienced franchising lawyers to properly vet it. Lawyers have different interpretations of provisions as well and advice provided may differ between firms and particularly between lawyers.

⁴ Uniform Franchise Offering Circular

- 2.73 The fact these documents are usually confidential and not available on a public register makes it difficult for a franchisor to access examples of other disclosure documents to compare the way in which items are answered and the level of disclosure they provide.
- 2.74 In my view the quality of disclosure of information given to a prospective franchisee can vary significantly for several reasons including:
- (a) The **drafting of the Item is already ambiguous and open to interpretation** - there is confusion about the extent or nature of information expected to be disclosed - Government controls the drafting process and it should be the first place to focus any change - make the information required clear and transparent and cover off on any 'grey areas'
 - (b) The **knowledge, extent of expertise or experience of the person completing it** - eg this varies depending on whether the franchisor, in-house counsel or experienced external lawyers are involved - an inexperienced person new to franchising is less likely to provide meaningful disclosure than if they had it prepared or vetted by an experienced franchising lawyer.
 - (c) The **different approaches to the level of disclosure required to be given** - some adopt a strict or minimalistic approach to give a concise answer (eg Yes or No) rather than details whereas others adopt a more considered approach usually expanding on a yes no answer with a qualification or additional details. In many items of disclosure the ACCC template simply encourage a Yes / No answer approach when a more comprehensive considered answer is required to make it meaningful.
 - (d) Some **concepts (such as geographic exclusivity) are dealt with in various items scattered across Annexure 1** which may make it hard for a 'complete picture' to be easily obtained - For example Items 9.1 and 9.2, items 11.1(b)⁵, 12.2(c) and 12.4⁶ and Item 13⁷ all can deal with aspects involving geographical exclusivity. In some respects it would be beneficial for a prospective franchisee to have all of the information about specific issues (such as geographical and other exclusivity) to be contained in one item or at least a cross reference to other relevant items made. In some cases it can also lead to duplication where the same information is disclosed in multiple items.
 - (e) **There is no pre-vetting service offered by the ACCC or ability for them to provide binding public or private rulings on interpretation of specific items.** It does not help that the ACCC is not empowered and resourced as a regulator to provide binding guidance on interpretation of

⁵ For example if there are national client accounts serviced by the franchisor or other franchisees in their area

⁶ Item 12 deals with online sales and there are territory issues and issues concerning competition and exclusivity embedded in these items. Again they assume there is a territory granted.

⁷ Item 13 requires a history of the site or territory to be disclosed including the circumstances in which the former business ceased to operate. Disclosure of a former franchisee that has left the system and operating in that territory in breach of its restraint may be relevant. The item should be amended to require disclosure of whether the franchisor has taken or intends to take steps to enforce contractual restraints against the former franchisee to protect the new geographical exclusivity granted.

ambiguous terms. There have been few cases where the judiciary has been asked to clarify ambiguous or inconsistent provisions⁸. I am sure they are aware of many things which need to be fixed at the appropriate opportunity.

Independent third party vetting and verification

- 2.75 FRANdata recently announced an important initiative to Australia. It is offering a vetting and verification process for franchisors embracing best practice to demonstrate transparency in their compliance obligations. That initiative facilitates registration, vetting and verification by FRANdata as an independent third party. The service would use a consistent approach to vet and verify a franchisor's transaction documents to a baseline or minimum standard of compliance with the Code. If the documents pass minimum standards FRANdata will accredit their documents for achieving the minimum compliance standard.
- 2.76 If done properly this positive initiative is likely to give greater credibility to the franchise sector and assist franchisors to identify and make improvements to their disclosure document if required and make them far more effective in discharging their disclosure obligation to prospective franchisees. It also encourages franchisors to use more experienced accredited franchising lawyers which will improve the level of information being provided to franchisees.

Choice of Advisors

- 2.77 In my view franchisors, lawyers and accountants who are inexperienced are more likely to misinterpret disclosure items and what information they are required to give and their code compliance obligations.
- 2.78 Franchisors who have obtained informed and experienced legal advice will generally provide more meaningful answers because their advisors understand the items of disclosure and have explained to them what the Item of disclosure is trying to make them disclose.
- 2.79 Most franchisors are generally aware of their Code obligations. Most franchisors will not deliberately or recklessly set out to breach the Code or mislead or deceive a prospective franchisee. If they do so deliberately or recklessly, they should be identified and prosecuted to the full extent of the law as they tarnish the efforts of those who strive towards best practice and incur the compliance costs.
- 2.80 The ACCC publishes a template disclosure document online which encourages franchisors to complete disclosure documents themselves. In my experience it is not difficult to identify those who have chosen to use it because the answers provided are usually very minimalistic. The ACCC should

⁸ SPAR Licensing Pty Ltd-v- MIS Qld Pty Ltd was decided in 2014 shortly before the new code was prescribed. It gave a degree of clarity to the interpretation of when a disclosure document had to be 'current and updated. It lead to changes to the Code

encourage franchisors that use their template, once they have completed it to seek advice from an experienced franchising lawyer to vet their answers to ensure it is complying with the Code before they commence to use it.

- 2.81 A higher standard of quality of disclosure is usually seen where a franchisor has engaged an experienced franchising lawyer to assist them to prepare or settle a disclosure document.
- 2.82 The effectiveness of disclosure to 'help' a franchisee make a reasonably informed decision must ultimately depend on whether items are properly and completely answered as the Government intended and in a way that achieves the overarching obligation imposed not to mislead or deceive.
- 2.83 Overloading a prospective franchisee with large amounts of information and risks faced by other small businesses does not mean that the prospective franchisee can absorb or effectively filter and interpret that information to make a better, more informed decision.
- 2.84 The minimum information required to be given should be presented in Annexure 1 in a way that is clear and unambiguous. Some existing items of disclosure are ambiguous or may ask for less meaningful information than they should. They need to be regularly reviewed in consultation with the sector and the drafting improved continuously over time where necessary.
- 2.85 The nature and extent of information required to be given can be difficult for franchisors (and inexperienced legal advisors) to clearly understand. As a consequence disclosure in some areas can be less helpful or accurate depending on their interpretation even though they may genuinely believe they are answering the Item properly.
- 2.86 Disclosure is less effective if the prospective franchisee does not undertake a due diligence to verify what has been provided about the opportunity and does not seek informed independent advice.
- 2.87 To make an effective decision about whether a business opportunity will be successful a prospective franchisee should get professional advice to carefully evaluate the business model from an accountant experienced in the franchising business model and include plans for what happens if the business or the franchisor fails.

ACCC Checking and enforcing compliance

- 2.88 Government should allocate greater resources to empower the ACCC to focus on monitoring and compliance⁹ and identify and take strong enforcement action those franchisors who recklessly or deliberately contravene the Code or the *Competition and Consumer Act*.
- 2.89 Identifying and taking appropriate action against those who deliberately or recklessly avoid or breach their compliance obligations or engage in unconscionable conduct will result in greater confidence in the regulator and ultimately credibility of sector.
- 2.90 In some cases non compliance may not be deliberate or systemic and the ACCC enforcement guidelines currently give a balance and allow sufficient latitude already to enable them to take a measured approach to enforcement. The ACCC does not need additional powers, simply more resources to check and enforce compliance and to jump onto those who exhibit opportunistic conduct that is damaging franchisees where that conduct breaks the law.
- 2.91 Whilst the ACCC is monitoring and enforcing compliance it has limits on its' resources which limits the extent of the number of compliance checks it can conduct. They are not full audits of a franchise systems compliance with the Code they are just limited compliance checks designed to enable the ACCC to ask for certain documents a franchisor is required under the CCA or Code to produce, give or retain. Despite the overall low number of annual compliance checks it is the highest number of compliance checks conducted compared to other industry codes.
- 2.92 There have been a number of recent successful cases brought by the ACCC to hold franchisors accountable for contraventions of the Code and CCA. The fine and penalty regime currently applicable for contravention of civil remedy provisions is being used by the ACCC albeit at a rate that franchisees may consider is not fast enough and therefore less 'effective'.
- 2.93 Australia does not have a scheme requiring registration of documents with the ACCC. As a consequence there is no pre-vetting of documents for minimum levels of disclosure compliance by the ACCC before a disclosure document is given to a prospective franchisee.
- 2.94 In addition in the absence of a formal complaint being lodged or a random compliance check (by a notice under S51ADD) being made the ACCC may not even have access to those documents to check even baseline levels of compliance let alone to determine if it contains unfair contract terms.
- 2.95 If there are approximately 1100 franchise systems in Australia. The issue of only 10 of these S51ADD compliance notices a year simply means that the vast majority of franchise systems will not be checked unless there is a formal complaint made against them.
- 2.96 The ACCC has a significant name and shame power which they can and do use to identify and take action against those who deliberately or recklessly do not prepare complying disclosure documents.

⁹ The ACCC have over many years only issued about 10 - S51ADD random compliance check notices a year and given the reported number of total systems in Australia this is simply not enough random compliance checks

- 2.97 These powers include the use of S87B enforceable undertakings which can lead to an effective solution and require a franchisor to prepare, implement and have reviewed by an independent reviewer an effective compliance program to comply with their Code obligations and ACL obligations as well. It is apparent that the ACCC is affectively seeking those undertakings where breaches of the ACL or the Code occur and the franchisor does not have effective compliance programs to minimise that risk.
- 2.98 This investigation and enforcement action should be targeted as well to those that do not regularly update their disclosure documents annually or those who systemically do not comply with their other express Code obligations¹⁰. The enforcement powers are already there they just need more resources and time to use them.

Contractual rights and obligations of all parties including termination rights and geographical exclusivity:

Rights and obligations including termination rights

- 2.99 Previous versions of the Code required disclosure of a summary of the conditions or a reference to the relevant clause where rights and obligations of the franchisor and franchisee under the franchise agreement were contained. This occurred in more 2 items.
- 2.100 The former 2010 version of the Franchising Code of Conduct mandated disclosure of termination rights and obligations in Item 17.1 albeit that it simply required disclosure of the reference to the relevant clause in the franchise agreement (not a summary).
- 2.101 That disclosure item was entirely removed¹¹ in a previous review because it was considered unnecessary. Disclosure of some of these rights and obligations still remains in the code eg disclosure of end of term arrangements. If that item or both items were brought back any form of duplication with other amended items in the Code should be avoided.
- 2.102 In my view it the former items were ineffective and often never properly completed by franchisors (where they usually cut and pasted the entire provision into the disclosure document). They are not a substitute for reading the agreement in its entirety. I do not think it is necessary to reinstate these Items. However if there was an intention to reinstate those items, my preference would be to allow the franchisor to chose whether to give either a summary or reference to the clause.

Geographical exclusivity

¹⁰ For example providing end of term notices (clause 18), providing annual financial statements and audit reports for marketing and cooperative funds, establishing a separate bank account for marketing funds

¹¹ Item 17.1 of the 2010 version of the Code

- 2.103 One of the terms of reference suggests that prospective franchisees may not be getting enough information about geographical exclusivity and that this is affecting their ability to make an informed decision. In my view this is more likely to occur simply because a franchisor is not completing it properly.
- 2.104 In my view the primary reason that inadequate disclosure of geographical exclusivity may occur is that the information required to be disclosed and the Items themselves are poorly drafted. In fact information concerning aspects of territory or geographical exclusivity are scattered in various items of Annexure 1. A prospective franchisee or franchisor may not be looking for that disclosure across multiple items, although an experienced franchising lawyer advising them should.
- 2.105 Item 9 of the disclosure document is the main item that deals with the nature of the franchise granted and whether an exclusive or non exclusive territory is granted or the franchise is limited to a site. Item 9.1 assumes that a territory is always granted when it may not be.
- 2.106 The drafting of Item 9 is poor and results in ambiguity about whether it is asking a franchisor to disclose exclusivity (and competition) issues to be disclosed if the franchise is limited to the site.
- 2.107 Currently Items 9.1 and 9.2, 11.1, 12.2(c) and 12.4 - online sales and Item 13 - history of site or territory all require some degree of disclosure about the site or territory and exclusivity (and exceptions to it).
- 2.108 Item 9.1 is presented in a way that encourages a "Yes/ No" answer to be given as to whether the franchise is for an exclusive or non exclusive territory or limited to a site. This approach to answering a question is reflected (and encouraged) in the ACCC's own template disclosure document.
- 2.109 If the franchise does not grant the franchisee any form of exclusive or protected territory then an answer you might expect to see in Item 9.1 would be:
- "No territory (exclusive or non exclusive) is granted. The franchise is limited to an approved Site".*
- 2.110 A legal advisor should consider and advise his client about geographical exclusivity when providing its advice as often it is one of the most important aspects of their decision.
- 2.111 The important disclosure about specific items of information about the nature and extent of geographical exclusivity of a franchise is contained in Item 9.2. Unfortunately in many cases a franchisee is NOT granted an exclusive or protected territory at all. Accordingly the franchise may simply be limited to a site.

- 2.112 The wording of Item 9.2 is restrictive and limiting. It appears to restrict and limit disclosure of issues concerning geographical exclusivity to circumstances where the franchise includes an exclusive or non exclusive territory. This is because the item begins with the words "*For the territory of the franchise:*"
- 2.113 As a consequence of the poor drafting of this item many disclosure documents do not contain meaningful information about geographical exclusivity issues involving a franchise that is limited to a site. It is not the fault of the franchisor but the consequence of poor drafting. Similarly this is reflected in item 12.2 and 12.4 where references to 'territory' appear.
- 2.114 The paragraphs in Item 9.2 regarding specific exclusivity questions can also be improved to add additional information about geographical exclusivity to enable a prospective franchisee to identify the circumstances in which competition will occur from a franchisor, its' associate or current or former franchisees. Some of that information is already given.
- 2.115 For example it would be a significant improvement to require a franchisor to give disclosure about the extent to which a franchisor has acted or is willing to act to enforce a contractual restraint against a current or former franchisee from competing with the prospective franchisee in that territory or in other territories.
- 2.116 Item 11.1(b) can also be relevant where for example there are national client accounts serviced by the franchisor or other franchisees and may amount to an exception to exclusivity where there may be an exception to the person to whom goods or services may be provided. it affects the exclusivity of a prospective franchisee to supply goods or services to those customers or whether those rights are reserved or restricted.
- 2.117 Item 12.2(c) and 12.4 are also relevant to the extent it deals with online sales and competition inside and outside the territory. They also refer just to a territory when they should also be expanded to cover online sales competition where the franchise is limited to a site.
- 2.118 Item 13 is relevant as it deals with the policy of how a territory or site may be selected which may also reflect a policy about exclusivity, rights of first refusal to take an adjoining territory etc.
- 2.119 In my view Item 9.2 should be changed so if the franchise is limited to a site they must disclose details of matters concerning exclusivity and competition in a *reasonable geographic area surrounding the site (including for example in the same shopping centre or retail precinct). That expression should be defined.
- 2.120 Quite often in retail franchises the franchise is limited to operating the franchise at an approved fixed site. In most shopping centre leases no exclusivity of permitted use is given even if the franchisor asked for it.

