

## **Executive summary**

The Parliamentary Joint Committee on Corporations and Financial Services inquired into the operation of Australia's Franchising Code of Conduct (the Code) with a view to identifying justifiable improvements to the Code. The committee has made eleven recommendations which are consistent with its overall aim of raising the standard of conduct in Australian franchising.

### **The nature of franchising**

Franchising is an ongoing relationship between two separate commercial parties, a franchisor and a franchisee. The franchising relationship is based on a prescribed business model which is offered by the franchisor and carried out under their guidance and oversight by franchise owners (franchisees). The nature of franchising dictates that each party's obligations are ongoing and variable, forming an interdependent contract that is fundamentally based on an ongoing relationship.

Contracts of this nature underpinning the franchising relationship can impair the viability and success of individual franchise agreements for the following reasons:

- differing expectations about the obligations of each party to the agreement; and
- an asymmetric power dynamic within franchise agreements, with potential to lead to abuse of power.

### **Pre-contractual arrangements**

The time during which a prospective franchisee is considering entering into a franchise agreement represents the best opportunity for both franchisee and franchisor to make an accurate and informed assessment about whether this is the right agreement for them. Undertaking unbiased pre-agreement education is important, but even more critical is obtaining sound legal and business advice before entering into a franchise agreement.

The franchisor disclosure process mandated in the Code is intended to assist, not replace, due diligence by prospective franchisees. Better disclosure does not necessarily mean more disclosure; disclosure documentation should be in line with Code requirements and should focus on the provision of information which is difficult and/or expensive for the franchisee to obtain through other means.

### **Recommendation 1** (paragraph 4.80)

**The committee recommends that the Franchising Code of Conduct be amended to require that disclosure documents include a clear statement by franchisors of the liabilities and consequences applying to franchisees in the event of franchisor failure.**

This amendment would ensure that, before franchisees agree to enter into a franchise agreement, they are aware of their liabilities in the event of franchisor failure.

**Recommendation 2** (paragraph 4.91)

**The committee recommends that the government investigate the benefits of developing a simple online registration system for Australian franchisors, requiring them on an annual basis to lodge a statement confirming the nature and extent of their franchising network and providing a guarantee that they are meeting their obligations under the Franchising Code of Conduct and the *Trade Practices Act 1974*.**

A system of this nature would generate an annual guarantee from franchisors that they are meeting their obligations under the Code. It would also mean that, for the first time, a central government agency would have useful data on how many franchises are operating in Australia.

**Recommendation 3** (paragraph 4.101)

**The committee recommends that the government review the efficacy of the 1 March 2008 amendments to the disclosure provisions of the Franchising Code of Conduct within two years of them taking effect.**

Some of the concerns about the disclosure process raised with the committee during its inquiry should be mitigated by the 1 March 2008 amendments if they function as intended. It is too soon for the committee to judge their efficacy at this stage.

### **Issues arising during franchise agreements**

Although many franchise agreements result in successful and profitable ongoing business relationships, issues arising during the term of the agreement can cause tensions with the potential to escalate into disputes.

There are substantial practical difficulties in trying to regulate specific elements of conduct in a franchise agreement. A useful regulatory alternative would be the introduction into the Code of an overarching standard of conduct in franchising.

### **The end of a franchise agreement**

Franchise agreements can end in early termination or through expiry and non-renewal of an agreement. Key concerns relating to end of term arrangements raised during the inquiry included:

- non-renewal of franchise agreements at the expiration of the first term, including whether there should be a right to automatic renewal or whether non-renewal by a franchisor should only be permitted where 'good cause' can be shown;
- the circumstances in which a franchisor should be able to terminate an agreement, including potential abuses of current termination provisions within the Code;

- whether a payment for the franchisee's contributed value to the business should be mandated if the agreement is terminated or not renewed for whatever reason;
- what happens when a franchisor fails;
- property rights; and
- transferability of equity in the value of the business as a going concern.

**Recommendation 4** (paragraph 6.40)

**The committee recommends that the government explore avenues to better balance the rights and liabilities of franchisees and franchisors in the event of franchisor failure.**

Although the Code gives franchisors the ability to terminate franchisees, it does not provide reciprocal termination provisions for franchisees. In the event of franchisor failure, this can have serious consequences for franchisees who have no avenue to exit the business.

