



Australian Government

Department of Jobs and Small Business

Parliamentary Joint Committee on
Corporations and Financial Services

***Inquiry into the operation and
effectiveness of the Franchising Code
of Conduct***

Amended—Submission of the
Department of Jobs and Small Business

4 May 2018

1. BACKGROUND INFORMATION

1.1. Outline of submission

- 1.1.1 The Australian Government Department of Jobs and Small Business (the Department) welcomes the opportunity to make a written submission to the inquiry of the Parliamentary Joint Committee on Corporations and Financial Services into the Operation and effectiveness of the Franchising Code of Conduct.
- 1.1.2 The focus of the Department's submission is to provide the Committee with an overview of the existing regulation and legal requirements applicable to the Committee's considerations as outlined in the inquiry's terms of reference (**Attachment A**). The submission also provides the Committee with information about the dispute resolution process prescribed by the *Franchising Code of Conduct* (Franchising Code).

1.2. The Australian franchising sector

- 1.2.1 Franchising is a common business model in Australia, with franchises present in almost all industries, including retail, food service and hospitality, domestic services, automotive, oil and petroleum, education, telecommunications, and fitness.
- 1.2.2 Franchises also come in a variety of different models, including bricks and mortar outlets, online businesses, home-based enterprises, and mobile businesses.
- 1.2.3 As a business model, franchising brings many benefits to both franchisees and franchisors. From a franchisee perspective, advantages of franchising over independent business models include use of a known brand with established goodwill; lower costs through group purchasing power; training and ongoing support from the franchisor; larger-scale advertising campaigns; and use of an established business model. The primary franchisor benefit is more rapid expansion and reach than would be obtained without a franchising model, resulting in increased revenue and brand profile. In addition, less investment is generally required by franchisors when looking to expand their business, as the bulk of start-up costs for new franchises are borne by the franchisee.
- 1.2.4 However, like all businesses, franchises also carry risks and downsides. For example, franchisees may find that they lack a certain degree of independence and be subject to franchisor decisions that they disagree with, while franchisors may find that the behaviour of certain franchisees is problematic and at times damaging to their brand.
- 1.2.5 The most recent statistics from the 2016 Franchising Australia report¹ show that there are approximately 1,120 business format franchises in Australia, with an estimated 79,000 individual franchise outlets (steady from the previous survey in 2014) employing over 470,000 Australians (an increase of 10,000 from the previous survey). Many of these franchises are small businesses, and approximately 4 per cent of small businesses in Australia are franchises.
- 1.2.6 These figures demonstrate that franchising contributes significantly to the Australian economy, including employing a large number of people. Accordingly, a successful

¹ The result of a biennial survey by Griffith University, sponsored by the Franchise Council of Australia.

franchise sector, where the business environment provides the best chance of success to franchises, is beneficial to the Australian economy and community as a whole.

1.3. Introduction to the legal environment

Australian Government regulation

- 1.3.1 The key items of Government regulation that apply to the conduct of franchising sector participants towards each other are:
- the Franchising Code; and
 - the *Australian Consumer Law* (ACL).
- 1.3.2 These regulations are complementary, with the ACL placing prohibitions on certain conduct when undertaking business in Australia (such as misleading behaviour) and the Franchising Code placing further specific conduct requirements on participants in the franchising industry.
- 1.3.3 In addition, the Oil Code of Conduct (Oil Code) applies instead of the Franchising Code to franchises operating in the fuel and petroleum industry (e.g. petrol stations) – see 2.3.2 for further discussion. The Oil Code is the responsibility of the Department of Environment and Energy. The Department understands that the Department of Environment and Energy will lodge its own submission concerning Oil Code matters. Therefore, this submission does not examine the Oil Code in detail.
- 1.3.4 In September 2017, the Government delivered on its election commitment to strengthen the *Fair Work Act 2009* to protect vulnerable workers. These changes included placing responsibilities on certain franchisors to take reasonable steps to ensure compliance with prescribed workplace laws within their franchise networks. Civil penalties apply for failing to meet these requirements, and courts have the option of ordering franchisors to pay underpaid employees in the network. A mechanism in the new laws has been included to enable franchisors to recover the underpayment amounts from the franchisees responsible for the underpayments.
- 1.3.5 These regulations do not constitute the extent of all laws applicable to the franchising sector. Various other state and Commonwealth Government regulations apply to the conduct of franchise business, including corporations law, taxation and workplace relations legislation. However, the above-mentioned regulations are considered the most relevant in relation to the matters identified in the inquiry's terms of reference.

Common law contract obligations

- 1.3.6 As franchise agreements are common law contracts, they are subject to common law contract rules and principles. Contract requirements that exist under common law that may be of relevance to this inquiry relate to matters such as:
- validity of restriction of trade clauses; and
 - the impact of pre-contract representations.
- 1.3.7 This submission does not go into the details of the applicable common law, but makes brief note of its requirements where relevant, to assist the Committee to assess the entirety of existing obligations on franchisees and franchisors.