- 2.121 It is not uncommon to see each of the paragraphs in Item 9.2 completed with the words "Not applicable" simply because no territory is granted.
- 2.122 In my view the drafting of the Item itself results in poor or no disclosure of issues that affect geographical exclusivity and the extent to which a franchisor, associate, current or former franchisee may compete against the business by opening or operating a business under the same or a different brand in close proximity to the Site.
- 2.123 Some systems operate multiple brands with franchisees in those brands located in the same shopping centre selling overlapping products (such as coffee or beverages) which can dramatically impact them. In some cases they open a second store in the same shopping centre or retail precinct including just outside of it in a close geographic proximity to the site.
- 2.124 I have suggested in the Schedule some wording which may improve disclosure of some of these things which can quite often appear in disputes.
- 2.125 If the items of disclosure are clearer then it should improve the quality of disclosure and result in a more 'informed' decision being made.
- 2.126 Experienced franchising lawyers undertaking a legal due diligence should consider and advise on issues concerning 'exclusivity' of the franchise including the scope and limits on the rights and when they may be suspended, varied or lost. Usually that review comes from the franchise agreement itself and comparing it against disclosure items to see what else has been disclosed. As a consequence if the franchisee does not seek independent advice it may not be fully appraised of these issues particularly where a strict approach to answering Item 9.2 is made or it is not mindful where else to look for issues affecting exclusivity because it has never seen a disclosure document before.
- 2.127 A franchisee may be more likely to make an informed decision not to proceed with a franchise if it was made aware that a franchisor could operate or grant a franchise (in the same or a different brand) in direct competition with the franchisee in the same shopping centre or in close proximity to the site.
- 2.128 Item 13 may remain the best place for that disclosure to occur as it can be either in the disclosure document or attached as a separate document and updated to the date it is given.
- 2.129 If claims about poor disclosure of geographical exclusivity are substantiated, Government should review and improve the drafting of existing disclosure Items 9.1, 9.2, 11.1, 12.2(c) and 12.4 and 13 to remove ambiguity and require disclosure of geographical exclusivity issues where the franchise is limited to a site

Disclosure of worse case failures

- 2.130 The Information Statement already outlines there is a potential for failure and a risk of a franchisor or franchisee to become insolvent as does the warning statement on the cover Item 1.1(e) of the Disclosure Document.
- 2.131 Whilst generic, the risk statement is given earlier than a disclosure document and was deliberately intended to be given at the earliest opportunity (rather than at the time a disclosure document is given and just before signing an agreement).
- 2.132 It is unclear whether prospective franchisees consider the Information Statement effective to identify and useful to assist them in assessing likely worse case failure risks.
- 2.133 Item 13.2 of Annexure 1 already requires a franchisor to disclose information relating to franchise failure as part of the history of the site or territory. This includes the circumstances in which it "**ceased to operate**". That would include an obligation to disclose failures occurring in the previous **10 years** for that site or territory. In my view the existing requirement is reasonable.
- 2.134 A failure to disclose that history could result in a claim of misleading and deceptive conduct or a breach of the Code. This would include potential liability where a franchisor operates or takes over from a franchisee a failing store and seeks to "re-grant" the franchise without disclosing its past history, particularly where that history is 'ugly' and resulted in a worse case scenario.
- 2.135 Importantly Item 13 of Annexure 1 **does not require** disclosure of failures that occur at other sites or territories.
- 2.136 Item 6.4 of Annexure 1 contains some details in terms of former franchises for the **last 3 financial** years and the number of franchises where the franchised business "**ceased to operate**"¹². To a degree they can overlap where an answer to item 6.4 involved the existing site or territory.
- 2.137 Clearly before imposing additional layers of disclosure, consideration as to the purpose and effectiveness of Item 6.4 and Item 13 of Annexure 1 in respect to worse case scenarios of that site or territory or for other franchised businesses, sites or territories would need consideration and improvements if any identified. Item 6.4 was a compromise and balance to ensure a prospective franchisee knew how many businesses had ceased to operate. That would include 'worse case' scenarios.
- 2.138 As I have mentioned disclosure items can always be improved. A franchisor could be asked to disclose if the business was relocated to that location or territory and why. (ie because it failed in another territory in close geographic proximity to the new site or territory). That type of information may allow a franchisee to understand why the business was relocated there and identify the need for further due diligence about whether the business model will

¹² Item 6.4(b)

succeed in the new site or fail like the last location. Accordingly that type of information is less about the history of business operated at the new site or territory but more of the business operated at the former site or territory from which it originally operated.

- 2.139 It would be unfairly prohibitive for a franchisor to list every case of business failure in a network or provide a precise cause why that business failed or closed or was not be renewed by a franchisee. I understand this may be why item 6.4 is crafted to just require disclosure of the specified number of events than trying to collate and provide details of other failures whilst still requiring the history of that site or territory to disclose those failures for the last 10 years.

Earnings information:

- 2.140 Item 20 of Annexure 1 is a complicated area of disclosure which is often poorly completed or no earnings information provided. In some cases I have seen the warning statement in Item 20.3 used when earnings information has in fact been given.
- 2.141 Most franchisors are reluctant to give any earnings information to prospective franchisees because of a higher risk of litigation, this includes passing on historical earnings information from other franchisees where they can be held liable if they do not rigorously vet or check its accuracy.
- 2.142 A franchisor should retain the right to decide whether or not it wants to give prospective franchisees earnings information where it relates to a 'greenfield' site or territory. That includes deciding whether to give historical earnings information (**earnings information**) or to give earnings information that amounts to a projection or forecast by making a representation as to a future matter such as turnover, earnings or profit (**a financial performance representation**).
- 2.143 There is a strong argument that could be made in favour of requiring a vendor of a franchised small business to give historical earnings information (if it is available) as part of disclosure requirements for sales of small business and assignments of leases. This may help a franchisee to make a more meaningful decision particularly if it seeks experienced accounting advice on that information

Oil Code - Annexure 3

- 2.144 The Government should review and see whether there is merit in reintroducing to the Code a disclosure requirement for franchisee vendors and adapt some of aspects of the current Annexure 3 of Oil Code and impose obligations similar to Division 2 Part 3 of Oil Code which apply to transfer of a fuel re-selling business.
- 2.145 Whilst a former earlier version of the Franchising Code did have a similar disclosure document requirement it was dropped because there was sector wide concern that franchisees did not prepare and give them in practice. I think one of the most important aspects of Annexure 3 that I like is for the

vendor to give details of outstanding liabilities in respect to its employees. With all of the issues surrounding underpayment of workers, it should not be unreasonable to require a Director or owner of a franchised business to be required to certify compliance with its payment obligations. This may allow a buyer to pursue the seller if the seller underpaid (or didn't properly pay all entitlements) to its staff. This is also useful to a buyer if Fair Work subsequently audits the business after the sale and discovers the former owner had not complied with their obligations.

- 2.146 Irrespective of any regime being introduced a franchisor should have the power to withhold its consent (or revoke it)¹³ if the franchisee does not comply with the requirements under the Code or any law that apply on a transfer of a franchised business. That outcome can be easily and simply achieved by adding the words "or this Code or any other law" after the words "requirement of the franchise agreement" in clause 25(3)(b) of the Code.

State based requirements

- 2.147 Similarly there are already State based initiatives (currently used in SA and VIC) which require a vendor of a small business with a purchase price of less than \$300,000 to give historical earnings and other information to a buyer. It includes certification of that information by the vendor's accountant. A review of the effectiveness of those initiatives should first be undertaken with Stakeholders to see how effective in practice it has been and whether there are examples where Vendors do not comply (or circumstances where they should not be required to comply).
- 2.148 The SA requirement obliges the vendor get a qualified accountant 'sign off' and provide a certification that the financial information in the trading statement provided fairly and accurately represents the financial operations of the business and that they are not aware of any circumstances that would render any of the information in the trading statement inaccurate or misleading. This would be beneficial to a prospective transferee but at a cost to the vendor.

Warning statement

- 2.149 There is currently an obligation to include in Item 20.3 a warning statement that must be included only if the franchisor does NOT give earnings information. That statement is meaningless if the franchisor, despite including that statement, actually subsequently does give earnings information or makes a projection or forecast. It may be better to require the applicable warning statement in Item 20.3 to appear in BOLD and size 12 font like other warnings given in Item 18 (end of term arrangements) and also to have an alternative warning statement if they do give earnings information or make a financial performance representation (projection or forecast).

¹³ The list of circumstances in Clause 25(3) should be expanded to cover the relevant requirement

- 2.150 Item 20.1 specifies that earnings information must be given with the disclosure document but it does not specify what happens if it is given after disclosure and whether re-disclosure is required simply because historical earnings information is supplied after disclosure but before execution. A solution may be to add such a requirement into clause 17 of the Code similar to clause 17(1).

Earnings information for other businesses

- 2.151 A franchisor should not be compelled to provide a prospective franchisee with historical earnings figures for other businesses (in different locations) when it is granting a franchise for a 'greenfield' site. It will invariably lead more litigation - not a better informed decision.
- 2.152 Any requirement to give earnings information should oblige a franchisor (or associate) to give historical earnings information to the buyer for the store or franchise unit they own or operate that is being sold but not every corporate business they operate or for businesses operated by other franchisees at other locations.

Exceptions

- 2.153 Any regime should include clear express exceptions to its application. For example the circumstances where it is not mandatory and can be waived by the buyer. Those circumstances should include circumstances where the business is being sold to the franchisor or an associate, as part of a restructure by a franchisee or a technical transfer of the franchise occurring (such as a change in shareholding in an existing franchisee from an existing shareholder, unitholder or partner to another). There may be other circumstances justifying an exemption as well.

Who should have the obligation to give it

- 2.154 It should be the outgoing franchisee selling their business that that is the person obliged under the Code to directly give that historical earnings information to the buyer rather than obliging the franchisor to obtain it from them and incur the risk and obligation to vet it or verify it when it passes it on. It should include an appropriate certification by the accountant for the franchisee but also the directors or owners of the franchisee including as to outstanding obligations to its employees.
- 2.155 There may also be circumstances where the financial reports relate to time where a former franchisee operated the business but has left the system. Former franchisees not involved in the sale may not be willing to provide those financial reports or documents because they are not selling. For example where they may have been terminated.
- 2.156 Obtaining it from former franchisees is problematic unless the Code required every franchisee to give financial reports certified by their accountants each year to their franchisor.

- 2.157 If that obligation was imposed it should also be coupled with an express right in the code to allow the franchisor to pass them on to a prospective franchisee if they have already left the system. In that case, a franchisor should be afforded express immunity for liability from misleading and deceptive conduct if it passes them on in good faith (and without any other representation as to them being made). There should be no obligation to vet them if the former franchisee's accountant has or has not certified them.

Benefit or costly burden

- 2.158 Whilst in theory those initiatives sound great but unfortunately that type of obligation and protection may be just too difficult, costly or complicated to introduce and enforce, particularly where it may be difficult to enforce against a franchisee or former franchisee. It also has problems where a former franchisee is less than helpful and the financial information may be 'less current' depending on when they leave the system.
- 2.159 Many franchise systems do not currently have the contractual right to require franchisees to provide their financial reports to the franchisor (or to disclose them) particularly where the model operates on a fixed fee basis rather than a % of turnover basis. A franchisor may also not have an existing contractual right to disclose that confidential historical earnings information to a prospective franchisee.
- 2.160 If the Code was to be amended to make it mandatory for the person operating the franchised business to give historical earnings information of that business to a prospective franchisee then:
- (a) **if the vendor is the franchisor or its associate:** - item 20 should be amended to require that historical earnings information to be included with the franchisor's disclosure document acknowledging the limits for example on the availability of financial statements provided by former franchisees who have left the system. Protections against liability should be afforded to the franchisor if it hands over financial reports prepared by former franchisees in good faith irrespective of whether the franchisee's accountant has certified them.
 - (b) **if the vendor is a franchisee transferring its business:** - clauses 24 and 25 of the Code should be amended to impose an obligation on the franchisee:
 - (i) to oblige the vendor franchisee to provide the historical earnings information (including an accountants certification) directly to the prospective transferee (rather than giving it to the franchisor to pass on in its disclosure document);

- (ii) to oblige the vendor franchisee to also give a copy to the franchisor with the written request for consent to transfer or other information¹⁴ as part of the request for consent to transfer; and
- (c) amend clause 25(3) as suggested to make it reasonable for the franchisor to withhold its consent (or revoke that consent) if the franchisee breaches that obligation to give that information and certification to the prospective transferee.

Disclosure of income guarantees

- 2.161 A small number of franchise systems offer all prospective franchisees with a so called 'financial or revenue support' or income guarantees' during the 'start up' phase of the new franchise. It may be beneficial for those who market that offering to give specific disclosure in Item 20 of those so called 'guarantees'. It should not however require disclosure if the support is offered is discretionary and given simply as a special condition negotiated between the parties on that occasion. (For example a franchisee may ask for some one off support because of their circumstances).
- 2.162 Any disclosure item should also oblige a franchisor who gives that guarantee to give details about the extent and limitations of the guarantee; particularly in light of the consequences of the recent ACCC decision against Fastway Couriers WA and that they may constitute a projection or forecast of future earnings.¹⁵

Likely financial performance - financial performance representations - projections or forecasts of earnings

- 2.163 Most franchisors are acutely aware of the risk of liability and from existing cases the consequences that arise if they are sued for misleading and deceptive conduct for making a financial performance representation¹⁶ about a 'greenfield' site.
- 2.164 It is my opinion that it is unreasonable and unwarranted to include a positive obligation on a franchisor in item 20 to give a financial performance representation as to the likely financial performance of a 'greenfield' site. If a franchisor is required to make a guestimate, it would not assist a prospective franchisee to make their decision 'more informed'.

¹⁴ Clause 24(1) or (2) of the Code

¹⁵ For example currently the ACCC commenced proceedings against West Aust Couriers Pty Ltd T/A Fastway Couriers WA. The ACCC considered that some franchisees may have relied on the income guarantee and other statements made at the time of purchase as a representation that \$1,500 was the minimum, or at least average, weekly income they could expect to earn at the end of the income guarantee period.

¹⁶ Trans-IT Freighters Pty Ltd -v- Billy Baxter's (Franchising) Pty Ltd

- 2.165 It would shift the entire due diligence risk of the 'greenfield' site and entire risk of failure of a 'greenfield' site or territory to the franchisor and make them strictly liable if their projection or forecast was overstated and the franchised business failed (even because of other factors such as the franchisees failure to perform).
- 2.166 A franchisor should not be compelled to make a 'guesstimate' of future earnings of every 'greenfield' site or territory. It should also not be forced to underwrite all of the financial risk of failure.
- 2.167 A franchisor may be more willing to give historical earnings information about other franchised and corporate business in the network if it was given protection from misleading and deceptive conduct claims relating to that earnings information. A safe harbour type protection as long as other express representations about financial performance are not made.
- 2.168 For example if a franchisor simply passes on earnings information provided by a former franchisee or another corporate store together with other information, qualifications and disclaimers and an accounting certification about that trading statement it should not be considered to be a projection or forecast of earnings and representation as to a future matter.
- 2.169 A franchisor should not however be relieved from liability if at the time it gives that earnings information it also makes other representations that are intended to be express forecasts or projections of future earnings for the business OR it withholds information that it is obliged to disclose to fulfil its duty of good faith and overarching obligation not to mislead or deceive.
- 2.170 The existing disclosure regime allows the franchisor to assess the risk of liability and, if it wants to accept that risk and has reasonable grounds, make a financial performance representation. The regime also prohibits a franchisor from requiring a prospective franchisee to waive a representation.
- 2.171 If a franchisor was compelled in every circumstance to make a financial performance representation in a disclosure document it will have an immediate adverse effect on the future of franchising in Australia.
- 2.172 In my view franchisors' will be less likely to look to grant 'greenfield franchises'. That will result in a significant decline in the expansion of their franchise networks. It would simply lead to more litigation and jeopardise the viability of existing franchise systems (and the significant investment that franchisors and franchisees have made) and the business model in Australia.
- 2.173 A far better approach would be to make it mandatory for a prospective franchisee to seek independent accounting and legal advice to evaluate earnings information or financial performance representations if they are given by a franchisor.

Financial disclosure Item 21

2.174 In my view many accounting firms who are engaged to assist franchisors to prepare:

- (a) audit reports (for Items 21.4, 21.5 or 21.6 of Annexure 1); and
- (b) annual financial statements of marketing funds and marketing fund audit reports (for Clause 15),

may not fully understand or appreciate the financial reporting obligations imposed under the Code and what is required to be disclosed by their clients.

2.175 When the new code commenced the corresponding Audit Guidance Statement GS018 for Item 21 was not updated until July 2015. There has never been an audit guidance statement prepared for marketing and cooperative funds. In my view there should be.

2.176 The purpose of GS018 was to assist auditors to prepare audit reports for the purposes of financial disclosure under Item 21. There is still some significant improvement that could be made in relation to the quality of audit reports¹⁷. In addition there are a number of drafting inconsistencies in Item 21 that could be fixed to improve disclosure

Disclosure and obligations relating to Master Franchisors

2.177 Currently clauses 7 and 12 exclude a master franchisor having to comply with obligations in Parts 2 and 3 of the Code entirely as it relates to obligations to subfranchisees. Whilst parts 1 and 4 still apply some important obligations are still in the other parts and master franchisors get out of those obligations because it is assumed that the franchisor has all of those obligations or rights. This may not be the case.