**Recommendation 5** (paragraph 6.91)

**The committee recommends that the Franchising Code of Conduct be amended to require franchisors to disclose to franchisees, before a franchising agreement is entered into, what process will apply in determining end of term arrangements. That process should give due regard to the potential transferability of equity in the value of the business as a going concern.**

Franchisee expectations about renewal need to be better managed, and the financial implications of non-renewal better understood, before fixed term franchise agreements are initially signed. Franchise agreements should clearly stipulate what the end of term arrangements and processes are, and these arrangements should be fully and transparently disclosed to prospective franchisees.

**Dispute resolution in franchising**

Due to a lack of sound data, the true extent of disputation in the franchising sector is difficult to determine. When disputes do occur and cannot be resolved through internal processes, parties may choose to enter into formal mediation. If mediation fails, litigation is an alternative (but generally expensive) avenue for pursuing settlement.

Suggestions for improving dispute resolution outcomes included: an increased focus on pre-mediation strategies; the creation of a tribunal to make determinations; or the introduction of a franchising ombudsman. But inserting another layer into the resolution process between mediation and the courts would most likely add another layer of complexity and expense to the process without achieving materially improved outcomes. Instead, many of the issues which lead to franchising disputes, and hence the need for mediation or alternative dispute resolution mechanisms, may be mitigated

by the introduction of an explicit obligation into the Code for all parties to a franchise agreement to act in good faith.

**Recommendation 6** (paragraph 7.22)

**The committee recommends that the name of the Office of the Mediation Adviser be changed to the Office of the Franchising Mediation Adviser and that the Franchising Code of Conduct be amended to reflect this change.**

This name change will aid understanding and recognition within the sector of the role this office plays in dispute resolution in franchising.

**Recommendation 7** (paragraph 7.28)

**The committee recommends that the government require the Australian Bureau of Statistics to develop mechanisms for collecting and publishing relevant statistics on the franchising sector.**

Improved collection of statistics on franchising in Australia, with a focus on disputes and dispute-related unit franchise turnover, will help in developing a better understanding of how extensive disputation truly is.

**Good faith in franchising**

There remains concern in the sector at the continuing absence of an explicit overarching standard of conduct for parties entering a franchise agreement. The interdependent nature of the franchise contract leaves the parties to the agreement vulnerable to opportunistic conduct. The committee is of the opinion that the optimal way to provide a deterrent against opportunistic conduct in the franchising sector is to explicitly incorporate, in its simplest form, the existing and widely accepted implied duty of parties to a franchise agreement to act in good faith.

**Recommendation 8** (paragraph 8.60)

**The committee recommends that the following new clause be inserted into the Franchising Code of Conduct:**

**6 Standard of Conduct**

**Franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.**

**Enforcement of the Code**

Many franchisees made submissions to the inquiry outlining perceived inaction by, and ineffectiveness of, the Australian Competition & Consumer Commission (ACCC) in pursuing complaints against franchisors who are alleged to be in breach of the Code.

The ACCC is responsible for administration of the *Trade Practices Act 1974* (TPA), and its role extends to litigating in circumstances where it can substantiate evidence

that the TPA, including the Code, has been breached. The ACCC is not, however, responsible for prosecuting franchising disputes that relate to contractual disputes. Increased education efforts by the ACCC about its role would assist in bridging the expectation gap that seems to exist amongst franchisees. Notwithstanding the limitations of the ACCC's role, there also appears on the face of it to be room for improvement by the regulator in taking a more active role in the franchising sector.

**Recommendation 9** (paragraph 9.35)

**The committee recommends that the *Trade Practices Act 1974* be amended to include pecuniary penalties for breaches of the Franchising Code of Conduct.**

The introduction of these penalties would assist the ACCC in its enforcement role by providing a greater deterrent for conduct that contravenes the Code.

**Recommendation 10** (paragraph 9.37)

**The committee recommends that consideration be given to amending the *Trade Practices Act 1974* to provide for pecuniary penalties in relation to breaches of section 51AC, section 52, and the other mandatory industry codes under section 51AD.**

Similar penalties may be of assistance in improving conduct beyond franchising.

**Recommendation 11** (paragraph 9.39)

**The committee recommends that the ACCC be given the power to investigate when it receives credible information indicating that a party to a franchising agreement, or agreements, may be engaging in conduct contrary to their obligations under the Franchising Code of Conduct.<sup>1</sup>**

This provision would assist the ACCC in taking investigative action in cases when franchisees fear retribution if they provide information directly to the regulator.

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1 The committee notes that the ACCC described this power as 'being able to undertake risk based audits' and went on to clarify that this would entail examination of disclosure documents and other material being circulated by a franchisor, as well as speaking with franchisees to discern any pattern of conduct. See Mr Brian Cassidy, ACCC, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 99