1.4. The Department's responsibilities

- 1.4.1 In relation to the inquiry's terms of reference (see Attachment A), the Minister for Small and Family Business, the Workplace, and Deregulation has responsibility for the Franchising Code. The Department is responsible for the Franchising Code.²
- 1.4.2 The Department also manages the Contract for Provision of Dispute Resolution Services (the Dispute Resolution Contract). The Dispute Resolution Contract governs the performance of the Government-appointed role of the Franchising Mediation Adviser under the Franchising Code. The Dispute Resolution Contract also covers the provision of the services of the:
- Horticulture Mediation Adviser under the *Horticulture Code of Conduct* (Horticulture Code); and
 - Dispute Resolution Adviser under the Oil Code.
- 1.4.3 The Horticulture Code is the responsibility of the Department of Agriculture and Water Resources.
- 1.4.4 The Department manages the Dispute Resolution Contract in relation to these codes on behalf of the Department of Agriculture and Water Resources, and the Department of Environment and Energy.
- 1.4.5 The Mediation Adviser and Dispute Resolution Adviser roles form key parts of the dispute resolution processes of each of the above-named codes (see section 4 for further discussion in relation to the Franchising Code).

1.5. The Treasury's responsibilities

- 1.5.1 Treasury has responsibility for consumer and competition policy, which includes the contents of ACL.³ This legislation contains numerous provisions that apply to conducting trade and commerce in Australia in general, including in the franchising sector.
- 1.5.2 Certain parts of this legislation are directly relevant to the Committee's terms of reference (namely the unfair contract terms provisions),⁴ while others relate to behaviours that are not permitted when conducting business in Australia in general such as prohibitions on misleading conduct.

1.6. Sources of information and support for prospective franchisees

- 1.6.1. The Franchising Code includes requirements for disclosure of information to potential franchisees, and encourages obtaining professional legal, accounting and business advice when entering into, renewing or extending a franchise agreement. See discussion of the Franchising Code at Section 2 for more details.

² Relevant to terms a), b) and e) respectively.

³ That *Australian Consumer Law* forms Schedule 2 of the *Competition and Consumer Act 2010* (Cth).

⁴ Term c)

- 1.6.2. In addition to these sources of information, there are numerous other resources available to prospective franchisees to assist them in deciding whether to purchase a franchise, or renew an existing agreement. This includes small business courses and workshops; franchise-specific education and training;⁵ government small business advisory services; franchising information and guidance documents;⁶ and advice and information available from community members, including existing and past franchisees.

2. THE FRANCHISING CODE OF CONDUCT

2.1. History

- 2.1.1 A guide for the conduct of franchising sector participants was first introduced in Australia in February 1993, with the introduction of a voluntary industry code for the sector.
- 2.1.2 A mandatory franchising code of conduct was first introduced by the Government on 1 July 1998 (the 1998 Code), as a regulation under the then *Trade Practices Act 1974* (Cth) (the TPA).
- 2.1.3 The 1998 Code was replaced by the current Franchising Code on 1 January 2015, which was prescribed under section 51AE of the *Competition and Consumer Act 2010* (Cth) (the CCA).⁷ The new code was implemented after an extensive review of the 1998 Code by Mr Alan Wein in 2013. The new code built on the 1998 Code, to:
- update provisions to reflect changes in the franchising sector and modern regulatory drafting practices; and
 - give effect to the Government’s proposed franchising policy reforms set out in its *The Future of Franchising* statement, which built on Mr Wein’s report following his review.⁸
- 2.1.4 A detailed history of the major reviews and amendments of the Franchising Code and its predecessors is contained in **Attachment B**.

2.2. Aim and Purpose

- 2.2.1 Clause 2 of the Franchising Code sets out its purpose as being:

...to regulate the conduct of participants in franchising towards other participants in franchising.

- 2.2.2 The Explanatory Statement of the 1998 Code (which the current Franchising Code built on) further identifies that code’s purpose as being:

⁵ Such as that offered by FranchiseEd - see www.franchise-ed.org.au/online-courses/franchise-business-management-essentials-online-course/

⁶ Including material published by the Australian Competition and Consumer Commission – see <https://www.accc.gov.au/business/industry-codes/franchising-code-of-conduct>

⁷ In 2010 the CCA replaced the TPA, which was repealed in its entirety.

⁸ *Explanatory Statement, Selective Legislative Instrument No 168, 2014*

...to regulate the conduct of participants in franchising towards other participants in franchising, in particular to:

- address the imbalance of power between franchisors and franchisees;*
- raise the standards of conduct in the franchising sector without endangering the vitality and growth of franchising;*
- reduce the cost of resolving disputes in the sector, and*
- reduce risk and generate growth in the sector by increasing the level of certainty for all participants.*

2.2.3 Accordingly, the Franchise Code is designed to steer the behaviour of franchisors and franchisees to ensure franchisees aren't disadvantaged by imbalances in bargaining power in the franchise relationship, franchise business decisions are made in a fully-informed manner with adequate risk assessments, and ensuring the sector operates in a way that is mutually beneficial for all parties to a franchise.

2.3. Application

General application

2.3.1 The Franchising Code applies to all conduct occurring on or after 1 January 2015 in relation to a franchise agreement entered into on or after 1 October 1998.

Exclusions

Petrol-supplying franchises

2.3.2 Subclause 3(2)(a) of the Franchising Code provides that the code does not apply to franchise agreements to which another mandatory industry code that has been prescribed under section 51AE of the CCA applies. Of the existing mandatory industry codes, the Oil Code applies to the franchising sector.⁹

Various other exclusions

2.3.3 Subclause 3(2)(b) provides that the Franchising Code does not apply to franchise agreements where specific pre-existing supply relationships exist, while Subclause 3(4) provides that certain provisions do not apply to agreements entered into before 1 January 2015.