2.178 **Clause 12 should be amended** so that it does not exclude the obligation of a master franchisor to comply with clauses 15 and 31 where the subfranchisee is directly or indirectly required to contribute to a marketing or cooperative fund controlled or administered by the master franchisor in Australia¹⁸. If contributions are paid to the master franchisor it should be obliged to comply. Similarly some master franchisors may control or receive rebates from suppliers- there should be an obligation in Item 7/ item 10 of the disclosure document for this to be disclosed because currently disclosure in Item 10 only is limited to whether the franchisor receives rebates. There is no mention made of a master franchisor.

Disclosure relating to marketing and cooperative funds

¹⁷ For example item 21.4 suggests an audit report must be for the franchisor entity. This differs to other items 21.5 and 21.6 that allows **either** the franchisor or consolidated entity to provide the audit report. Item 21.4 should be reviewed to make it consistent in the event that the franchisor is part of the consolidated group (and be prepared for **either** the franchisor or the consolidated entity).

¹⁸ There are a number of funds controlled by master franchisors. The master franchisees collect the payments or make payments go directly to the fund. Unless the master franchisee also contributes to that fund for corporate units it operates there may be no obligation for a franchisor to comply with clause 15 and 31 or even item 15

- 2.179 The ACCC has already indicated their concerns with financial statements of marketing funds not containing 'meaningful information'. This includes disclosure in Item 15 of the Annexure 1 to a prospective franchisee and the annual financial statement of the fund given to franchisees.
- 2.180 In my view those statements relating to those funds are often not helpful and contain items that are questionable but not able to be challenged by a franchisee 'after the event'.
- 2.181 In some cases a statement can indicate at the end of a year that the fund is in significant arrears simply because the marketing spend has continued and the marketing strategy and spend not been adjusted even though contributions have decreased.
- 2.182 The costs of administration of a fund can include overheads incurred by the franchisor where it employs a marketing team rather than outsourcing that function. There can be good reasons and efficiencies in doing so however administration costs may include an apportionment of overhead costs (such as rent, outgoings, telephony, depreciation, staff salaries etc) incurred by the franchisor.
- 2.183 There is no where in the Annexure 1 disclosure document which requires a franchisor to give information about revenue it derives through the system and how important it may be to a franchisor to defray costs or make a profit. Revenue from things including royalties, providing goods and services to franchisees (including those paid for by a marketing or cooperative fund) and rebates is not disclosed. It would be better if a prospective franchisee knew before it entered the network that the model does factor those things in - it would in my view lower disputation because there is more transparency. It would be too difficult for some franchisors to disclose ALL sources of revenue but some relevant disclosure of the types identified above would be useful. Identifying the need to disclose the % or the weighting of those revenue sources is a more controversial issue and there may be legitimate reasons why a franchisor would not like to do that.
- 2.184 It would be beneficial for more **meaningful information** to be given of administration costs and the costs of or method of calculation and basis of charging for, goods or services charged by the franchisor or associate to the fund. This becomes more important where a significant portion of the fund is used to reimburse those costs.
- 2.185 In my view the existing obligation to provide meaningful information about receipts and expenses should include disclosing the status of the fund such as the opening and closing balance of the fund. Item 15.1(f) of Annexure 1 specifies different information to that contained in the annual financial statement. The benefit to a franchisee of an audit report is questionable if the auditor does not express meaningful opinions or qualifications about a variety of matters concerning the administration of the fund and compliance by the franchisor with its compliance obligations under clauses 15 and 31.
- 2.186 In my view there has to be a balance achieved. Adding additional burdens can simply increase costs ultimately paid for out of the fund. However existing franchisees expect transparency. That includes being kept informed with meaningful information to be confident that the fund they are

contributing to is being administered properly in accordance with the Code. They want to know that the marketing strategies are appropriate and effective and that they get real value for their marketing spend on coordinated marketing or advertising initiatives paid for out of the fund.

- 2.187 In many cases franchisors are inclusive and transparent. In a lot of cases they are not. Those that are transparent will give meaningful consultation or information about the strategies for the fund and the transparency including costs they are charging to the fund. On balance, however it is important also to remember that franchisors also want to keep confidential brand initiatives from their competitors particularly where some of these funds are very large and there is fierce competition between brands to secure greater market penetration and share.
- 2.188 This transparency should include a clear understanding of the kind of goods or services that a franchisor or its associate provides to the fund and the cost or method or basis of how it is calculated and charged to the fund.
- 2.189 It is not uncommon to see franchisees complain that the decisions made about 'marketing spend' are made without prior meaningful consultation with them in circumstances where there is a lack of transparency and accountability about costs charged to the fund. They do not want to see the fund being used as just another revenue source for the franchisor. They expect bang for their buck but also that a franchisor will act reasonably in developing and implementing marketing strategies.
- 2.190 An audit report does not give franchisees 'comfort' in this area at all. They usually simply recited the template wording used by the auditor and express a single opinion about the fairness of the presentation of the financial information.
- 2.191 I have seen quite a number of marketing fund financial reports. Many contain fundamental mistakes or limited opinions. On several occasions I have had to ask auditors to reissue the report because of those mistakes.
- 2.192 For example:
- (a) Sometimes they refer to the wrong reporting entity - eg another member of a consolidated group of companies which does not have the financial reporting obligation but has retained the accounting firm to prepare the consolidated accounts.
 - (b) Some refer to the report being special purpose "report to members" of the company and prepared to comply with reporting requirements to those members and for their benefit. As a consequence the report outlines that it only members who are entitled to rely upon it - when in fact the report is paid for by the Fund and designed to comply with financial reporting obligations under the Code to give the report to franchisees. They should be entitled to rely upon it.

- (c) Some express only a narrow opinion about whether the statement *'fairly represents the receipts and expenses of the fund'* without making any statement or opinion about other matters. This is despite the obligation in clause 15(1)(b) which requires the financial statement to contain 'meaningful information' about the sources of income and items of expenditure.
- 2.193 The nature and extent of what opinion is required to be given by the auditor is not articulated in the Code and because there is no Audit Guidance Statement prescribed by the AUASB auditors simply limit their opinion and address some general statements about their process.
- 2.194 Some consultation with industry stakeholders, accountants and auditors and the AUASB should occur to determine whether it is possible for an auditor to express an opinion of the 'meaningfulness' of the information and the franchisor's compliance with its marketing fund obligations. It should also consider whether there is a benefit in having a Director of a franchisor provide in its financial statement a certification that is reasonable about specific code compliance obligations that relate to the fund.
- 2.195 Under the existing regime it is difficult to identify whether the franchisor has complied with its obligations under clauses 15, and 31 of the Code including:
- (a) whether the fund statement contains 'meaningful information' as opposed to a very limited financial information without notes;
 - (b) whether a separate bank account has been opened and receipts and expenses properly paid into it;
 - (c) whether the fund has only been used for the purposes of clause 31(3) of the Code including whether the franchisor has conducted and passed a vote of franchisees before incurring an expense that is not a legitimate advertising or marketing expense nor disclosed (eg an expense of the kind identified in clause 31(3)(a)(iii) of the Code);
 - (d) whether the franchisor's expenses reimbursed from the fund for administration or goods or services supplied are reasonable and transparent (eg the method or basis of calculation has been disclosed).
- 2.196 The Government should instruct the AUASB to prepare and issue an audit guidance statement for marketing and cooperative fund audits to give guidelines:
- (a) to assist accountants and franchisors in the preparation of financial statements for a marketing or cooperative fund - including a form of directors certification for compliance; and
 - (b) to assist auditors to prepare audit reports for marketing and cooperative funds.

- 2.197 It would be useful for a standard or minimum Chart of Accounts to be developed and published for presentation of financial reports of a fund including notes and guidance on how it should be presented. This could be developed in consultation with the sector and have regard to the fact that some are prepared on a cash and others on an accrual basis. Some standardisation of coding for particular items would help with a catchall "Other" that gives more details or require notes about that expense to be disclosed.
- 2.198 The ACCC has already in 2017 indicated to the sector its concerns about the lack of meaningful information being contained in annual financial statements of marketing funds. This may result from a lack of understanding by accountants and auditors of the relevant provisions of clauses 15 and 31 of the Code and Item 15 of the disclosure document.
- 2.199 In my view best practice should require an obligation in relation to marketing fund reports to specifically address compliance requirements listed in clause 31 such as a requirement to provide a director's declaration as to compliance. It should also clarify what is meant by 'meaningful information'.
- 2.200 Improvement in this area will assist prospective franchisees to have a greater understanding of the position of a marketing fund before they join a network.
- 2.201 I am surprised that clause 31 was not made a civil remedy provision when the new code commenced even though clause 15 was. There can be no real accountability for administration of marketing and cooperative funds unless Clause 31 is made a civil remedy provision with a fine or penalty for contravention and some way for a franchisee to determine whether they have complied before the expense is incurred.

Leasing arrangements and limits on the franchisees ability to enforce tenants' rights

- 2.202 If In many cases a franchise system will deliberately have particular site control policies including where it or its associate holds the head lease for a location. In many cases large landlords prefer to deal with the franchisor to ensure it has the mixture of franchised brands in its food court or shopping centre. Many franchisors have experience in lease negotiations and securing preferential lease terms and in a few cases in strip shopping centres even submit a template lease they prefer to use. As a consequence a franchisor can be primarily responsible for the head lease obligations (rent and outgoings etc) even if the franchisee does not pay them or observe them.
- 2.203 The franchisor also can ensure it is willing to take on responsibility if the franchisee simply walks away and leaves them with the lease burden. It may mean that the franchisee does not hold the lease (but holds either a sub-lease or licence) and some rights are appropriately retained by the franchisor or its associate.
- 2.204 In cases where the franchisor or associate holds the lease there may be circumstances (subject to express Retail Shop Lease legislation) where the franchisor or its associate are involved to the exclusion of the franchisee in direct negotiations and contact with the lessor for things such as:

- (a) rent reviews;
- (b) end of term lease negotiations for renewal or a new lease;
- (c) tenancy disputes;
- (d) relocation
- (e) the franchisor or its associate does involve the franchisee in negotiations and disputes.

2.205 In many systems franchisors would not make a decision without some consultation or agreement from the franchisee. I do not think additional regulation in this area is warranted.

Disclosure of end of term arrangements - including in clauses 6, 18, 23 and Item 18

- 2.206 Currently end of term issues, including non renewal of a franchise are one of the largest areas of disputation in the franchising sector. This is particularly evident in disputes in the motor dealership sector where a dealer does not have its dealership renewed at end of term. The adequacy of disclosure concerning policies of renewal of a franchise and procedures that apply at end of term of varies dramatically and can lead to dispute.
- 2.207 I think disclosure of end of term issues is less effective than it can be. In my view this arises primarily because end of term terminology is used inconsistently in the Code and last minute changes to the Code involving end of term concepts was poorly and inconsistently drafted (compared to other existing provisions where those terms were used) when it was rushed to be prescribed. In addition terminology in franchise agreements does not always coincide with terminology used in the agreement and that can cause confusion particularly where the drafting inconsistently uses terminology which is defined in the Code.
- 2.208 To be able to make an 'informed decision' a prospective franchisee must be given meaningful information. This includes information about end of term arrangements to determine whether it will have an option or right to continue the business and what happens to their right to operate the business (and on what terms) once it reaches end of term of its existing agreement. If a franchisor has the discretion to allow them to continue it should deal with when it must make a decision and give notice of exercise of that discretion.
- 2.209 There is a significant inconsistency in the terminology used in Code about end of term concepts. They are primarily contained in clauses 6, 18, 23 and Item 18. They need to be reviewed and fixed when the Code is next reviewed. I have already made suggestions to the ACCC about how to address and fix this.

- 2.210 Attached is a Schedule of suggestions specifically dealing with end of term arrangements to improve the application and interpretation of those provisions.

3. The operation and effectiveness of the Franchising Code of Conduct.

- 3.1 Parliament did not intend the industry codes regime to 'cover the field' to regulate every aspect of a franchise relationship. It covers only those minimum standards that the Parliament considers are necessary to provide reasonable protection to franchisees.
- 3.2 The effectiveness of the Franchising Code depends on your point of view. There is a mismatched understanding and expectation by parties to a franchise agreement about the nature and extent of the Code and what its purpose and intent is and what protections it offers.
- 3.3 There are existing effective legal remedies already available including under the *Australian Consumer Law* and *Competition and Consumer Act* to enable a party to obtain relief where the other party (such as a franchisor) breaches its obligations. A contravention of the Code is a contravention of the *Competition and Consumer Act*.
- 3.4 The real problem about the effectiveness of those remedies is as I mentioned before that most legal disputes involve significant cost and time before an outcome of any kind (even adverse) is reached. It does not always lead to a commercial solution that the parties wanted. Mediation will not always result in a commercial outcome for either party and litigation may be the only available next step to get what they want. Alternatively they may simply turn their back on the remedy simply because it is not a commercially sensible remedy to pursue.
- 3.5 Mediation was included to enable disputes to be resolved in a cost effective manner whilst preserving the right of a party to seek relief from the Courts where appropriate. In my view most significant disputes go straight to Court rather than mediation because the outcome needed requires a Court order. Some franchise systems also include additional contractual mechanisms for dispute resolution including Arbitration that can be used if mediation fails.
- 3.6 The cost and time to obtain effective remedies in any small business dispute is an important factor which can dissuade a business or individual from exercising their rights. This leads to a perceived 'bad' outcome in their eyes where they consider the "Code" is ineffective simply because it does not give them a cost and time effective remedy or outcome in every case.
- 3.7 In addition to disputes there are more fundamental obligations in the CCA and ACL that affect franchisor conduct (competition issues) and those provisions have been recently reviewed and extended.

- 3.8 Similarly a franchisee may think the ACCC should take action in every case where it receives a complaint about the conduct of a franchisor even though the ACCC may investigate the complaint and determine it is unsubstantiated or apply a more lenient approach than the franchisee would prefer they take. This may unfairly lead to a perception that they are not 'doing their job'.

Effectiveness of independent advice

- 3.9 Whilst a franchisor has an overarching obligation not to mislead or deceive a prospective franchisee, prospective franchisees must accept some personal responsibility to:
- (a) undertake a pre contract legal, accounting and business due diligence of the business opportunity - irrespective of their perception of cost or benefit; and
 - (b) seek appropriate advice from experienced legal and accounting professionals to assist them to prepare business plans and make a reasonably informed decision about the business opportunity.
- 3.10 I am not saying it will in all cases prevent worst case experiences but it will at least lead to a more informed decision.
- 3.11 I have seen a number of cases where a franchisee has deliberately chosen not to obtain independent advice before it entered into an agreement but subsequently sought to get out of their contract with a franchisor when it didn't turn out as well as they thought it would. Whilst the Code provides a degree of protection it should not underwrite decisions made by those who do not seek informed advice and conduct thorough due diligence. In a number of cases I have seen examples where a decision has been made not to proceed with a particular franchise based on sound commercial due diligence.
- 3.12 Conversely I have also seen examples where independent advice has been sought but it has been less helpful because the advisor used was inexperienced in franchising.
- 3.13 The various law societies offer specialist accreditation of lawyers in various disciplines including "Business Law" but almost all do not offer a specialty only in "Franchising Law". There is a significant cost and time involved in preparing a specialist accreditation program. In Qld members of the QLS franchising committee examined whether it was possible to develop and run a specialist accreditation program for franchising (as distinct from just Business Law). Existing accreditation programs take time to develop and the exams are usually extensive and not easy to pass.

- 3.14 Law Societies may be less interested economically in developing a specialty program when financially the number of persons who may seek that specialty accreditation is low and would not justify the expense. It is always possible for Law Societies to refer prospective franchisees to experienced lawyers listed with that organisation.
- 3.15 Whilst Business Law specialisation is one of the disciplines offered I suspect that there may not be a large number of experienced specialised advisors interested in doing a dedicated Franchising Law specialist accreditation course each year to attain that accreditation unless it was a sub specialty of the Business Law program that enabled you to also complete a sub specialty in that stream¹⁹.
- 3.16 I suspect that most law societies would need to question the viability of doing so and simply rely on the more general "Business Law" accreditation including something on franchising. This may mean that a specialist in that discipline may have some knowledge of it but no experience in advising a franchisor or franchisee.
- 3.17 Currently it is difficult for a franchisor to compel a prospective franchisee to seek independent advice before entering into an agreement. A franchisee may simply elect to sign the waiver rather than incur a cost which they believe is unnecessary or disproportionate the cost of the investment they are to make.
- 3.18 Where the upfront entry cost is low (for example a lawn mowing service franchise where the cost is less than \$30,000), it is difficult to ask a franchisee to incur a cost of seeking independent legal and accounting advice. That cost may be upwards of 10% or more of the upfront cost even though it is in their interests to get that advice.
- 3.19 In my view:
- (a) In that circumstance a prospective franchisee is more likely to decline to seek prior advice and sign the waiver.
 - (b) This is usually because they do not want to spend the money to get advice and they may be more prepared to walk away and lose their entire upfront investment if the venture is not successful (particularly if there is no residual liability arising after the termination).
 - (c) Many have argued that the Code should make it mandatory for a prospective franchisee wanting to invest upfront more than a minimum threshold (say \$30,000) to seek prior independent legal and accounting advice rather than sign a waiver. If they are to secure a retail shop lease they may also be compelled to get legal and accounting advice certificates in any event.

¹⁹ I understand this occurs in NSW

- (d) In my view if advice was made mandatory it is most likely that the commercial reality will be that prospective franchisees in lower entry cost franchises (less than \$30,000) will simply shop around to get the cheapest advisor willing to sign an advisor certificate rather than an experienced legal or accounting advisor who can provide them with sound legal, accounting and commercial business advice and assist to evaluate the opportunity and negotiate the agreement to protect their interests. In that case there may be justification in retaining the right a monetary threshold to be included to enable them to elect whether they want to get advice or simply sign the waiver.
- (e) Mandatory advice certificates should not be required if the franchisee is simply entering into an agreement to extend the term of an existing franchise agreement but should be obtained for a transfer, renewal or extension of the scope of a franchise agreement.
- (f) Any mandatory obligation should also include exceptions that clearly outline the circumstances where the obligation should not be mandatory. For example an exception should include circumstances where the prospective franchisee is a multi unit holder signing an agreement the same or substantially the same as it already signed or the prospective franchisee is an associate of the franchisor or a sophisticated investor (for example some motor dealers are in fact very large businesses with in-house counsel and do not need to seek financial advice).
- (g) If a prospective franchisee investment is less than the specified amount or the prospective franchisee is a sophisticated investor it should be up to the franchisor / franchisee to decide whether it is required or whether a certificate from the prospective franchisee is a suitable alternative.

4. Effectiveness of dispute resolution under the Code

- 4.1 Mediation remains the preferred and effective method to allow parties access to affordable dispute resolution processes whilst retaining the right to approach the Courts where appropriate.
- 4.2 In my experience mediation normally will result in an outcome for less serious disputes and in most cases a better outcome than engaging in expensive litigation. This can include negotiating an exit to the system to end the agreement rather than going to Court. In some cases franchisees have unrealistic expectations of what mediation can achieve and think a mediator should have the ability to make a decision that is binding on the parties.
- 4.3 In most cases disputes are initiated by franchisees however many franchisors also use the process to get uncooperative franchisees to the table.
- 4.4 I have suggested in the Schedule some drafting changes to improve Part 4 of the Code.

Group mediation

- 4.5 The dispute process involves parties to the agreement. In some (but not all) cases where a common dispute arises amongst groups of franchisees it would be beneficial to allow a group mediation to occur. Group mediation is not appropriate in all disputes.
- 4.6 It should only be considered and allowed in a very **limited range of disputes** such as disputes involving the marketing fund or where changes are being made to the system that affect all (or a group) of franchisees that will be rolled out across the network. These types of disputes should be able to be resolved on a group level (including with involvement by a Franchise Advisory Committee) without the requirement to make a collective bargaining notification under the *Competition and Consumer Act*.
- 4.7 An express exclusion from the obligation for franchisees or the franchisor to lodge a collective bargaining notification under the *Competition and Consumer Act* in those circumstances could be beneficial. Currently clause 33(b) prohibits a franchisor preventing franchisees associating for a lawful purpose, if a notification is required before group disputes could be negotiated then arguably a franchisor could prevent it because it is not a lawful association. In some cases franchisees are competitors between themselves or in competition with the franchisor.
- 4.8 **Genuine disputes**
- 4.9 A respondent to a notice should not be obliged to follow the process in Part 4 where the complainant acts in breach of the obligation to act in good faith and issues a notice as an abuse of process, for example where there is no genuine dispute between the parties.
- 4.10 I have **suggested some amendments to clauses 36 and 45** that may allow the mediation advisor to end the process if it reasonably believes that there is no genuine dispute or the notice is an abuse of process and issued in breach of the obligation to act in good faith. The respondent should not have to incur the costs of complying with a process where a complainant simply tries to use it to waste time and money.

Cancelling mediation dates

- 4.11 I have seen franchising mediations cancelled at the last minute by a party without good cause or reasonable notice.
- 4.12 In most cases the parties in a dispute will discuss a venue and time and date for a mediation (based on convenience) and seek agreement by all parties and the mediator. Unfortunately the process in the Code does not clearly deal with (or protect a party) circumstances where after that agreement is reached one of the parties simply cancels or tries to change those arrangements on short notice. Whilst it may not amount to acting in a reconciliatory manner as required by clause 36 of the Code the other party incurs significant thrown away costs and becomes frustrated with the process. In some cases a franchisee may use that process whilst also seeking orders from the Court for pre litigation disclosure.

- 4.13 A failure to act in a reconciliatory manner is not an express obligation under the Code for which a civil remedy provision applies. it would be better if the code obligation in clauses 39 and 41(3) made it an obligation to "*act in a reconciliatory manner and attend mediation*". This may also require them to participate in meetings before mediation with a consequence to them if they don't.
- 4.14 The obligation in the Code to 'attend mediation' does not specify that the party has to attend at a venue and on the date and time agreed between them and the mediator. It also does not outline the consequences of them failing to do so. Whilst it is a civil remedy provision I am yet to see the ACCC issue a fine for contravention on a party, including a franchisee when they cancel without good cause or reasonable notice.
- 4.15 Cancellation without good cause or on unreasonable notice can cause immense frustration. It results in costs thrown away by the other party and a perception that the Code is flawed because it does not give more structure to the processes that apply once the notice of dispute is served (but before mediation). It cannot be an effective process if a party can simply cancel the mediation for any reason and ask it to be rescheduled. For example a complainant wanting to seeking on one or more occasions pre litigation disclosure orders from the Court as a 'fishing expedition' precursor to litigation should not justify cancellation or rescheduling of mediation.
- 4.16 The Code requires the parties have to bear their own costs and equally share the costs of the mediation. This would include costs thrown away where it was cancelled at the last minute. Those costs can be significant if flights and accommodation can not be changed.
- 4.17 In my view once the parties commit to a date and time of mediation with the Mediator they should be compelled by the OFMA/ the ACCC to attend the mediation on that day and time other than in exceptional circumstances (ie good cause) and on reasonable prior notice to both the other party and the mediator. For example the death or significant illness of a party or the mediator or a significant logistical issue such as flights being cancelled that make it impossible to attend would be good cause.
- 4.18 Clause 42 of the Code allows a mediator to terminate 'mediation' once 30 days after the mediation has started. It does not deal with circumstances **before** the party actually gets to mediation if the party who commenced the dispute wants to change the date and time at the last minute without good cause. This can be frustrating to the other party and mediator. it also does not make it clear when mediation starts the period running.
- 4.19 A change in the process that could allow the mediator or OFMA (on the request of a party) to terminate the dispute process (as opposed to mediation) would be useful if the mediator believes that it is unlikely to actually get to mediation or to resolve the dispute within a specific period.
- 4.20 The Code does not currently include a process to follow if the parties cannot sensibly reach agreement on a date or time or venue. Possibly if that agreement cannot be reached within 3 weeks after appointment of the mediator by a party the OFMA could be asked by the mediator to specify a binding date, time and venue by giving not less than 3 weeks reasonable prior notice.

- 4.21 The obligation to attend mediation in clauses 41(3) and 39(3) could easily be improved to make it clear that in the absence of good cause and reasonable notice a party who cancels mediation at the last minute has to pay the other sides' costs and the other sides' share of the costs of mediation that are thrown away. This should apply to both parties. It would provide a strong incentive to attend and not cancel mediation once it has been set down. It not even clear whether the ACCC would use its enforcement powers against a franchisee who cancels the mediation at the last minute without good cause or reasonable notice.
- 4.22 I have suggested an amendment in the Schedule that deal expressly with Part 4 of the Code including to fix some errors that occurred when the new code was drafted.

5. Impact of the ACL unfair contract terms on new, renewed and terminated franchise agreements entered into since 12 November 2016 including whether changes to standard franchise agreements resulted.

- 5.1 The sector is aware that franchise agreements may be considered to be 'standard form' and the ACCC has indicated particular clauses in a franchise agreement that may be unfair. This resulted in structured reviews of the terms of franchise agreements and other transaction documents before the regime was extended to small business standard form contracts.
- 5.2 In some cases in-house legal teams for franchisors have sought to review their agreements themselves without engaging external lawyers others have used external advisors to review their documents.
- 5.3 The ACCC did consult with the sector and did approach a few franchisors to seek voluntary removal or amendment of clauses that the ACCC suggested were unfair in their franchise agreements. The outcomes of those discussions have not been made public nor reasons give why the ACCC suggest those clauses are unfair.
- 5.4 The ACCC should continue to regularly update and publish examples of terms it sees which it considers unfair and why they are considered unfair so the sector can monitor and consider whether to modify, mitigate or discontinue using those terms in franchise agreements. In addition if clauses in a franchise agreement have been found by the Courts to be unfair then some consideration to banning their use in the future may be warranted given the Code currently renders void or unenforceable only some specified terms.
- 5.5 If franchisors have properly conducted UCT reviews, there should now be fewer arguments about unfair terms in negotiations with prospective franchisees and with franchisees that are renewing. In my view the UCT regime is being more effectively used to assist in negotiations before entering into an agreement (or upon renewal or extension of the term or scope of an agreement).

- 5.6 It is now quite common for lawyers acting for franchisees to request a change to a term on the basis that they assert the term is 'unfair' under the UCT regime. As a consequence lawyers may be more willing to negotiate to remove, modify, qualify or amend the term in negotiations than they were before.
- 5.7 Despite this beneficial approach at the time of entering into the contract, some lawyers advising franchisees may elect not to raise concerns with clauses at negotiation. Instead they may raise the regime and its application to a clause with their client and seek to allege it was unfair later if the clause is to be enforced.
- 5.8 It may be too early still to get an understanding of whether there are many disputes about unfair contract terms in franchise agreements working their way through dispute resolution processes or the Courts.

6. Whether Oil Code contains advantages or disadvantages relevant to franchising relationships

- 6.1 It has both advantages and disadvantages. There are just too many differences to list them or compare their benefits. The one I like the most relates to Annexure 3 and the obligation for a vendor to certify its outstanding obligations to its employees. Whilst this applies more to sales between franchisees it would give greater protection to a buyer where a transaction involves a sale by an existing franchisee.
- 6.2 The Report by Alan Wein clearly recommended that
- " It is advisable that when the Oil Code is next reviewed, the government consider aligning the wording of the provisions which appear in both codes to reflect improvements to the Franchising Code in the context of the current and previous reviews."*²⁰
- 6.3 The original Oil code started in 2006 and was based to a degree on the Code at that time, however subsequent reviews at different times out of step with the Code has resulted in different provisions and inconsistencies between the 2 codes growing wider.
- 6.4 The 2 industry codes have some similar clauses²¹ but also have clauses that are quite different²² or inconsistent²³.

²⁰ Appendix D to Alan Wein's report

²¹ For example the purpose of disclosure under oil Code (clause 14) is similar in effect (but not identical) to the equivalent provision in clause 8(2) the Franchising Code

²² For example the Franchising Code has an express obligation to act in good faith whereas Oil Code does not. Franchising Code has certain provisions which are expressed as civil remedy provisions whereas Oil Code does not have any provisions expressed to be civil remedy provisions. The Oil Code has different dispute resolution provisions to the Franchising Code and the dispute resolution advisor has the power to make non binding determinations about the dispute whereas the OFMA does not have that power

²³ For example the Franchising Code of Conduct was recently updated in March 2017 but has

- 6.5 An example of an inconsistency can be seen in Clause 13(2) of Oil Code where the update of a disclosure document must occur within 3 months after the end of the financial year whereas that obligation must occur within 4 months after the end of the financial year under the Code.
- 6.6 "Financial Year" is defined in the Code to be the franchisor's financial year and not the financial year ending 30 June each year. This is different to Oil Code. That definition was added to the Code as a result of the Alan Wein review which identified concerns by franchisors that the relevant financial year should be their financial year not the normal financial year. This difference may cause concern if the fuel reseller has a financial year other than ending 30 June (which is quite often the case).
- 6.7 The 2 codes are not exactly aligned and use different terminology. The next review should coincide or at least provide that the 2 should be checked carefully for inconsistency where the codes both use some common provisions.
- 6.8 By way of an example of how inconsistently they are updated simply look at the definition of a franchise agreement in clause 5(3)(f) of the Code and the equivalent definition of a fuel re-selling agreement in clause 5(4) of Oil Code.
- 6.9 In paragraph (f) of the Franchising Code it refers to various state and territory cooperatives legislation. If you look at the equivalent provision in Oil Code that commenced in April 2017 the legislative references for NSW, VIC, SA, TAS and ACT are different. This is despite a new version of the Franchising Code being issued in March 2017 and Oil Code commencing in April 2017.
- 6.10 Conversely in Oil Code there are no definitions of renew or extend which are terms defined in the Franchising Code. This is despite the fact that the Oil Code does refer to 'the renewal or extension of a fuel reselling agreement'²⁴.
- 6.11 The right to terminate a fuel re-selling agreement under Oil Code for special circumstances does not specify that there has to be a contractual right to terminate in the agreement itself whereas in the Code does. It suggests that in the Oil Code it is a statutory right to terminate. I have already made detailed submissions to treasury and the ACCC about the differences between the Codes in light of a review they were undertaking about whether those rights need to be excluded by regulation from the ipso facto reforms.
- 6.12 I have included a specific schedule of comments about Cooling Off and non refundable money. They apply to BOTH Oil Code and the Franchising Code

7. Adequacy and operation of termination provisions of the Code

²⁴ Refer to clause 5(3)(a) of the Oil code

- 7.1 In my view it is unnecessary to include a statutory right to terminate for special circumstances if the franchisee is involved in minor contraventions of the Fair Work Act. All small businesses struggle to comply and can make mistakes which can be corrected and should not justify termination.
- 7.2 The imperative for including a statutory right is much stronger where the conduct of the franchisee amounts to a 'serious contravention'²⁵ of the Fair Work Act. It is a balance between allowing an opportunity to remedy minor contraventions using the breach notice process as opposed to circumstances where serious contraventions may need an express right and not be restricted by clause 27(4) of the Code.
- 7.3 Where fraud is identified and sufficient evidence to meet the onus of proof the franchisor can rely on clause 29(1)(g) of the Code and terminate the agreement without having to rely on the breach process²⁶. Fraud has a high burden but morality dictates a franchisee should not hide behind a "process to remedy a breach" when its conduct is so bad that it constitutes fraud. I think the law already differentiates between simply being dishonest and someone committing fraud. You can be dishonest by failing to tell someone something - it doesn't mean that you commit fraud.
- 7.4 One of the arguments I have heard put forward in the debate is that a franchisee that deliberately and systemically breaks the law and underpays their employees (and commits fraud) does extensive damage to the franchise brand to warrant immediate expulsion.
- 7.5 The fabric of trust between them is broken and even if the franchisee does remedy the breach and immediately pay their employees, it has damaged the brand to such an extent by their conduct that it should warrant immediate termination and expulsion from the network. Fraud is an existing example of where that does work however there is an evidentiary burden and process to follow which means the proper process is followed. Under the Code the element is that the franchisee is 'fraudulent in connection with the operation of the business'. This is appropriate because it means the fraud does not have to be against the franchisor alone but could be directed to other persons such as employees, landlords, the tax office, customers and others when the franchisee is operating the business.
- 7.6 The current restriction in clause 27(4) (which is not in Oil Code) prevents a franchisor from terminating a franchise agreement for repeated breaches by the franchisee where it has remedied the breach. It can lead to frustration in dealing with serial offenders who do exploit the benefit of the clause. Conversely the Oil Code allows termination where there have been repetitive breaches of the agreement at least 3 times²⁷ (other than other special circumstance provisions in clauses 36(1)(a) to (f)).