2.3.4 Franchise agreements originally entered into prior to 1 January 2015 will be covered by the entire Franchising Code if that agreement is renewed, transferred or varied in any way on or after 1 January 2015.

2.4. Key franchisee protections of the Franchising Code

Obligation to act in good faith

2.4.1 Clause 6(1) of the Franchising Code imposes an obligation on parties to a franchise to act in good faith towards each other, in relation to any matter arising under the franchise agreement or the Franchising Code. Clause 6(2) extends this obligation to any person

⁹ The Unit Pricing Code will also apply to some franchises that sell certain grocery products, but is not relevant for the purposes of this inquiry.

who proposes to become a party to a franchise agreement (for example, a franchisor looking to enter a new franchise agreement with a prospective franchisee) in relation to any dealings or disputes relating to a proposed franchise agreement, negotiations of a proposed agreement, or matters under the Franchising Code.

- 2.4.2 The Franchising Code prescribes that it is not possible for a franchise agreement to limit or exclude the obligation to act in good faith.¹⁰
- 2.4.3 Accordingly, franchisees and franchisors are required to act in good faith towards each other throughout the entire franchise relationship, including during the purchasing process (which would include representations about the proposed franchise's performance).
- 2.4.4 The Franchising Code does not contain a definition of what 'good faith' means, but states that it is 'within the meaning of the unwritten law'.¹¹ This refers to the common law precedents of what constitutes 'good faith'.
- 2.4.5 Under common law, good faith has been interpreted as requiring parties to exercise their powers and rights under a contract in a way that is reasonable, and not arbitrary. Conduct may be considered to not be in good faith if a party did not act honestly, or failed to have regard to the interests of the other party.
- 2.4.6 The Franchising Code recognises these principles by outlining that a court may consider the following when deciding whether conduct was in good faith:
- whether the parties acted honestly and not arbitrarily; and/or
 - if the parties cooperated to achieve the purposes of the agreement.¹²

A court can also take into account any other relevant matter when considering good faith.

Termination provisions¹³

- 2.4.7 Division 5 of the Franchising Code governs the termination of a franchise agreement where there has and has not been a breach of the agreement, and in special prescribed circumstances. This Division also provides franchisees with a cooling off period when entering into a new franchise agreement, but not when renewing/extending an existing agreement. These provisions are outlined below.
- 2.4.8 These provisions operate in addition to the extensive existing common law contract termination principles as to when a party has the right to terminate a contract (noting that termination is not necessarily permissible for any breach of a contract).

Franchisee cooling off period

- 2.4.9 Clause 26 provides franchisees purchasing a franchise (but not renewing/extending an existing agreement) with a cooling off period of seven days from entering a franchise agreement or making a payment under the agreement, whichever is earlier. This

¹⁰ Clauses 6(4) and (5)

¹¹ Clause 6(1).

¹² Clause 6(3).

¹³ Term e).

provides for termination by the franchisee for any reason, and for repayment of any monies paid by the franchisee (minus the franchisor's reasonable expenses if these have been set out in the franchise agreement).

Termination for breach by a franchisee

- 2.4.10 Clause 27 of the Franchising Code sets out how a franchisor may terminate a franchise agreement where there has been a breach by a franchisee. This clause provides franchisees protection from termination of their franchise agreements by their franchisors if a breach occurs that is able to be remedied in a reasonable timeframe.
- 2.4.11 What constitutes a breach of a franchise agreement will depend on the contents of the individual agreement itself. The contents of franchise agreements are a matter for negotiation between the franchisor and potential franchisee when buying the franchise, subject to applicable contract law (common law) of the agreement's jurisdiction, and the unfair contract term provisions of the ACL (if they apply to the agreement, see 3.3 below).
- 2.4.12 A franchise agreement may include clauses that require franchisees to comply with all applicable Australian laws (such as workplace relations and work health and safety requirements), meaning a contravention of these laws constitutes a breach of the franchise agreement.
- 2.4.13 Clause 27 provides that, before a franchisor may terminate a franchise agreement after a franchisee's breach, the franchisor must:
- provide the franchisee reasonable notice in writing that they propose to terminate the agreement due to the breach;
 - tell the franchisee what is required to be done to remedy the breach; and
 - allow the franchisee reasonable time to remedy the breach (Subclause 27(3) provides that the 'reasonable time' does not need to be more than 30 days).
- 2.4.14 If the franchisee rectifies the breach within the reasonable time frame, then the franchisor is unable to terminate the franchise agreement because of that breach.

Termination where there has been no breach by the franchisee

- 2.4.15 Clause 28 of the Franchising Code governs the manner in which a franchisor can terminate a franchise agreement before it expires, in circumstances where the franchisee has not breached the franchise agreement, and the franchisee does not consent to the agreement being terminated.
- 2.4.16 Clause 28 provides that a franchisor may terminate a franchise agreement in these circumstances, in accordance with the agreement, if they give reasonable written notice, and reasons for it, to the franchisee. However, termination in these circumstances is also governed by the general contract law of the jurisdiction applicable to the franchise agreement.

Termination in special circumstances

- 2.4.17 Clause 29 of the Franchising Code provides that a franchisor may terminate a franchise agreement, without needing to comply with Clause 27 or 28, where special circumstances exist and the franchise agreement gives the franchisor a right to terminate in that circumstance (i.e. the franchise agreement must prescribe this). These circumstances include where the franchisee has acted fraudulently, becomes bankrupt or insolvent, or is convicted of a serious offence.