²⁵ As intended by recent additional reforms to the Fair Work Act made with responsible franchisor provisions

²⁶ Recent appeal decision in *Chahal Group Pty Ltd & Anor-v- 7 Eleven Stores Pty Ltd*

²⁷ Clause 36(1)(g) of Oil Code

- 7.7 In my view sometimes a franchisee can unfairly take advantage of clause 27(4) and repeatedly breach the same provision of an agreement (for example always paying their rent or royalties late knowing they can't be terminated until a notice complying with clause 27 is given and they have a chance to remedy. The use of an undertaking is in those circumstances an effective way to manage and prevent future repeat conduct.

Statutory or contractual right

- 7.8 Making a change to clause 29 to make it a special circumstance right to terminate would limit the application to exercise of a contractual right to terminate only if the agreement contains a provision that allows it. It is a contractual right not a statutory right. This could mean its application is limited to future agreements not current agreements if they are silent on that issue. Making the ability to terminate a statutory right raises the issues of why other rights to terminate under clause 29 should not also be statutory rights. That would require a change to wording to the whole of clause 29.
- 7.9 One solution to avoid making it a statutory right would be to expand the existing definition of 'serious offence' in the Code. Simply expanding that definition may mean that Clause 29(1)(e) can be used by a franchisor to terminate agreements that were entered into before the change to the definition is made. This is because many agreements already define serious offence in a way that just adopts the code definition from time to time. Unfortunately some do not and instead simply restate each of the elements of the definition set out in the code as at the time it was entered into. Whilst this may offer a solution to most, it will not unfortunately help others who don't use that method until they next renew those agreements.
- 7.10 I think the existing breach process does allow a franchisor an appropriate remedy as well as the ability to terminate immediately if the franchisee operates fraudulently but requires them to obtain evidence of that fraud before doing so.

Ipsa facto and its application to agreements regulated by the Code or Oil Code

- 7.11 Clause 23 of the Code contains a process enabling a franchisor to terminate if the franchisee becomes a Chapter 5 body corporate. To do so you must have a clause in your agreement empowering you to do so. Unfortunately the EM to the legislation did not make it clear that the regime was not intended to apply a stay to a statutory right to terminate. I understand that the regulation to exempt certain rights and contracts may make that clearer.
- 7.12 The Oil Code provision is slightly different and doesn't currently require the agreement to contain that right. Both codes may need to be reviewed if the ipsa facto reforms apply to that right for agreements entered into on or after 1 July 2018. It may simply need a relevant note to deal with agreements entered into after 1 July to make its application in the Codes clear.

- 7.13 Other than that I believe that on balance the existing rights of termination for a franchisor under both Codes are adequate. It is fair to say that most agreements do not contain a termination for convenience clause of the kind outlined in clause 28 of the Code.

Non refundable payments and cooling off

- 7.14 Provisions in the code relating to taking non refundable payments are poorly drafted. The explanation about the scope of the cooling off and refund rights and obligations set out in page 36 of the Explanatory Memorandum is limited and provides no guidance on how it should be applied where the prospective franchisee makes a non refundable payment to the franchisor before the franchise agreement is entered into.
- 7.15 In practice most franchisors will require a payment to be made before an agreement is entered into with a prospective franchisee. In many cases that payment may be wholly or partly non refundable. A franchisor will want a deposit to cover their costs (including legal costs) before they incur costs to evaluate and approve the prospective franchisee or site and to prepare transaction documents. The non refundable nature of those costs may be made clear in the agreement and also Items 14.1 and 14.2 of its disclosure document given to a prospective franchisee
- 7.16 The reality is that some franchisees do not get to the point of entering into an agreement; they simply pull out and tell the franchisor they will not be proceeding once the franchisor has incurred costs associated with evaluation of the franchisee and the site and legal costs to prepare documentation. In many cases a franchisor will want to deduct its reasonable costs to that point including legal costs. In most cases training costs will be non refundable.
- 7.17 I have attached a separate Schedule of suggestions outlining the problem and how both Codes could be amended to fix cooling off and non refundable payments.

8. Imposition of restraints of trade on former franchisees following termination of a franchise agreement

- 8.1 Given the ipso facto changes possibly applying to franchise agreements, there is no need to give a franchisee an express right (contractual or statutory) to terminate simply because the franchisor becomes a Chapter 5 body corporate.
- 8.2 I am unaware of any circumstance where clause 23 has been successfully argued by a franchisee to avoid a restraint. Despite that a franchisee may have relied upon it but there is yet no reported Court judgement where such relief has been sought and granted.
- 8.3 The Governments response to the recommendation made by Mr Wein was to develop circumstances where the restraint would not be enforceable. It relates solely to "expiry" when the franchisee wanted to obtain an extension to their franchise and not circumstances arising

from "termination" of the agreement. It does not apply to circumstances where a franchisee's agreement is not renewed when it has been granted an option to renew but does comply with the conditions of renewal.

- 8.4 Accordingly whilst the terms of reference relate to 'termination' it should be remembered that clause 23 only applies to 'expiry' not termination. The Courts have recognised the difference between termination of an agreement during the term and an agreement ending by effluxion of time (expiry).
- 8.5 There is no justification to extend the application of clause 23 to any other circumstances.
- 8.6 In many cases termination leads to enforcement of restraint. There are cases where franchisees deliberately try to avoid their end of term obligations including restraints. If the restraint terms are reasonable, the Code should not be used to allow a franchisee to avoid their existing contractual obligations on termination.

Schedule of recommended amendments

Point No	Clause or item	Comment	Suggested improvement
Clauses in the Franchising Code Conduct			
1.	Definitions	electronic signature	(a) When the ETA provisions were removed from the former code the definition of electronic signature was left in even though it is not used anywhere in the Code. There is no similar definition in Oil Code. It would be beneficial to include a note or provision in Annexure 1 which recognises that the disclosure document and Directors statements and declarations can use an electronic signature.
2.	Clause 5	cooperatives legislation references	(a) Reconcile references to cooperatives legislation with Oil Code and ensure they are consistent between the 2 codes.
3.	Clause 7 and 12 and Item 7	Master franchises	<p>(a) Clauses 7 and 12 make it clear that Parts 2 and 3 of the Code do not apply to a master franchisor in relation to its sub-franchisees.</p> <p>(b) Whilst disclosure obligations are shifted to the franchisor who grants the franchise there is still confusion of some Code obligations to sub-franchisees where for example the master franchisor (or some other entity) operates or controls a marketing or cooperative fund to which contributions from franchisees are applied from their Fund. Currently a master franchisee does not have direct Code responsibility under Clause 15, 31 or item 15 in relation to those sub-franchisees,</p> <p>(c) Item 7 has been drafted based on a master franchisee giving disclosure to a</p>

franchisee. The items of disclosure are designed for a master franchise- franchisee disclosure document.

- (d) Consider if Item 7 or 10 should be amended to ensure a prospective franchisee is informed if there are rebates paid to the master franchisor directly or indirectly from suppliers to subfranchisees within the franchisor's network.
- (e) The current items of information to be disclosed in Item 7 are specific. Some are not relevant to a disclosure given by a master franchisor to its master franchisee (eg US franchisor giving disclosure to its Australian master franchisee).
- (f) The next review of the Code should consider what items of additional disclosure should apply to disclosure by a master franchisor to its master franchisee in that item.

4. **Clauses 9 and 10 and 26** Non refundable payments

- (a) Refer to attached Schedule of Suggested amendments to fix the poor drafting and inconsistency with clauses 9 and 10 and Clause 26.

5. **Clause 10** Mandatory advice

- (a) Consider whether there is a benefit in and support for making it mandatory for a prospective franchisee to obtain legal and accounting advice from experienced / accredited franchising lawyers and accountants and to give those certificates to the franchisor.
- (b) Consider the benefit in and support for mandating prospective franchisees to get that advice where earnings information is provided or the upfront price is \$30,000 or more but include a range of circumstances where it is not be mandatory.
- (c) If not mandatory, a waiver of advice similar to clause 10(2)(b)(ii) of the Code should still be able to be given.
- (d) Independent Advice should not be mandatory if the transaction involves:

- (i) a simple extension of the term of an existing agreement or holding over (on same commercial terms);
- (ii) a new grant, transfer, renewal or extension of the scope of a franchise agreement where the upfront price is less than a specified amount (eg under \$30,000);
- (iii) a franchisee who is a multi unit franchisee in the same system;
- (iv) a person or company who would otherwise be considered to be a sophisticated investor²⁸; or
- (v) the franchisor entering into an agreement with an associate of the franchisor.

6. Clause 15 Require a Directors compliance certificate

- (a) Consider the benefit and whether there is Sector support to amend clause 15 to impose an obligation on a franchisor to include in the Annual Financial Statement of the fund a Director's compliance certification as to whether the fund has been maintained and used in accordance with Clause 31 of the Code (particularly clause 31(3)) of the Code.
- (b) Consider the benefit and whether there is Sector support for a director of the franchisor to certify that the franchisor has complied with their financial reporting obligations and obligations relating to administration and audit of the fund will give greater confidence to franchisees and allow an auditor to express an opinion on that certification.
- (c) The certification should include specific statements such as that it has opened and operates a separate bank account for the fund (clause 31(1)), that it has contributed for corporate units on the same basis as other franchisees (31(2)) and a statement as to

²⁸ Some franchisees are in fact public companies

whether an expense for which the fund has paid required approval or not by a majority of franchisees (clause 31(3)). If it did, the fact that a vote was undertaken before the expense incurred (and outcome of that vote) should also be certified.

- (d) The expenses charged by a franchisor for administration have to be reasonable. There is no opinion expressed about that by the auditor. Charges for goods or services provided should also contain more meaningful information than they currently do.
- (e) This information would make a director accountable to certify their financial reporting and code obligations under clause 15 and 31 of the Code.
- (f) An auditor should be obliged to express an opinion about that compliance certification and whether it presents fairly their financial reporting and compliance obligations under clause 15 and 31.

7. Clause 15(1)(b) Guidance on meaningful information

To help franchisors to understand what standard of information is meant by 'meaningful information' the ACCC should work in consultation with stakeholders to prepare and publish guidelines on interpretation of the 'meaningful information' obligation for the purposes of Item 15.1(g), and the annual financial statement and audit report for a marketing fund.

8. Clause 17(3) Continuous disclosure of closures

Consider whether continuous disclosure under clause 17(3) is required to be give if actual or intended closures of businesses (from any cause) during a financial year result or would result in a reduction of more than 10 or 10% (whichever is the greater) of corporate or franchised units from the number in existence at the commencement of the financial year. If a franchisor for example terminates franchisees or does not renew them or the franchisees close their business and that number exceeds the threshold it would trigger a disclosure obligation. The threshold should be subject to a test of 'significance". Unfortunately in smaller systems (eg 10 or less) losing 1 franchise would trigger disclosure if it was based just on a %). A similar express item could be included in Item 4 that relates to a change in number of 'terminations or cessations if that number exceeds the trigger.

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| 9. | Clause 18 | Holding over | <p>(a) Make it clear that the definition of extend in relation to the term of the agreement does not include a holding over of the franchise at end of term on a periodic basis of one month or less eg for a holding over period of 1month or less - eg month by month or weekly or fortnightly or other periodic basis irrespective of whether the agreement contains an express right to hold over</p> <p>(b) Consider if clauses 18 should not apply to a holding over. Clause 23 should not apply to a request to hold over on the basis of a franchisors current term but on a short term basis of 1 month or less.</p> |
| 10. | Definitions of renew, extend and Clauses, 6 18, clause 23 and Item 18 generally | Extent of end of term notice obligation and fix inconsistent drafting of clause 18 and also clause 23 and Item 18 | <p>(a) In my view the most important technical changes is to fix the inconsistent use of terminology in end of term arrangements.</p> <p>(b) I have attached a separate schedule of comments relating to all of the relevant parts to fix them.</p> |
| 11. | Clause 24 | Historical earnings information | <p>(a) If you impose an express obligation on a vendor of a business to give historical earnings information include that obligation as a civil remedy provision. Make it clear that if it is a resale by a franchisee that it has that obligation.</p> <p>(b) Oblige an existing franchisee (transferor) requesting consent to provide historical earnings information directly to the prospective transferee and a copy to the franchisor.</p> <p>(c) I prefer the idea of the franchisees accountant certifying those historical earnings information. The SA model disclosure obligations that apply to a vendor of a small business (worth less than \$300,000) deserves investigation.</p> <p>(d) Some carve outs should be included to cover exceptions (eg where it is a transfer to an associate of the franchisor) or a technical transfer from one existing partner to another</p> |

etc.

12. Clause 25

- (a) Add a new ground to make it reasonable for a franchisor to withhold or revoke consent where the franchisor reasonably believes the that purchase price of the business is materially or substantially overvalued compared to other businesses in the network or if it believes on reasonable grounds that the franchisee is misleading the prospective transferee as to the real market value of the business compared to other businesses in the network.
- (b) If a mandatory obligation is included to require a vendor of a franchise to give historical earnings information to a prospective transferee then amend clause 25(3) to make it reasonable for the franchisor to withhold its consent (or revoke that consent) if the franchisee fails to give the franchisor a copy of historical earnings information that obligation to give that information to the prospective transferee. Simply add the words "or this Code or any other law" after the words "requirement of the franchise agreement" in clause 25(3)(b) of the Code.

13. Clause 31

AUASB Guidance statement for marketing and cooperative funds

Instruct the Australian Audit and Assurance Board to prepare an audit guidance statement for marketing and cooperative fund audits relating to financial reporting obligations under the Code including clauses 15, 31 and item 15 of Annexure 1. The AUASB prepared GS018 for financial statements under Item 21, but no equivalent has been done for marketing and cooperative funds.

14. Clause 31(3)

Civil remedy provisions

To improve compliance and provide a direct and significant outcome for contravention of marketing fund obligations consider whether non compliance is at such a level to justify making clause 31(1), (2) and (3) civil remedy provisions for which a fine or penalty may arise for contravention. Clause 15 already is a civil remedy provision but Clause 31 is not.

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| 15. | Part 4 | Dispute resolution | Refer to the joint submission made by myself and Sean O'Donnell regarding that area. |
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Items of disclosure in Annexure 1

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| 1. | Item 1.1(c) | Insert a note allowing 'electronic signature' | The Code includes a definition of 'electronic signature' but does not use it anywhere in the Code. This happened when the ETA provisions in the old code were removed. It can still be useful if you include a note that an electronic signature can be used for Item 1.1(c) and or for other signatures in Item 21. |
| 2. | Item 1.1(e) | Review Warning Statement | 5 th paragraph of the Warning statement warns a prospective franchisee that cooling off starts when the agreement is signed. It does not mention it could start at the earlier to occur of entering the agreement or paying non refundable money under the agreement. Consider need to ensure it is consistent with clause 26 of the Code. |
| 3. | Item 3.2 | Experience of Associates | Widen Item 3.2 to require disclosure of relevant business experience of associates. In many cases the relevant experience is held by associates. Widen item 3.2(b) so the reference to 'franchisor' reads 'franchisor or its associates' where it appears. |
| 4. | Item 4 | Item 4.2(b)
judgements other than civil | <p>Change in Item 4.2(b) the words "<i>paragraph 4.1(a)</i>" to read "<i>paragraph 4.1</i>".</p> <p>Item 4.2(b) is currently limited to disclosure of judgements for 'civil' proceedings in the last 5 years. It should require disclosure of civil judgements but also judgements and Court enforceable undertakings obtained by a public agency, and judgements involving criminal proceedings that are commenced before the disclosure document is prepared.</p> <p>This would then make it consistent with continuous disclosure of judgements under Clause 17.3(c). Also Items 4.3(f) and (g) relate to concluded proceedings once a judgement is made or</p> |

the proceeding ends it assumes those judgements are disclosed when they are not required to be. Whilst continuous disclosure of judgements is contemplated in clause 17(3) it just hasn't been added to Item 4 yet to oblige it to be included

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| 5. | Item 4.2(b) and Item 17.3(c) | Disclose proceedings and judgements against franchisor/ associate for contraventions of S558B of FWA | Amend and expand Item 4.2(b) and Clause 17(3)(c) of the Code to require disclosure of any proceedings or judgements arising from the recent amendments to the <i>Fair Work Act</i> if a franchisor contravenes S558B of the <i>Fair Work Act</i> or an associate is held liable as an accessory under S550 to that contravention. Proceedings and judgements under this regime are not currently included under 4.2 |
| 6. | Item 6 | Disclosure of events where consent has been withheld | Amend item 6.4 - add a new disclosure for the number of agreements in which " <i>the franchisor withheld or revoked its consent to transfer of the franchise</i> ". |
| 7. | Item 6.4(e) | Disclosure of end of term decisions | Amend Item 6.4(e) - expand circumstances to require disclosure of other end of term concepts to read " <i>the term of the agreement was not extended, the agreement was not renewed or a new agreement was not entered into</i> ". |
| 8. | Item 9 | Geographical exclusivity of a franchise limited to a site | <p>(a) Improve the drafting of Items 9, 11.1(b) 12.2 and 12.4 and 13 to improve disclosure of geographical exclusivity issues particular in a reasonable geographic area around a site.</p> <p>(b) Include a warning statement in Item 13 in bold and size 12 font as follows:</p> <p><i>If the prospective franchisee is buying an existing franchised business it should before signing a contract of purchase seek legal advice on including an appropriate restraint of trade clause in the contract. Refer to item 13.2. A franchisor may not have a right or</i></p> |

obligation to enforce a contractual restraint against a former franchisee.

- (c) In some larger systems the franchisor may coordinate the network to provide goods or services to those National Client accounts. A franchisee may be requested or obliged to provide goods or services to National Client accounts in their territory. If they do not wish to the franchisor or another franchisee may provide those goods or services even though they may not establish a business outlet location within the franchisees territory. This can result in an exception to exclusivity that should be disclosed.
- (d) The current items of disclosure in item 9 do not really deal with this obligation or circumstances where a franchisor or another franchisee can supply goods or services to a national account customer in their territory. This would be disclosed in Items 11.1(b) / (c).
- (e) Item 9 should make clear that disclosure is required of competition and exclusivity issues where there is a territory but also if a franchise has no territory and is limited to the site. In that case disclosure of geographical exclusivity issues in a reasonable geographical proximity to the site should also be disclosed.
- (f) Government should consider and define what it considers to be *a reasonable geographical proximity to a site (eg a specified radius from the site) but should be mindful that not every territory is determined by reference to a map or radius from a site location. In some cases post codes or other determinants can be used.
- (g) Adding a requirement for information about exclusivity issues where the franchise is limited to a site should relate to a reasonable geographical area concept. It would include disclosure of issues concerning a retail precinct. For example if the site is within a shopping centre a franchisor should be required to disclose if it or its associate is able to operate or grant a franchise and allow another competing business to operate within the shopping centre in competition with the prospective franchisee. Whilst exclusivity may be limited to the site, a prospective franchisee should be told whether the franchisor, an associate or another franchisee may during the term of the franchise compete against them. It is a relevant factor which may affect their ability to

make an informed decision.

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| 9. | Item 9 | History of enforcing restraints against former franchisees | <p>(a) If a restraint of trade is included in the agreement require disclosure of whether a franchisor is obliged to take steps to prevent a former franchisee breaching any contractual restraint by continuing to operate in the territory or in a geographical proximity to the site and if it has ever taken action to enforce it.</p> <p>(b) If it has the discretion, it should also indicate its policy or the basis on which it will exercise that discretion and take that action. In some cases despite having a contractual right to enforce a restraint, the cost of doing so may prevent a franchisor from doing so.</p> |
| 10. | Item 9 | Cross reference other relevant items that relate to exclusivity | To a prospective franchisee is made aware that other items may include disclosure of exclusivity, Include a note to direct a franchisee to refer to other relevant items that relate to issues concerning exclusivity and competition by the franchisor and other franchisees e.g. Items 12 and 13. |
| 11. | Item 12.2(c) | Online sales competition issues | <p>Expand to include disclosure of online sales in a geographic area surrounding the site. Government should specify the reasonable geographical area. Amend so it reads as follows. Changes are underlined.</p> <p><i><u>"the extent to which those goods or services may be supplied outside the territory or in a reasonable geographical area surrounding the site of the franchise"</u></i></p> |
| 12. | Item 12.4 | Online sales competition issues | <p>Expand to include disclosure of online sales in a geographic area surrounding the site. Government should specify the reasonable geographical area. Amend Item 12.4 to make it consistent with changes to item 9. Changes are underlined.</p> <p><i>(a) the extent to which those goods or services may be supplied in the territory of the franchise</i></p> |

or to locations within a reasonable geographic area surrounding the site of the franchise;

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| 13. | Item 13 | History of site or territory | <p>Existing disclosure of business failure or closure should be disclosed under Item 13.</p> <p>It currently requires disclosure of historical details of the cessation of a former business in the territory or site (a worse case scenario). Consider whether it is necessary to amend Item 13 to make it clear specific disclosure of information relating to business failure must be given</p> <p>Item 6.4 already requires disclosure of the number of franchised businesses in the last 3 financial years which have ceased to operate.</p> <p>It is too onerous to require disclosure of details of every business across the network that ceased to operate. The prospective franchisee can also obtain information about the history of network business failures from asking other franchisees.</p> |
| 14. | Item 15.1 (including existing items) | Goods or services provided by the franchisor or associate | <p>(a) Consider the benefit and support of the sector in disclose to require a franchisor to disclose the amount and % attributable to costs of goods and services supplied to the fund by the franchisor or its associate.</p> <p>(b) Consider the benefit and support of the sector to require a franchisor to disclose more detail about the basis on which those arrangements work including if appropriate the importance to the franchisors business model to seek reimbursement of costs it incurs for those goods and services and administration of the fund.</p> |
| 15. | Item 15.1(g) | Expenses requiring a vote | <p>Require a franchisor to disclose if the fund was used in the last 12 months to pay for any expenses that required approval by the franchisee under clause 31(3)(a)(iii) of the Code. If so provide details of that vote and expense and outcome of the vote.</p> |

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| 16. | Item 15 / Clause 15 | Fund contributions to other international funds | In some cases a marketing fund administered by a master franchisee may require contributions to be made to another international fund. Item 15 should require disclosure of the amount and % of funds required to be contributed or paid to another fund and whether the franchisee will be provided with an annual financial statement and audit report of that other fund. |
| 17. | Item 15.1(h) | Marketing and Cooperative fund disclosure to outline basis of charging of goods and service supplied to fund by the franchisor or associate | Amend Item 15.1(h) of Annexure 1 to add the words " <i>and the amount payable or the basis on which the franchisor or associate calculates and charges the cost of those goods or services to be paid by the fund;</i> " |
| 18. | Item 18 | Fix inconsistencies in drafting and make Item 18 more meaningful about end of term disclosure | (a) Refer to suggestions in attached schedule to make improvements to End of Term arrangements. |
| 19. | Item 20/ clause 24 and Clause 25 | | <p>(a) This item may need amendment if the <u>vendor</u> of an existing franchised business with a trading history (ie a franchisor (if the business is operated by the franchisor or associate) or the current franchisee) is obliged to provide available historical earnings information about the existing business actually being sold.</p> <p>(b) A former version of former code contained an Annexure 2 that specified a form of disclosure document for a transferor and required the current franchisee transferring its business to disclose financial reports to the buyer. It should as a minimum require a vendor to certify outstanding employee liabilities and obligations and substantiate what arrangements the vendor is taking to discharge them before settlement. It should</p> |

include an unconditional indemnity in favour of the buyer if it has to pay employees in circumstances after the sale where that certification is false.

- (c) If an obligation to give earnings information is mandatory then amend clauses 24 and 25 of the Code to enable a franchisor to withhold its consent (or revoke it) where that obligation is not fulfilled by a franchisee.
- (d) Identify if other information should also be given by a franchisor for a corporate store sale to ensure the historical earnings information is meaningful (eg whether royalties, fees etc have been waived or not).

20.	Item 20	Earnings information for other sites and greenfield sites should NOT be mandated	<ul style="list-style-type: none">(a) Do not make it mandatory for a franchisor to include historical earnings information for other sites which have been operated by an existing or former franchisee or 'greenfield' sites. Whether a financial performance representation is made should remain a decision of the franchisor.(b) Amend to require a franchisor to disclose the terms and limits of any income guarantees it offers to a prospective franchisee and whether it is intended to constitute a forecast or projection of earnings of the business one the guarantee period ends.
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21.	Item 20 .3	Relevant warning statements	Amend Item 20.3 and include 2 additional alternative warning statements in Size 12 font and bold. These should cover where earnings information is given and whether or not that earnings information is intended to constitute a financial performance representation. I have suggested wording in this submission.
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Include optional warning statements in Item 20.3 as follows:

Option 1: No earnings information - no projection or forecast:

The franchisor does not give earnings information to a prospective franchisee

about a [*insert type of franchise*] franchise.

Earnings can significantly vary between franchises.

The franchisor cannot estimate or project or forecast earnings for the franchise.

No financial performance representation is made.

Option 2: Earnings information is given but it is NOT intended to constitute a forecast or projection (eg actual historical figures for the business are given but no projected earnings for the business):

The franchisor does give earnings information about a [*insert type of franchise*] franchise to a prospective franchisee.

The earnings information comprises [*insert details based on Item 20.2 eg historical financial reports for the business for the last 2 financial years*] but is not a projection or forecast of earnings for a franchise.

Earnings can significantly vary between franchises.

The franchisor cannot estimate or project or forecast earnings for the franchise.

No financial performance representation is intended to be made.

Option 3: Earnings information that is intended to constitute a forecast or projection namely a financial performance representation (eg actual historical earnings information of another store is given together with projected earnings and assumptions in Item 20.4):

The franchisor does give earnings information about a [*insert type of franchise*] franchise to a prospective franchisee.

The earnings information comprises *[insert details based on Item 20.2(a) to (d) eg a franchise in the franchise system and projections of earnings for the business and assumptions set out in Item 20.4]*.

The franchisor does make a projection or forecast of earnings for a franchise which is a financial performance representation about the franchise.

Earnings can significantly vary between franchises.

You should also refer to and consider the information contained in Item 20.4 that applies to the financial performance representation and *[you should/you must]* seek independent legal, accounting and business advice from experienced advisors.

- | | | | |
|------------|------------------|--|--|
| 22. | Item 21.4 | Amend 4 month audit report window to 12 months if the exemption under clause 8(8) is applied | <ul style="list-style-type: none">(a) Amend Item 21.4 after the words "<i>within 4 months</i>" to add the words "<i>or 12 months (if the exemption in clause 8(8) has been applied)....</i>".(b) This would allow a franchisor to obtain and give an audit report prepared after the 4 months window expires if it applied the exemption in clause 8(8) but subsequently (after the 4 month period) receives a request under clause 16(1)(a) of the Code to give an updated disclosure document.(c) Without this change a franchisor would be compelled to give financial reports when it wants to obtain an audit report outside that 4 month window or incur the expense of an audit report even if it applied the exemption.(d) The benefit of the exemption and ability for a franchisor to save costs is undermined if a franchisor has to go to the expense of obtaining an audit report within 4 months even if it has been able to apply the update exemption.(e) A franchisor should not be compelled to obtain an audit report within 4 months even if it qualifies for and applies the exemption from the obligation to update its disclosure |
|------------|------------------|--|--|

document at that time. The prospective franchisee is not affected by this change as the franchisor can still obtain an audit report within the 2 month disclosure window required by clause 16.1(a).

- (f) In Alan Wein's review the recommendation to change the 12 month audit report window to 4 months was based on the fact that a franchisor should get the audit report within that period to align with its update obligation. At that time the old code did not include the ability to apply for an exemption from the annual update obligation.

23.	Item 21	Fix inconsistent drafting for consolidated entities	Amend item 21.4(b): Make it consistent with items 21.5 and 21.6 so that the audit report can be for the " <i>franchisor or the consolidated entity</i> ".
24.	Item 21/ Clause 15	Registered company auditors	Amend the Code to make it clear that any audit report required under Item 21 such as for items 21.4, 21.5 or 21.6 and an audit report for the annual marketing or cooperative fund statement must be prepared by a registered company auditor.
25.	Item 22	Other details	<p>Divide Item 22 into 2 parts like the former code to allow a franchisor to disclose other information it may want to give. I think this was accidentally removed when the old code was redrafted. In that way</p> <p>Item 22 Updates and other details</p> <p>1. Item 22.1 covers the Information regarding the existing wording relating to Clause 17 disclosure in Item 22.1;and</p> <p>2. Item 22.2 can cover other details it may want to include in Item 22.2.</p>

Schedule of suggested amendments - Non refundable money and cooling off

1. Improve consistency in terminology used in the Code

1.1 Why is it necessary?

- (a) The issues I raise go to interpretation and application problems in the Code. However any changes or refinements would require a degree of consultation between Treasury, the ACCC and stakeholders in the Sector to ensure the balance ends the gaps that currently exist.
- (b) The drafting of various provisions in the Franchising Code including clause 26, 9(1), 10(1) and (2) and item 1.1(e) and items 14.1 and 14.2 of Annexure 1 of the Franchising Code is inconsistent, flawed and needs review and fixing. That can occur when the next review of the provisions of the Code is being undertaken but only after consultation.
- (c) These issues only relate to prospective franchisees and not existing franchisees.
- (d) The problem would not normally arise if a prospective franchisee signs and enters into a written agreement before they pay non refundable money to the franchisor or its associate.
- (e) It becomes a clear problem when they make a non refundable payment to the franchisor or its associate and want to 'walk away' before they sign an agreement of any kind
- (f) Inconsistent drafting in these clauses directly causes disputes including as to:
 - (i) whether you have to sign an agreement before your right to cool off can be exercised;
 - (ii) whether your cooling off right commences if before entering an agreement a prospective franchisee pays an amount that is fully refundable or only if it is non refundable¹;
 - (iii) when a franchisor or its associate can keep (in whole or in part) a non refundable payment taken before an agreement is signed or otherwise 'entered into';
 - (iv) how do you deal with agreements that are conditional:
 - (A) because they are expressed NOT to be binding until a franchisor signs them; or

¹ Clause 26(1)(b) refers to a payment - it does not differentiate between a refundable or non refundable payment. A refundable payment remains refundable whereas a non refundable payment may be non refundable in whole or in part. The trigger should be when they make a non refundable payment not 'any payment. Similarly clause 26(1) refers to making a payment- it does not say whether that payment is the franchisor or its associate and covers both

- (B) because they are expressed NOT to be binding unless a condition is fulfilled by a date which is after the cooling off period ends.
- (g) The warning statement may mislead a prospective franchisee as to their right to terminate and obtain a refund of money.
- (h) A franchisor, a prospective franchisee and their advisors should not have to fight over these issues simply because the drafting of the Code was intended to be brief but it is in fact vague and inconsistent.
- (i) This problem arises in BOTH the Franchising Code and Oil Code.
- (j) I have set out what the problem is and what I suggest can be done to fix it. It would be a mistake to leave it as it is indefinitely.