Disclosure document¹⁴

- 2.4.18 Clause 8 of the Franchising Code requires franchisor to maintain a ‘disclosure statement’, that complies with specific requirements.
- 2.4.19 The purpose of the disclosure document is to provide information to prospective or existing franchisees to help the franchisee make a reasonably informed decision about a franchise, as well as provide the franchisee with information that is material to the running of a franchise. It also alerts potential franchisees to the need to conduct their own due diligence when considering purchasing a franchise, and is also useful for the prospective franchisee in undertaking a risk assessment about their potential franchisor (such as historical information about franchisor behaviour and solvency).
- 2.4.20 The Franchising Code requires the franchisor to supply the disclosure document to:
- prospective franchisees (at least 14 days before the franchisee enters into a franchise agreement or makes a non-refundable payment in connection to the franchisor in connection with the proposed franchise agreement); and
 - existing franchisees looking to renew or extend a franchise agreement (at least 14 days before renewal or extension).
- 2.4.21 The franchisor must also supply the disclosure document to a franchisee if the franchisee requests it in writing (no more than once every 12 months).¹⁵
- 2.4.22 Annexure 1 of the Franchising Code sets out the form and content requirements of the disclosure document. Content of that document includes an introductory statement containing general information about the binding nature of a franchise agreement, the cooling off period, and the desirability of conducting independent due diligence (including seeking professional advice, talking to other franchisees, and undertaking business training) prior to entering a franchise agreement.
- 2.4.23 The disclosure document is also required to include information about the following:
- The franchisor’s business experience.
 - Relevant legal (civil and criminal) proceedings and findings against the franchisor or its associates.
 - Territorial exclusivity of the franchisee (if any).
 - Details of current franchisees and a 3-year history of franchise closures, terminations and instances where a franchise agreement wasn’t renewed.
 - Supply of goods or services to the franchisee including whether they are any restrictions on sources of where the franchisee obtains these goods or services, obligations of the franchisee to accept the goods or services from the franchisor or its associate, conditions where these goods can be returned or a refund provided, and whether the franchisor or its associate will receive a rebate or other financial benefit from the supply of goods or services to the franchisee.
 - Details of how any marketing or other cooperative fund collected or administered by or for the franchisor is managed.

¹⁴ Term a)

¹⁵ Clause 16.

- Circumstances under which the franchisor has unilaterally varied a franchise agreement in the past three financial years, and when this may occur in the future.¹⁶
- Details of arrangements that are to apply at the end of a franchise agreement, including the franchisee's option to renew the agreement or extend its term, management of unsold stock, and the rights of the franchisee to sell the business.
- Details about the franchisor's solvency, and financial reports.

2.4.24 The disclosure document may also contain earnings information, in the form of either historical data for the concerned franchise business (if it is already in existence) or another franchise in the franchise system. If the data provided is for another franchise in the franchise system, the disclosure document is required to provide details of any difference between that franchise and the business the potential franchisee is considering purchasing. If the document contains projected earnings, it must disclose assumptions on which these are based. The disclosure document may also include and any other information from which historical or future earnings of the business can be assessed.

2.4.25 If earnings information is not included, then the disclosure document must include a statement that it is not provided, earnings may vary between franchises, and the franchisor cannot estimate earnings for that particular franchise.

Information statement¹⁷

2.4.26 Clause 11 of the Franchising Code requires franchisors to provide a copy of the code's Information Statement to prospective franchisees as soon as possible after the prospective franchisee formally applies for or expresses interest in a franchise. The text of the Information Statement is contained in Annexure 2 of the Franchising Code.

2.4.27 The Information Statement highlights key considerations that a prospective franchisee should consider when entering a franchise. It contains recommendations to conduct due diligence, including getting professional advice and making enquiries to ensure that buying a franchise is the right decision to make, and attending a franchising or general business course to improve relevant skills and knowledge. The Information Statement also outlines risk associated with entering a franchise.

Restraint of trade limitation¹⁸

2.4.28 Historically, many franchisee agreements have contained restraint of trade clauses that place contractual restrictions on franchisees that prohibit them from engaging in certain business activity once the franchise has ended. One of the most common restraints is to prohibit a franchisee from operating a business similar to the franchise within a certain timeframe after the end of the franchise agreement (e.g. a franchised café owner may be prohibited from opening a non-franchise café within the timeframe).

¹⁶ Noting a term of a franchise agreement that allow unilateral variation may be considered an unfair contract term and rendered void – see 3.3.

¹⁷ Term a)

¹⁸ Term f)

2.4.29 The validity of these clauses is guided by common law principles, with certain restriction of trade clauses not permissible for inclusion in contracts. In addition to these principles, the Franchising Code places restrictions on the operation of these clauses, by providing that a restraint of trade clause in a franchise agreement has no effect if the franchisor does not extend the existing franchise agreement and:

- the franchisee had given written notice to the franchisor that they wished to extend the franchise agreement on substantially the same terms as those contained in the franchisor's current franchise agreement and that apply to other franchisees or would apply to prospective franchisees;
- the franchisee had not breached the franchise agreement or infringed franchisor intellectual property; and
- either:
 - the franchisee claimed compensation for goodwill as the agreement was not extended but the goodwill provided was only nominal and did not provide genuine compensation; or
 - the franchise agreement did not allow the franchisee to claim compensation for goodwill in the event that the franchise was not extended.