1.2 What is the problem?

Warning statement inconsistent with clause 26(1)

- (a) The disclosure document contains a mandatory warning statement in Item 1.1(e) of Annexure 1. It specifies when a prospective franchisee's right to terminate the agreement during the cooling off period commences.
- (b) It is flawed because it misleads a prospective franchisee into believing that in **all cases** the right to terminate during the cooling off period commenced when they **SIGNED** the agreement.
- (c) The warning statement disregards application of clause 26(1)(b) and is inconsistent with clause 26(1)(a) because it ignores 'oral and implied' agreements.

When is an oral or implied agreement considered to be entered into by a prospective franchisee?

- (d) The Code gives NO guidance on this at all.
- (e) Clause 26(1)(a) is inconsistent with the warning statement because it does not say that you enter into an agreement when the prospective franchisee 'signs' the agreement - it simply talks about 'entering into an agreement'.
- (f) It is not possible to sign an oral agreement. You can sign a document that reflects oral or implied terms or by your conduct adopt those terms (without signing a document). Unfortunately simply signing a receipt of disclosure or a statement under clause 10(1) does not get you to an agreement². If that was the argument it is flawed because before signing you also need the statement under clause 10(2).
- (g) This causes unnecessary disputes (and legal costs) in circumstances where a franchisor complies with its Code obligations under clauses 9(1)³ and 10(1)⁴ before

² Because you must still get the statement under clause 10(2) BEFORE you enter into the agreement

³ Clause 9(1)(a),(b) and (c) oblige a franchisor to give certain things before it enters into an agreement OR before a **franchisor** or its **associate** takes non refundable payment.

⁴ Clause 10(1)(e) of the Code prohibits a franchisor from entering into an agreement or taking a non refundable payment unless it has received a clause 10(1) statement from the prospective franchisee that it has received, read and had a reasonable opportunity to understand the disclosure document and code.

they (or an associate) takes non refundable money but they are being asked to hand it back and not deduct their reasonable costs.

- (h) The warning statement is directly inconsistent with:
 - (i) the definition of a 'franchise agreement' in the Code⁵; and
 - (ii) clause 26(1)(b) - which links the commencement of the cooling off period to an event, namely payment of money (refundable or not) before an agreement is entered into
- (i) **Item 1.1(e) can mislead or confuse the prospective franchisee because it does not:**
 - (i) make it clear that an agreement could be oral or implied⁶ as opposed to an agreement in writing; or
 - (ii) warn them when an agreement is considered to be "entered into" if that agreement is oral or implied - eg what thing the prospective franchisee has to do to enter into an oral or implied agreement; or
 - (iii) warn them if they make a payment (whether it is refundable or not) before they sign a written agreement that the cooling off commences earlier than when they sign.

Is making a payment considered to be entering into an implied agreement

- (j) The application of Clause 26(3) and (4) is unnecessary limited and tied to termination of an agreement rather than contemplating the fact that prospective franchisees do pay non refundable payments and do cool off and walk away before they sign an agreement.
- (k) There is also an argument that clauses 26(3) and (4) are limited. and only apply if an agreement is entered into because it refers to termination of an agreement. If no agreement is entered into they simply do not apply. A prospective franchisee simply elects not to proceed before it signs or otherwise enters into an agreement.
- (l) Hence a 'gap' arises between those protected and those that are not.
- (m) It is unclear if the legislative intent was for clause 26(1)(b) to be interpreted in a way that a prospective franchisee who makes a 'payment' to the franchisor OR its associate is considered to be entering into an implied agreement to enter into a franchise agreement.
- (n) If that is the legislative intent then it is fundamentally flawed logic because:
 - (i) Paragraph (1)(b) is mutually exclusive to Paragraph (1)(a) - both circumstances cannot apply because the right to cool off / terminate arises on the "earlier to occur" of those events⁷.

⁵ And definition of a fuel re-selling agreement under Oil Code which has a similar element

⁶ Clause 5(1)(a) of the Code defines a franchise agreement to be an agreement that takes the form, in whole or in part of a written agreement, an oral agreement or an implied agreement

- (ii) Paragraph 1(b) can only apply if a payment (refundable or not) is made before an agreement is signed
- (iii) Clause 26(1)(a) would also apply to an oral or implied agreement even though paragraphs (a) and (b) are clearly intended to be mutually exclusive events.
- (iv) The concept of payment somehow being an implied agreement is inconsistent with the express terms of the Code simply because the Code:
 - (A) DOES require independent advice certificates to be obtained⁸ before entering into that implied agreement;
 - (B) BUT DOES NOT require them before a franchisor (or its associate) can take a NON REFUNDABLE PAYMENT⁹.
- (v) The agreement would have to be implied because it is not signed¹⁰.
- (vi) The argument would have to rely on an assumption that an implied agreement is entered into when ANY payment is made - not just when a non refundable payment made.
- (vii) That could mean that a fully refundable payment made will trigger the cooling off right much earlier than intended when a franchisee should be able to walk away and cool off anytime up to the time it 'enters into an agreement'.
- (o) It also suggests that a franchisor's right to deduct its reasonable expenses is limited to when it deducts that amount from a payment actually taken by the franchisor or associate under clause 26(3) and (4). Whereas Clauses 9(1)(e) and 10(1)(e) and 10(2) suggest otherwise.
- (p) As a consequence there is an argument that clause 26 does not prevent a franchisor OR its associate retaining its reasonable non refundable costs if a prospective franchisee makes a non refundable payment to either the franchisor or its associate.

Inconsistency between clause 9(1) and clause 10

- (q) Independent advice certificates:
 - (i) are required before a franchisor enters into an agreement¹¹.
 - (ii) but are NOT required before a franchisor takes a non refundable payment¹².
- (r) Clause 10(1) and (2) are not civil remedy provisions but clause 9(1) is a civil remedy provision for which a fine or penalty for contravention applies. The distinction between

⁷ They are mutual exclusive because clause 26(1) gives to alternatives to when cooling off starts and it starts from the 'earlier to occur' of those 2 alternatives - ipso facto they MUST be mutually exclusive

⁸ Clause 10(2)

⁹ Both Codes are consistent in this respect. if Government wanted to stop a franchisor or associate from taking a non refundable payment before it entered into an agreement the independent advice certificate obligation should also have applied to non refundable payments

¹⁰ Clause 26(1)(a) applies if it is a written agreement

¹¹ including an agreement to enter into a franchise agreement

¹² Clause 10(2) of the Code

why one is a civil remedy provision and the other one is not remains an enigma other than an argument is designed to prevent contravention in a Master of Education Services- v- Ketchell type case where the statement could not be produced..

- (s) A franchisor's right to deduct its expenses currently requires:
 - (i) A payment of some kind being made either **before** or **after** an agreement is entered into or **both**.
 - (ii) Termination of an agreement by a prospective franchisee during the cooling off period.
 - (iii) Disclosure of those expenses or method of calculation in the agreement¹³ as opposed to the disclosure document.
 - (iv) The expenses to be reasonable.
- (v) Clause 26 only permits a franchisor to 'deduct from an amount repaid' rather than to seek reimbursement from the prospective franchisee if no payment had been received even if those costs were disclosed in the agreement.
- (vi) A clause in an agreement may require reimbursement one the agreement is signed (irrespective of whether the prospective franchisee cools off) as opposed to any requirement for a deposit to be paid before the agreement is entered into.
- (vii) The wording in clause 9(1)(e) is different to 10(1)(e) and this needs to be fixed because:
 - (A) 9(1)(e) covers payments to a franchisor or its associate where 10(1)(e) does not mention associates at all;
 - (B) the wording used in clause 9(1)(e) of "to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement" should be mirrored in clause 10(1)(e) but is not¹⁴.

Conclusion

- (t) Currently both the Franchising Code and Oil Code contain a right to cool off and deal with the repayment of money paid and what deductions are permitted from the amount to be refunded.
- (u) Both Codes should be consistent because they deal with the same issues but their drafting varies.
- (v) I am not advocating a change to current policy about taking non refundable money other than to say the drafting is ambiguous, flawed, inconsistent and most importantly - unnecessarily confusing to franchisors, prospective franchisees and advisors.
- (w) I am simply suggesting that when the Code is next reviewed and scheduled for update that the drafting of the current provisions I have identified be considered and

¹³ There is no ability to satisfy that requirement simply by including disclosure in item 14 of Annexure 1

¹⁴ It limits it to a payment to the franchisor and also says it is "under a franchise agreement or agreement to enter into a franchise agreement

refined to give greater protections for all concerned. There are many lawyers alert to these inconsistencies and like me, they are equally as frustrated by the inadequacy of what should be an otherwise clear provision¹⁵.

- (x) Government should also consider revisit the Policy and discuss with the Sector the current practice to understand why in some cases it may be commercially justifiable to be able to deduct or retain some non refundable expenses (or seek a reimbursement). This is particularly relevant when a franchisor (as most small businesses are without legal counsel) could be forced to engage lawyers to prepare the contract documentation and engage in extensive negotiations just to have them walk away and the franchisor unfairly left with the expense. A right to cool off is one thing - a right where it has been agreed to be reimbursed or to deduct reasonable expenses is something else entirely.

2. How can you fix it?

- (a) **The first change** - Include definitions of **payment** and **non refundable payment** in clause 4(1):

payment means a payment (whether of money or other valuable consideration).

non refundable payment means a payment which is non refundable (in whole or part) including a payment that may be expressed to be fully refundable at the time it is paid but will become wholly or partly non refundable upon an event occurring or not occurring.

- (b) **The second change** - apply that terminology in clauses 9(1)(e) and 10(1)(e) and 10(2) to ensure it is much clearer that a non refundable payment (ie an amount which is non refundable in whole or in part) cannot be accepted by a franchisor or an associate unless the requirements in clause 9(1) and clause 10(1) are completed first.

Replace existing wording with the following:

Clause 9(1)(e)

"makes a non refundable payment to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement or agreement to enter into a franchise agreement."

10(1)(e):

"receive nor allow its associate to receive, a non refundable payment in connection with the proposed franchise agreement or agreement to enter into a franchise agreement."

- (c) **Third change** - Item 14.1 and 14.2

Amend Item 14.1 to add the words **"(including a non refundable payment)"** after the words "requires a payment". Add also

¹⁵ Note even the ACCC template disclosure document does not deal in item 14.2 any real guidance on how to deal with non refundable payments and cooling off when it should

Add the words "including the circumstances in which the franchisor or its associate or other person will be entitled to deduct its reasonable costs (including legal costs) from the payment or require a reimbursement of its expenses if the right to cool off is exercised" after the words ""who will hold the money"

It may also be beneficial to include a drafting note that is along the lines of

"This will include a payment which may be required to be made to reimburse the franchisor or associates for its reasonable costs if it does not proceed with the franchise if it exercises its right to cool off during the cooling off period."

Replace Item 14.2 - with:

14.2 The conditions under which a payment (or part of it) will be refunded by the franchisor or an associate of the franchisor.

- (d) Consider the following wording to give better clarity to cooling off and refund of money:

26 Cooling off and refund

- (1) **A prospective franchisee has a legal right to cool off and not proceed with a franchise at the earlier to occur of the following events:**

- (a) ***Before entering into an agreement or agreement to enter into an agreement:***

If the prospective franchisee has made a non refundable payment but not yet entered into an agreement to enter into a franchise agreement or a franchise agreement then it may cool off and not proceed with the franchise at any time before it enters into that agreement. The prospective franchisee should inform the franchisor in writing at the earliest opportunity that it does not wish to proceed with the franchise.

- (b) ***After entering an agreement to enter into a franchise agreement:***

If the prospective franchisee enters into an agreement to enter into a franchise agreement then it may cool off and terminate that agreement by giving written notice to the franchisor. That notice must be given to the franchisor within 7 days of the day that the prospective franchisee enters into that agreement.

- (c) ***After entering into a franchise agreement:***

If the prospective franchisee enters into a franchise agreement then it may cool off and terminate that agreement by giving written notice to the franchisor. That notice must be given to the franchisor within 7 days of the day that the prospective franchisee enters into that agreement.

- (2) **A franchisor must not include in a franchise agreement or agreement to enter into a franchise agreement a provision that limits or excludes a prospective franchisee's right to cool off. Any limitation or exclusion will be unenforceable by the franchisor to the extent of any inconsistency. Nothing prevents a**

franchisor offering in a franchise agreement or agreement to enter into a franchise agreement a longer cooling off period within which the prospective franchisee can give notice exercising its right to cool off.

Civil Penalty: 300 penalty units

- (3) For the purposes of clause 26(1) a prospective franchisee will enter into a franchise agreement or agreement to enter into a franchise agreement if:
- (a) in the case of a written agreement - when the prospective franchisee signs the agreement; or
 - (b) in the case of an agreement that is oral or implied - when *[insert Government policy here as it is currently uncertain¹⁶]*.
- (4) Subject to paragraph (5):
- (a) if a prospective franchisee exercises its right to cool off under clause 26(1), the franchisor or its associate must refund any payment made to it; and
 - (b) the franchisor must refund the payment less any reasonable expenses it is entitled to retain within 14 days after the date the prospective franchisee exercises its right to cool off.

Civil Penalty: 300 penalty units

- (5) A franchisor or its associate is entitled to deduct or retain from any non refundable payment it has received, its reasonable expenses (including legal costs) if the franchisor's reasonable expenses or their method of calculation:
- (a) in respect to the circumstances listed in clause 26(1)(a), those expenses or method of calculation have been disclosed in Item 14.1 and 14.2 of the disclosure document; or
 - (b) in any other circumstance they have been set out in the prospective agreement to enter into a franchise agreement or franchise agreement.
- (6) Clause 26 does not apply to:
- (a) an existing franchisee in respect to the renewal of an existing franchise agreement or the extension of the scope or term of an existing franchise agreement; or
 - (b) a prospective transferee in respect to an agreement it enters into to give effect to the transfer of an existing franchise agreement.
- (7) To avoid doubt, a franchisor must not (and must ensure its associate does not) accept a non refundable payment unless the franchisor has first complied with

¹⁶ Government should clearly articulate what it considers to be the event where a prospective franchisee is taken to enter into an oral or implied agreement. This may include where that agreement requires them to proceed or they pay non refundable money.

its obligations to the prospective franchisee under clauses 9(1) and clause 10(1).

Civil Penalty: 300 penalty units

Schedule of Suggested Amendments - End of Term Arrangements

1. Why is it necessary?

- 1.1 The issues I raise go to interpretation and application problems in the Code.
- 1.2 However any changes or refinements would require a degree of consultation between Treasury, the ACCC and stakeholders in the Sector to ensure the balance ends the gaps that currently exist.
- 1.3 To ensure that interpretation and application of a right or obligation involving these concepts is clear.
- 1.4 The changes suggested below should vastly improve consistency in terminology in the entire code and application of the end of term arrangements.
- 1.5 Currently in some provisions of the Code (and even the Explanatory Memorandum) the terminology and application is clear¹, but in other parts it is not².

2. What is the problem?

- 2.1 In various places the Code uses different terminology for end of term concepts.
- 2.2 In some provisions it uses them in a way that assumes there are only 2 concepts³ - renew or extend. In other places it suggests there are 3 (eg Item 18.1(a) and (b) and clause 18.1).
- 2.3 The concepts arise because of the use of the words "**renew the agreement**", "**extend the term of the agreement**" and "**enter into a new agreement**".
- 2.4 The definition of '**renew**' and the definition of '**extend**' do not make it clear if it was intended to include the third concept as part of each or either of their definitions.
- 2.5 This inconsistency is clearly evident when you look at Item 18.1(a) and the obligation to disclose whether the franchise agreement includes an option to either "renew" or to "enter into a new agreement". The EM has also clearly indicated that a reference to an option is intended to include a legal right.
- 2.6 It is also seen in clause 18 where a franchisor has to make a decision and give notice of whether it intends to "enter into a new agreement" at end of term. This suggests there is a difference between '**renew**', '**extend**' and '**enter into a new agreement**' and may depend on the terms offered and that the 3 concepts are mutually exclusive.
- 2.7 In other provisions it only refers to end of term concepts of "renew" and "extend" when the third concept should also be included⁴.
- 2.8 The definition of **extend** does not make it clear how you treat a **holding over** of the franchise on a month by month basis. In particular whether it is an agreement to 'extend' if the

¹ Clause 9(2)(b) and 10(1)(c) and (d) where it says 'extend the term or scope' rather than simply 'extend'.