2.4.30 These provisions protect franchisees from restraint of trade clauses that are designed to prevent competition by a former franchisee, where the former franchisee has contributed to the goodwill of the franchise (which the franchisor could take advantage of) without being properly compensated.

Franchisee advice before entering franchise agreement¹⁹

2.4.31 Clause 10 of the Franchising Code prohibits a franchisor from entering into a franchise agreement,²⁰ or accept a non-refundable payment under a franchisee unless the franchisee provides the franchisor with a statement that they have received, read and had a reasonable opportunity to understand the disclosure document and the Franchising Code (this applies equally to renewing or extending an existing agreement).

2.4.32 Clause 10 also provides that, before a franchise is entered into, a franchisor must have received from the prospective franchisee signed statements that they have been given advice about the proposed franchise agreement or franchise business by an independent:

- legal adviser;
- business adviser; or
- accountant.

2.4.33 Where one of all of the statements in the second dot point above are not provided, the franchisor may instead accept a signed statement that the franchisee has been told that kind of advice should be sought but has chosen not to seek it.

¹⁹ Term a)

²⁰ Or renew or transfer an franchise agreement; extend the term or scope of an franchise agreement, or enter into an agreement to enter, transfer or renew a franchise agreement; or accept a non-refundable payment under a franchise agreement or agreement to enter a franchise agreement.

3. RELEVANT OBLIGATIONS UNDER THE *AUSTRALIAN CONSUMER LAW (ACL)*

3.1. Background

- 3.1.1. Parties to a franchise agreement are also required to abide by the general provisions of the ACL, including prohibitions on misleading and deceptive conduct, unconscionable conduct, and unfair contract terms regulations.
- 3.1.2. The ACL sets out a nationally consistent law for fair trading and consumer protection. The ACL commenced on 1 January 2011 and is contained in Schedule 2 of the CCA.

3.2. Misleading and Deceptive Conduct, and Unconscionable Conduct

- 3.2.1. The ACL provides a mechanism to protect consumers and to stimulate competition by prohibiting misleading or deceptive conduct in trade or commerce, including false or misleading representations.
- 3.2.2. The ACL also provides that it is illegal to engage in unconscionable conduct (which is conduct against conscience, as judged against the norms of society) in trade or commerce, including when offering to supply a good or service in trade or commerce. Applying unreasonable sales pressure may be considered to be unconscionable in certain circumstances.
- 3.2.3. These obligations and protections apply equally to art, food, motor vehicles and practically any type of product sold in trade or commerce, other than financial products, which are dealt with under separate legislation (the *Australian Securities and Investments Commission Act 2001* (ASIC Act)).
- 3.2.4. The ACL allows these obligations to be enforced by providing:
 - ACL regulators (in the form of the Australian Competition and Consumer Commission (ACCC) and state and territory offices of fair trading) with enhanced capacities to investigate potential breaches of the ACL and to seek penalties from a court for breaches of the ACL; and
 - ‘any’ person with a right to seek an injunction from a court to stop a breach of the ACL and allowing persons who have suffered loss or damage from a breach of the ACL to recover the amount of that loss or damage from the person who breached the ACL.

3.3. Unfair contract terms

- 3.3.1. The ACL, and mirror consumer protection provisions of the ASIC Act, contain provisions to protect consumers from unfair contract terms. The ACL provides protections for contracts for goods and services, while the ASIC Act provides protections provide for contracts for financial services.

- 3.3.2. The unfair contract term protections apply to standard form consumer contracts. A standard form contract is typically a contract prepared by one party to the contract and not negotiated between the parties – it is offered on a ‘take it or leave it’ basis.
- 3.3.3. To be unfair, a term must:
- cause significant imbalance in the parties’ rights and obligations;
 - not be reasonably necessary to protect the legitimate interests of the party advantaged by the term; and
 - cause detriment (financial or otherwise) to a party if it were to be relied upon.
- 3.3.4. As part of its 2013 election commitment, the Government agreed to extend the unfair contract term protections to small business contracts. A small business contract is a contract entered into with a business that employs less than 20 people and has an upfront price that does not exceed \$300,000, or \$1,000,000 for contract with a duration of more than 12 months.
- 3.3.5. Findings from an extensive public consultation process in 2014 indicated that small businesses are vulnerable to the inclusion of unfair terms in standard form contracts. Like consumers, they can lack the time and legal or technical expertise to understand or critically analyse such contracts and the bargaining power to negotiate terms. Compared to larger businesses, small businesses often have a more limited capacity to manage certain risks.
- 3.3.6. The *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (which was passed through Parliament on 12 November 2015) legislated to:
- extend the consumer unfair contract term protection in the ASIC Act and the ACL to small business contracts that meet the prescribed criteria; and
 - make provision for exempting small business contracts that are subject to prescribed laws that are deemed equivalent to the unfair contract term protections in the ASIC Act or the ACL, and which are enforceable.
- 3.3.7. The extension of the unfair contract terms law to small business came into effect 12 November 2016 after a 12 month transition period.
- 3.3.8. The protections allow a court to declare a term of a standard form consumer contract to be unfair. Once a term is declared to be unfair, it will be void. However, the remainder of the contract will continue to apply without the void term.
- 3.3.9. There are some terms that are not covered by the protections, including those terms that go to the main subject matter of the contract, the upfront price payable and terms that are required by other laws.
- 3.3.10. A small business contract that is covered by an industry code prescribed under the CCA, such as the Franchising Code, is also subject to the unfair contract terms law. However, if a contract term is required or expressly permitted by that code, the unfair contract term provisions do not apply to that particular term.

4. DISPUTE RESOLUTION

4.1. Franchising Code dispute resolution system²¹

- 4.1.1 During the course of operation of a franchise agreement, the parties may find themselves in dispute with each other over various matters. This can range from alleged breaches of the franchise agreement, to claimed breaches of the Franchising Code or other laws (e.g. alleged misleading conduct).
- 4.1.2 It is open for parties to take legal action to try to resolve these matters. However, Part 4 of the Franchising Code contains provisions that establish an informal dispute resolution process which aims to facilitate resolution of franchise-related disputes before resorting to formal legal action. This process is able to be used for any dispute that arises in relation to a franchise agreement, which includes breaches of the Franchising Code, franchise agreement, or provisions of the ACL. It is not mandatory to use this dispute resolution process (e.g. parties may instead chose to go straight to legal action), but if one party initiates the process, it places an obligation on the other party to engage in the process.
- 4.1.3 The Franchising Code provides for both internal dispute resolution (using the franchisor's established system) and code-based dispute resolution procedures. Clause 35 of the Franchising Code provides that parties to a dispute may begin action to resolve the dispute either under the franchise agreement's internal procedures, or the Franchising Code's procedures. This provides options for parties to decide how they wish to handle their disputes, including adding additional steps and aspects that are not present in the Franchising Code's provisions.
- 4.1.4 If these dispute resolution processes are used to try and resolve a matter, the Franchising Code provides that this does not affect the disputing parties' rights to bring legal proceedings.²²

Internal dispute resolution

- 4.1.5 Clause 34 of the Franchising Code provides that all franchise agreements must contain an internal complaint handling procedure, and this must comply with the minimum requirements set out in Division 4 of Part 4. These minimum requirements are set about below (in consecutive order).
1. Notification of a dispute – the complaining party must notify the respondent in writing of the dispute's nature, the outcome they would like and the action they believe will resolve the dispute.
 2. Mutual negotiation - following the written notification, the parties should attempt to resolve the dispute between themselves, through communication and negotiation.
 3. Mediation - if the parties cannot reach an agreement on the matter within three weeks of the written notification, either party is able to refer the matter to mediation, either under the franchise agreement's internal procedures (which may do things such as nominate a certain mediator) or the Franchising Code's procedures.

²¹ Term b)

²² Clause 37.

- 4.1.6 If the parties refer the matter to mediation, they may decide which mediator they would like to use (or this may already be nominated in the franchise agreement if they chose to use this procedure). The Franchising Mediation Adviser is required by the Dispute Resolution Contract to maintain a list of appropriate mediators on their website (the parties may choose from this list, or select a different mediator).²³
- 4.1.7 If the parties are unable to agree on a mediator, they may ask the Franchising Mediation Adviser to appoint a suitable mediator.

Franchising Code dispute resolution process

- 4.1.8 The Franchising Code's dispute resolution procedure is set out in Division 3 of Part 4, and adopts the same minimum requirements as those required by the internal complaint handling procedure outlined above. However, this procedure includes further provisions in relation to the termination and cost of mediation. The parties are equally liable for the costs of mediation, unless they agree otherwise, and that they must pay their own costs of attending the mediation.

Mediation – general information

- 4.1.9 Mediation is an alternative dispute resolution process, where an independent mediator assists parties in dispute to identify the key issues, develop options, consider alternatives and try to reach an agreement to resolve the matter. In mediation, the focus is on the interests of the parties, resolving the dispute, and avoiding potentially expensive and lengthy legal proceedings.
- 4.1.10 The outcome of a successful mediation is an agreement by the parties on how to resolve the dispute, which may include matters such as a required change of behaviour by one or both of the parties, a payment of funds to compensate for the issue, or variations to the franchise agreement. As mediation is focussed on reaching an agreement that the parties agree is sufficient to settle the matter, the outcome may be somewhat different to what may have been found by a court if the matter had proceeded to litigation.
- 4.1.11 Divisions 2 and 3 of Part 4 (internal and Franchising Code dispute resolution processes) outline requirements for mediation under these processes. Requirements include that the mediator may decide on the time and place of the mediation, the mediation must be conducted in Australia, the parties must attend the mediation, and must try and resolve the dispute through the mediation. Clause 36 provides that a party will be taken to be trying to resolve a dispute if the party approaches resolution of the dispute in a reconciliatory manner.

Dispute resolution and mediation through other independent parties

- 4.1.12 Despite the existence of the Franchising Code dispute resolution system, the Department has been informed of parties approaching other dispute resolution facilitators to try and resolve franchising disputes (primarily, state-based Small Business Commissioners and the Australian Small Business and Family Enterprise Ombudsman). Depending on the practices of these agencies, they may be referring the complainant

²³ The list of appropriate mediators maintained by the Franchising Mediation Adviser is located at <https://franchisingcode.com.au/list-of-mediators/>

party to the Franchising Mediation Adviser and the Franchising Code's procedures, or they may be providing assistance directly to the parties such as through facilitated negotiation and mediation.

- 4.1.13 The Department supports this dispute resolution assistance by other agencies, as the ultimate aim is prompt and effective resolution of the dispute, which these bodies are equipped to facilitate.