² Clause 6(7), 18, 23

³ Clause 6(7)

⁴ For example clause 18(1)(a) and Item 18.1(a) use the alternative concept of 'enter into a new agreement' whereas Clause 18(3) and Items 18.3, 18.4 and 18.5 do not.

franchisor consents to a franchisee holding over (irrespective of whether the agreement contains contractual terms that permit it).

- 2.9 Simply using 'extend' (rather than indicating which limb of it applies) leaves open for interpretation that either of the limbs or both of the limbs of the definition could or should apply when the intent was that only one limb was to apply.
- 2.10 Some clauses and items in the disclosure document refer to one end of term concept when another end of term concept really applies.

3. How can you fix it?

3.1 The first change - fix terminology to ensure consistency

- (a) **Determine** which of the following words to add to the expression "**extend the agreement**" to make it clear which limb of the definition of "**extend**" the right or obligation is intended to apply to when the provision uses the words "**extend the agreement**".
- (b) The words to consider adding are: "**the term of**" or the "**the scope of**" or "**the term or scope of**" to make it clear and to make it consistent with other parts of the Code where they are used.

3.2 The second change - Clause 23

- (a) Refine the wording used in clause 23 because its drafting is poor when it suggests the request must be to "extend the agreement". This is because the definition of 'extend' simply relates to a change in the 'term' of that current agreement and not a replacement of the old agreement with a new agreement.
- (b) Clause 23(1)(a): Delete the words "**to extend the agreement**" and replace them with "**an extension of the franchise and to enter into a new agreement**".
- (c) The use of the qualifying words "**terms of the agreement**" set out in clause 23(1)(a) mean that the request could only be a request "**to enter into a new agreement**" on the terms set out in clause 23(1)(a)(i) and (ii).
- (d) Currently a request just to extend the term of its current agreement on its current terms would not appear to satisfy that provision.
- (e) **EXAMPLE 1:** Consider the following request and whether clause 23 could apply:

"I don't have an option to renew. Please renew my current agreement for a further 6 months on the same terms as my current agreement. I do not want to sign an agreement on the terms that you offer other franchisee sand I don't want to pay another initial franchise fee or renewal fee to extend"

A franchisor will have to interpret the written request and understand precisely what they are asking for to determine whether the clause applies or not. I have no doubt that some of those requests will use proper terminology but many will not.

If conflicting terminology is used that does not reflect the strict code terminology then the application of the clause will be difficult. In the example above it seems he doesn't have an option to renew but uses 'renew'. He asks for 6 months when the franchisor

offers a new agreement on its current terms for 5X5 year terms. He doesn't want to pay a fee whilst other prospective franchisees would. In that event it appears the clause does NOT apply to the request.

- (f) **EXAMPLE 2:** A different example of a request makes the intended clause's application clearer:

"I don't have an option to renew however I want to extend my franchise for a further 5X5 year term on the terms of your current agreement that you offer to other prospective franchisees."

This appears to be an example of a request where the franchisee asks to enter into a new agreement on the terms offered to other prospective franchisees and would comply with clause 23(1)(a). He is not asking to extend the term of the existing agreement but to sign a new one on the same basis as other new franchisees

- 3.3 **Third change - Add** the words **"or enter into a new agreement"** in places where it is relevant if there are in deed 3 end of term concepts.
- 3.4 **Fourth change - Add** the words **"enforceable legal right"** when used in relation to **"enter into a new agreement"** or **"extend the term of the agreement"** in various places to make it clear whether it is an enforceable legal right as opposed to a discretion. For example in clause 6, clause 18(1) and Item 18.1 where there is the discretion as opposed to an enforceable legal right.
- 3.5 **Fifth Change - refer** to other suggested changes below.

4. Use and Interpretation

- 4.1 The expressions **"extension of the agreement"**, **"extend the agreement"**⁵, **"extend the franchise agreement"**⁶, **"extend the term or scope of the agreement"** as well as **"extend the term of the agreement"** are used in various places in the Code and Explanatory Memorandum.
- 4.2 In other places expressions such as **"enter into a new agreement"** and **"renew the agreement"** are used, sometimes in the same place⁷.
- 4.3 In some places the Code should for consistency include a reference to a term but it does not⁸.
- 4.4 The different use of those words affects the interpretation but more importantly determines (or limits or extends) the application of a right or obligation⁹ in a way inconsistent with what its purpose was. This can lead to an unintended consequence including where a right or obligation is applied when it should not be.
- 4.5 The last explanatory draft of the Code which Treasury issued for consultation before the new code was prescribed contained in clauses 18 and 23 the words **"renew the agreement"**, it also had a different clause 6 (that did not include clause 6(7)).

⁵ The qualification of the obligation to act in good faith

⁶ Clause 18(3)

⁷ Item 18.1 where it specifies option to renew the agreement or to enter into a new agreement

⁸ Item 17 requires disclosure of unilateral variations but does not say whether it should be limited to or include circumstances where there has been variations which amount to an extension of the 'scope of the agreement'.

⁹ Clause 18(1) and Clause 23

- 4.6 Changes were made to those clauses and the word '**extend**' replaced the word '**renew**' because of changes in terminology.
- 4.7 The word "**renew**" is defined and is intended to have a mutually exclusive meaning to "**extend**".
- 4.8 I understand the intent of the last minute changes to clause 18 and 23 was to ensure that those provisions did not apply to a renewal of the agreement where there was an option or legal right to renew.
- 4.9 Unfortunately the last minute change in terminology was not open to scrutiny and was used in Clauses 6, 18 and 23 and Item 18 and the Explanatory Memorandum in a way that has made them ambiguous compared to other clauses of the Code.
- 4.10 The draftsman should have looked at the way other clauses used these expressions¹⁰ to ensure the circumstances of application of the right or obligation throughout the whole code and EM was clear.

Insert the words "term of" after "extend" to avoid ambiguity.

- 4.11 Make it clearer which limb of the definition of "extend" was intended to apply - eg scope or term or both "
- 4.12 Use the words "extend the term or scope of the agreement" or "extension of the term or scope of the agreement" (depending on the context). This will make it clear which limbs of the definition of extend are or were intended to apply.
- 4.13 If both concepts of term and scope are intended to be used just use "**extend the term and scope of the agreement**". This makes which would make it consistent with other clauses such as Clauses 9(2)(b), 10(1)(c) and (d).
- 4.14 A global change cannot be made to every reference if it is intended to cover both concepts of 'term and scope'. Each reference must be checked and adjustments made.
- 4.15 The Explanatory Memorandum makes it clear that where the word 'option' is used in relation to renewal it is intended to include an enforceable legal right as well (for example where the wording used in the agreement is not technically the grant of an option).
- 4.16 The use of the word '**or enforceable legal right**' is not currently used in the Code but could be included to reflect the EM intent and assist to differentiate whether the franchisee has an option or an enforceable legal right to renew or to enter into a new agreement.
- 4.17 Some clauses such as 9 and 10 where both limbs are expressly mentioned do not need change for this concept as they already have been refined before. They use the concept more consistently
- 4.18 It would also make it consistent where the Code also uses wording to apply the other part of the definition to extend namely - "**extend the scope of the agreement**".
- 4.19 As a consequence when those changes are made in the Code it is clear whether the expression was intended to one or more of those limbs of the definition.

¹⁰ For example when it wanted both limbs of the definition of extend to apply it uses "extend the scope or term"

- 4.20 In some places in the Code the words **'or enter into a new agreement'** should be included to cover the other end of term concept to ensure it covers appropriately an 'extension' as the EM outlines.
- 4.21 The diagram in the EM shows extension is intended to cover both where you extend the term of the agreement and also where you enter into a new agreement.

5. Clause 6 - Good faith obligation

- 5.1 Clause 6(7) was introduced just to deal with end of term arrangements.
- 5.2 Amend clause 6(7)(a) to include the words **"or enforceable legal right to enter into a new agreement"** after "renew the agreement" so it is consistent with Item 18.1.
- 5.3 **Amend clause 6(7)(b)** Use the words **'extend the term of the agreement'** rather than 'extend the agreement' to be make it clear it applies only to 'end of term concept' rather than the other limb of the definition of "extend".
- 5.4 That change will make it clear that in the absence of any such right the clause applies.

6. Clause 23 - Enforceability of a restraint of trade

Interpretation of meaning of a request seeking to extend the agreement

- 6.1 I do not believe the legislative intent was to apply this clause to a request seeking to 'extend the agreement' at all. It may have been intended to cover an **'extension of the agreement'** and cover both concepts that the EM states namely:
- (a) to extend the term of the existing agreement; or
 - (b) to enter into a new agreement,
- but the qualification is, that the terms must be on the franchisors' current franchise agreement AND they must apply to other franchisees or would apply to a prospective franchisee.
- 6.2 Currently in the absence of the words "term of", the interpretation of that clause is unclear. An ordinary person would think it means 'extend the term' however there are 2 limbs to the definition of 'extend' and if you tried to use the second limb (extension of the scope) it may make its application even more ambiguous.
- 6.3 In my view the clause only makes sense if the request is really to seeking an extension of the franchise and to enter into a new agreement on the terms set out in 23(1)(a)(i) and (ii) rather than a request to extend the existing term of the agreement for 6 months.
- 6.4 Unless amended and clarified ultimately the Courts will have to interpret what is meant by **"extend the agreement substantially on the terms of:"** and whether the qualification wording o clause 23(1)(a)(i) and (ii) limits its application to requests to **'enter into new agreement'**.
- 6.5 In my view the qualifications in clause 23(1)(a)(i) and (ii) and the EM limit the type of request that can be made. That is that the terms asked for must be on terms that reflect Clause 23(1)(a)((i) and (ii).

Renewal

- 6.6 To ensure application of the clause is clear it would be useful to make it clear that the request is not a request where a franchisee exercises an option or enforceable right to renew as the code terminology uses. I say this because many agreements use terminology that does not follow the wording of the Code. The agreement may talk about renewing the franchise but may actually be an extension as the code considers it.
- 6.7 If it is not intended to apply to a request where the franchisee is exercising an option to renew or other lawful right to enter into a new agreement then it would be useful to add the words **"did not have an option or right to renew the agreement or legally enforceable right to enter into a new agreement and"** to the first line of clause 23(1)(a) after the words 'franchisee'. This is to ensure that a franchisee knows that it does not apply where a notice exercising that right or option is given.
- 6.8 This clarifies that the request does not apply:
- (a) to a notice exercising an option or enforceable legal right to renew the franchise; or
 - (b) to a notice exercising an enforceable legal right to enter into a new agreement,
- and makes it clear that the clause applies where the franchisor has a discretion (as opposed to an enforceable legal obligation to let the franchisee continue with the franchise).
- 6.9 Replace the words **"seeking to extend the agreement"** with **"seeking to enter into a new agreement"** to make it clearer and eliminate any ambiguity relating to a request to extend its existing agreement for say 6 months. Making this change:
- (a) removes any ambiguity as to whether the second limb of the definition of 'extend' applies (ie extend the scope); and
 - (b) gives clarity that the basis and terms of the agreement specified in clause 23(1)(a)(i) and (ii) are in a new agreement they are asking for.
- 6.10 Other minor changes to clause 23 required would include:
- (a) **A change to clause 23(1)(d)** - delete the words "not extend the agreement" and replace with **"not enter into a new agreement"**
 - (b) **A change to clause 23(1)(e)(i)** - delete the words **"the agreement was not extended"** and replace with **"a new agreement was not entered into"**
 - (c) **A change to clause 23(1)(e)(ii)** - delete the words **"it was not extended"** and replace with **"that a new agreement was not entered into"**.

7. Clause 18 - End of term notice

- 7.1 **Amend Clause 18(1)(a) and 18(3)** replace "extend the agreement" with **"extend the term of the agreement"**.
- 7.2 **Amend Clause 18(3)** insert the words **"or to enter into a new agreement"** after the words "extend the agreement" so a statement is not required to be included in both cases.
- 7.3 **Clarify** definition of extend - Make it clear that the definition of extend in relation to the term of the agreement does not include a holding over of the franchise at end of term on a periodic

basis of one month or less eg a month by month or weekly or fortnightly or other periodic basis irrespective of whether the agreement contains an express right to hold over.

7.4 **Item 18 - End of term arrangements**

- (a) **Amend Item 18.1(a)** to reflect page 46 of the explanatory memorandum which specifically provides that it is intended that reference to option includes reference to a legal right.
- (b) **Amend Item 18.1(a)** - insert " **or enforceable legal right,**" after the word option in item 18.1(a) to make it clear of the requirement to also consider if there is a 'right' but it is not expressed as an option.
- (c) **Amend Item 18.1(b)** replace the words "**extend the agreement**" with "**extend the term of the agreement**" where it appears in that item.
- (d) **Amend Item 18.1(c)** delete "**option to renew**" and replace it with the words "**option or enforceable legal right to either renew the agreement or enter into a new agreement or to extend the term of the agreement**". In my opinion It should require disclosure of whether compensation is payable in each of those events. This is essential because clause 23 has an element regarding whether compensation is payable if a franchisee cannot extend the agreement. Disclosure is currently limited to 'non renewal'.
- (e) **Amend Item 18.1(d)** Insert the words "**or used in the business at the end of term**" after the words "**purchased when the franchise was entered into**". This will ensure that the obligation at end of term to disclose arrangements for assets includes those acquired after the agreement was entered into, not just those at the time it was entered into.
- (f) **Amend Item 18.1(f)** Insert the words "**or an option to purchase and, if so, the process that applies including how market value or the purchase price is determined**" after the words "right of first refusal". Most agreements contain an option rather than a right of first refusal.

7.5 **Amend the Warning Statements.**

- (a) The 3 alternative warning statements in Items 18.3-18.4 contain distinct parts.
- (b) The intent as I understand is firstly for the warnings statements to make it clear whether there is not option to renew or enforceable legal right to extend the term of the agreement or enter into a new agreement. That should align with the answer given in Item 18.1.
- (c) Secondly they all contain a general sweeping statement that makes it clear the franchisor has the 'discretion' and if it doesn't exercise the discretion the opportunity to operate the business ends.
- (d) **Amend Items 18.3 - 18.5** change the first sentence of each statement to reflect amended end of term concepts in the way I suggested above eg:

Item 18.3 - The franchisee does not have the option or enforceable legal right to renew the franchise agreement or to enter into a new agreement.

Item 18.4 - The franchisee does not have the enforceable legal right to extend the term of the franchise agreement.

Item 18.5 - The franchisee does not have the option or enforceable legal right to renew the franchise agreement or to enter into a new agreement and does not have the enforceable legal right to extend the term of the franchise agreement.

- (e) The other 2 common paragraphs of the warning statement in each item should be amended to be consistent with 18.1(a) and (b) as follows. It also makes it clear these relate to where the franchisor has a 'discretion' rather than the franchisee having an enforceable legal right:

At the end of term of the franchise agreement, the franchisor may, but does not have to extend the term of the agreement or enter into a new agreement.

If the franchisor does not extend the term of the agreement or enter into a new agreement the franchise agreement ends and the franchisee no longer has the right to carry on the franchised business.

- (f) Currently there is a slight difference in Item 18.4 (compared to item 18.3 and 18.5) of those common paragraphs where it uses the words "**does not do so**" rather than "**does not extend the term of the agreement**". The common parts of each warning statement should be identical and also include the words "or enter into a new agreement" as suggested above.
- (g) **Consider just combining Items 18.3- 18.5 into one item.** It is more effective and clearer to a prospective franchisee to have just 1 item (eg Item 18.3) to contain the Warning Statement not 3 different ones. It should be structured to allow the franchisor to include ONLY the relevant wording depending on whether it answers Yes or No in its answer to items 18.1(a) and (b).
- (h) **Add a drafting note to item 18** explaining that the relevant different sentence of each of the warning statements are mutually exclusive (eg one applies to the exclusion of the other depending on your answer to item 18.1) will help franchisors identify which statement applies to which event so it is simpler to complete. For example if there is an option to renew or option or enforceable legal right to enter into a new agreement but no right to extend the agreement then they should include the wording above that relates to the current Item 18.4.