Use and effectiveness of Franchising Code dispute resolution system

- 4.1.14 Under the Dispute Resolution Contract, the Department is provided statistics by the Franchising Mediation Adviser of the dispute activity undertaken by the Adviser. Due to the nature of the dispute resolution system set up by the Franchising Code, and the involvement of other agencies in assisting with franchising disputes, these statistics do not form a full data set to show the number or resolution rate of franchising disputes. This is due to the fact that there may be a significant amount of disputes resolved through:

- mutual negotiation; or
- mediation without the assistance of the Franchising Mediation Adviser (either by the parties directly or with the assistance of another agency).

- 4.1.15 However, the available Franchising Mediation Adviser statistics provide an indication of the nature of disputes raised with the Franchising Mediation Adviser, and effectiveness of mediations conducted.

Requests for mediation

- 4.1.16 During calendar year 2017, the Franchise Mediation Adviser received 286 requests to appoint a mediator. These requests related to various types of franchising disputes, as outlined in Table 1 below (noting that many requests for mediation covered more than one issue).

Disputed issue (alleged)	Percentage of mediation requests
Breach of franchise agreement	22%
Breach of obligation to act in good faith	18%
Disclosure/misrepresentation	10%
Support/franchise systems	9%
Compliance with franchise operations manual	7%
Unilateral contract variation	6%
Exiting the franchise	5%
Other	5%
Monies owed <u>by</u> franchisor	4%
Monies owed <u>to</u> franchisor	4%
Renewal/termination of a franchise	4%
Management of marketing funds	3%
Territory disputes (e.g. exclusivity)	2%
Significant capital expenditure	1%
Total	100%

*Table 1: Nature of disputes requesting mediation from the Franchising Mediation Adviser
1 January 2017 – 30 December 2017*

4.1.17 Table 1 demonstrates that the top three disputed issues raised with the Franchising Mediation Adviser are for alleged breaches of the franchise agreement, the obligation under the Franchising Code to act in good faith, and alleged issues with disclosure and misrepresentation.²⁴

Initiators of mediation

4.1.18 Table 2 below demonstrates the break-down of which parties to franchise agreements requested the Franchising Mediation Adviser appoint a mediator during calendar year 2017.

Requesting party	Percentage of mediation requests
Franchisee (including master franchisees)	71%
Franchisor	29%
Total	100%

*Table 2: Nature of disputes requesting mediation from the Franchising Mediation Adviser
1 January 2017 – 30 December 2017*

Outcomes of mediation

4.1.19 During calendar year 2017, the Franchising Mediation Adviser was advised of the outcome of 180 mediations by the appointed mediators. These reports indicated whether the mediation went ahead,²⁵ and whether mediations that occurred were successful (i.e. an agreement was reached at mediation).²⁶

²⁴ This includes to alleged misleading and deceptive conduct under the *Australian Consumer Law*.

²⁵ Some disputes can be resolved prior to the mediator occurring, or parties can withdraw from the mediation prior to commencement.

²⁶ The specifics of what is agreed at successful mediations is confidential and not reported on by the mediators.

4.1.20 Of these 180 reports, 149 mediations went ahead (31 did not commence). Table 3 below reports on the success rates of these 149 mediations.

Outcome	Percentage of mediation requests
Successful (agreement/settlement reached)	80%
Unsuccessful (settlement/agreement not reached)	20%
Total	100%

*Table 3: Outcomes of conducted mediations on referral from Franchising Mediation Adviser
1 January 2017 – 30 December 2017*

4.1.21 Table 3 demonstrates that, where mediations were conducted following a request for the Franchising Mediation Adviser to appoint a mediator, a significant majority of the disputes (80%) resulted in a mutually agreed outcome at mediation. This is consistent with general observations that mediation has a high success rate as a dispute resolution method, and mediation is generally a successful mechanism for resolving disputes in the franchising sector.

4.2 Formal legal action (litigation)

- 4.2.1 Where one party considers that a breach of the Franchising Code, ACL or franchise agreement has occurred in relation to a franchise, the aggrieved party may take formal legal action against the other party to seek a legal remedy.
- 4.2.2 The procedures for litigation are complex, and governed by court rules and rules of evidence. Legal action can often be complex, time consuming, and costly to the parties.

5. GOVERNMENT ENFORCEMENT

- 5.1 The ACCC is an independent statutory body that administers the CCA, under which the Franchising Code and Oil Code are prescribed. The ACCC regulates industry codes prescribed under the Act and provides guidance to industries about their rights and responsibilities under the Act more broadly.
- 5.2 The ACCC's Compliance Policy sets out the principles the ACCC adopts to achieve compliance with the Act, and outlines its compliance and enforcement functions, strategies and tools.
- 5.3 Ensuring small business receives the protections of industry codes and the unfair contract terms law, with a focus on Franchising Code of Conduct issues involving large or national franchisors is a priority under the ACCC's 2018 Compliance and Enforcement Policy.
- 5.4 The ACCC uses a range of compliance tools to prevent breaches of the Act, including business and consumer education, and working closely with stakeholders and other agencies. The Act also provides the ACCC with a range of enforcement remedies to address contraventions of the Act, including court-based outcomes and court enforceable undertakings.
- 5.5 Financial penalties and infringement notices are available for certain provisions of the Franchising Code. For example, to act in good faith, attend mediation and provide reasonable written notice of proposed termination for breach. Failure to comply with a penalty provision could result in the ACCC taking court action seeking a financial penalty, or

issuing an infringement notice for the breach. Financial penalties and infringement notices are not available for the Oil Code.

ATTACHMENT A

TERMS OF REFERENCE

INQUIRY INTO THE OPERATION AND EFFECTIVENESS OF THE FRANCHISING CODE OF CONDUCT

The following matters were referred to the Parliamentary Joint Committee on Corporations and Financial Services for inquiry and report by 30 September 2018:

(a) the operation and effectiveness of the Franchising Code of Conduct, including the disclosure document and information statement, and the Oil Code of Conduct, in ensuring full disclosure to potential franchisees of all information necessary to make a fully-informed decision when assessing whether to enter a franchise agreement, including information on:

- (i) likely financial performance of a franchise and worse-case scenarios,
- (ii) the contractual rights and obligations of all parties, including termination rights and geographical exclusivity,
- (iii) the leasing arrangements and any limitations of the franchisee's ability to enforce tenants' rights, and
- (iv) the expected running costs, including cost of goods required to be purchased through prescribed suppliers;

(b) the effectiveness of dispute resolution under the Franchising Code of Conduct and the Oil Code of Conduct;

(c) the impact of the Australian consumer law unfair contract provisions on new, renewed and terminated franchise agreements entered into since 12 November 2016, including whether changes to standard franchise agreements have resulted;

(d) whether the provisions of other mandatory industry codes of conduct, such as the Oil Code, contain advantages or disadvantages relevant to franchising relationships in comparison with terms of the Franchising Code of Conduct;

(e) the adequacy and operation of termination provisions in the Franchising Code of Conduct and the Oil Code of Conduct;

(f) the imposition of restraints of trade on former franchisees following the termination of a franchise agreement;

(g) the enforcement of breaches of the Franchising Code of Conduct and the Oil Code of Conduct and other applicable laws, such as the CCA, and franchisors; and

(h) any related matter.

ATTACHMENT B

HISTORY OF THE FRANCHISING CODE

Date	Action
1991	The Government established the Franchising Task Force to examine the franchising industry.
1 February 1993	As a result of the Task Force's findings, a Voluntary Franchising Code of Practice (Voluntary Code) for the franchising sector is introduced for a two-year trial period. This is administered by the then Franchising Code Administration Council.
1994	The Voluntary Code was reviewed by Mr Robert Gardini, directed by the then Minister for Small Business, Customs and Construction. This review responded to complaints by franchise industry participants about lack of effectiveness. The Gardini report indicated that the voluntary code had not achieved sufficient coverage of the sector and that a mandatory code may be appropriate.
December 1996	Franchising Code Administration Council ceased operations.
26 June 1996	The House of Representatives Standing Committee on Industry, Science and Technology commenced an inquiry into fair trading. This extended to franchising matters.
26 May 1997	The Committee's <i>Finding a Balance</i> report was published. The report called for Commonwealth regulation specifically targeting franchising conduct (a code of practice).
September 1997	The <i>New Deal. Fair Deal</i> reform package for small business was released by the Government. This package included a commitment to introduce a mandatory Franchising Code of Conduct underpinned by legislation (the then <i>Trade Practices Act 1974 (TPA)</i>).
22 April 1998	Reforms to the TPA were implemented to allow for prescription of mandatory industry codes.
1 July 1998	The <i>Trade Practices (Industry Codes – Franchising) Regulations 1998 No. 162</i> commenced. This introduced the first mandatory franchising industry code of conduct (the 1998 Code). This code included provisions concerning disclosure, conditions of franchise agreements, and franchise dispute resolution.
28 June 2006	A review chaired by Mr Graeme Matthews commenced into the disclosure provisions of the 1998 Code. This review was directed by the then Minister for Small Business and Tourism.
31 October 2006	The Matthews' review report was provided to the Minister for Small Business and Tourism.
1 March 2008	The 1998 Code was amended in response to the Matthews review. This included changes to the disclosure document, required a copy of the code to be provided alongside the disclosure document, and provided for franchisors to charge franchisees for reasonable expenses where a franchise is terminated during the cooling off period.
25 June 2008	The Parliamentary Joint Committee on Corporations and Financial

	Services commenced an inquiry into the operation of the Franchising Code and other matters.
1 December 2008	The Committee on Corporations and Financial Services provided its report (<i>Opportunity not opportunism: improving conduct in Australian franchising</i>) to Government.
27 November 2009	The then Department of Industry, Science and Research and the Treasury convened an expert panel to examine strengthening statutory unconscionable conduct and the 1998 Code.
February 2010	The Panel delivered its findings to Government, <i>Strengthening Statutory Unconscionable Conduct and the Franchising Code of Conduct</i> .
1 July 2010	Amendments commenced to the 1998 Code in response to the expert panel and Parliamentary Joint Committee on Corporations and Financial Services' findings. The amendments sought to increase franchisor disclosure on a number of different matters and to establish guidance to franchisees and franchisors on the conduct expected of them during dispute resolution processes.
4 January 2013	An independent review into franchising matters was commenced, headed by Mr Alan Wein. The review focused on the 2008 and 2010 amendments to the Code, good faith in franchising, the rights of franchisees at the end of the term of their franchise agreements; and provisions for enforcement of the Code.
30 April 2013	The report from Mr Wein's review of the Franchising Code of Conduct was presented to Government.
1 January 2015	The previous code was replaced by the current Franchising Code, the <i>Competition and Consumer (Industry Codes—Franchising) Regulation 2014</i> . This incorporated recommendations from the Wein Review and the Government's 2014 <i>Future of Franchising</i> statement.