

Chapter 1

Introduction

Terms of reference

1.1 On 25 June 2008 the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into the operation of the Franchising Code of Conduct (the Code) and related matters. The terms of reference for the inquiry were:

The Committee is to inquire and report on the operation of the Franchising Code of Conduct, and to identify, where justified, improvements to the Code, with particular reference to:

1. the nature of the franchising industry, including the rights of both franchisors and franchisees;
2. whether an obligation for franchisors, franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code (having regard to its presence as an element in paragraph 51AC(4)(k) of the *Trade Practices Act 1974*);
3. interaction between the Code and Part IVA and Part V Division 1 of the *Trade Practices Act 1974*, particularly with regard to the obligations in section 51AC of the Act;
4. the operation of the dispute resolution provisions under Part 4 of the Code; and
5. any other related matters.

Relevant regulation and legislation

1.2 The Franchising Code of Conduct is a mandatory industry code established under section 51AE of the *Trade Practices Act 1974* and enforceable under section 51AD. The code and related information are at <http://www.accc.gov.au/content/index.phtml/itemId/815503>

1.3 The *Trade Practices Act 1974* can be accessed at <http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/current/bytitle/FE54557126EA18EFCA257487000B9A3E?OpenDocument&mostrecent=1>

Conduct of the inquiry

1.4 The inquiry was advertised in *The Australian* newspaper and through the internet. The committee invited submissions from a wide range of interested organisations, government departments and authorities, and individuals. The closing date for submissions was 12 September 2008, and the committee agreed to table its report on 1 December 2008.

1.5 The committee investigated deficiencies in the operation of the Franchising Code of Conduct and related legislation, and ways in which they might be improved. The focus of the committee's inquiry was on addressing broad structural, procedural and regulatory issues relating to franchise agreements in Australia, rather than on any particular franchising disputes. As such, the committee decided that it would not publish the details of individuals or corporations adversely commented on in submissions. Material deemed to have fallen within this category was deleted by the committee, and the amended version of submissions was made public on the inquiry webpage.¹

1.6 The committee received 159 formal submissions and nine supplementary submissions, as well as associated correspondence and supporting material. A list of individuals and organisations that made public submissions to the inquiry is at Appendix 1.

1.7 The committee held four public hearings, in Sydney, Brisbane, Canberra and Melbourne. A list of witnesses who gave evidence at the public hearings is at Appendix 2.

Acknowledgement

1.8 The committee thanks those organisations and individuals that made written submissions and gave evidence at the public hearings.

Note on references

1.9 References to submissions in this report are to individual submissions as received by the committee and published on the Internet. References to the committee Hansard are to the proof Hansard, and page numbers may vary between the proof and the official Hansard transcripts.

Report structure

1.10 Chapter 2 describes the franchise business model, explaining the nature of the variable contracts that necessarily underpin a successful franchise agreement. The chapter highlights the potential benefits for both franchisee and franchisor from entering into such a business arrangement. It also acknowledges the potential for disputation to arise between the parties, either as a result of differing expectations or as a consequence of the power imbalance inherent in the relationship.

1.11 Chapter 3 opens with a statistical snapshot of franchising in Australia, followed by a description of the current regulatory framework that applies to the sector. A brief history of the development of the Franchising Code of Conduct and of previous inquiries into franchising in Australia reveals that many of the issues raised

¹ http://www.aph.gov.au/senate/committee/corporations_ctte/franchising/submissions/sublist.htm

during the committee's current inquiry have also featured prominently in past deliberations.

1.12 Chapter 4 briefly discusses coverage of the Code and then focuses on pre-contractual arrangements that precede, or should precede, a decision by a franchisee and franchisor to enter into a franchise agreement. In particular, it emphasises the importance of engaging in pre-contractual education; obtaining appropriate legal, accounting and other business advice; and conducting due diligence. It also canvasses a range of factors that can influence the utility of the pre-contractual disclosure process mandated in the Code. In this chapter, the committee recommends that the Code be amended to include a statement in disclosure documents that sets out the specific consequences for a franchisee in the event of franchisor failure. The committee also recommends that the government investigate the benefits of establishing a simple online franchisor registration system, requiring a franchisor to guarantee on an annual basis that they are meeting their obligations under the Code. The committee further recommends that the government reviews the impacts of the March 2008 amendments to the disclosure provisions in the Code after they have been in effect for two years.

1.13 Chapter 5 highlights a selection of issues which were drawn to the committee's attention as having the potential to influence the smooth running of a franchise agreement, including unilateral variations to agreements; requirements to comply with operations manuals; opportunism; restraint of trade clauses; confidentiality clauses; and the use of advertising or other collective funds. The issues raised are indicative of tensions that may lead a franchisee and franchisor into dispute (Chapter 7), termination or non-renewal (Chapter 6), or litigation (discussed in Chapter 9). This chapter also foreshadows the need for an overarching standard of conduct in franchising, which is discussed in detail in Chapter 8.

1.14 Chapter 6 outlines the circumstances in which franchise agreements can end, be it through early termination or through expiry and non-renewal of an agreement. Many submissions and witnesses to the inquiry expressed concerns regarding lack of clarity and/or lack of fairness in relation to the ends of agreements, and this chapter summarises those concerns. In particular, it addresses whether existing arrangements for non-renewal are sufficient, explores the notion of goodwill in franchising, and canvasses whether franchisees should have any right to an exit entitlement that recognises the contribution they have made to building the reputation and success of the franchise. In this chapter, the committee recommends that the government explore avenues for better balancing the rights and liabilities of franchisees and franchisors in the event of franchisor failure. The committee also recommends that the Code 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.

1.15 Chapter 7 recognises the need for a dispute resolution process in franchising and sets out the mediation provisions currently in the Code. Building on discussions in Chapter 3, the committee makes recommendations regarding a change to the name of

the Office of the Mediation Adviser and the need for better statistics collection in relation to franchising. The chapter presents views on the effectiveness of current mediation arrangements and some suggestions for improvements. It also points to the impact codification of good faith (discussed in Chapter 8) might have on franchising disputation.

1.16 Chapter 8 examines the need to introduce an overarching standard of conduct into the Code. It summarises arguments presented to the committee for and against the inclusion in the Code of an explicit obligation on all franchisors, franchisees and prospective franchisees to act in good faith. It also canvasses whether or not 'good faith' should be defined. In this chapter, the committee recommends that a new clause be put into the Code to specify that franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.

1.17 Finally, Chapter 9 sets out the enforcement framework applicable to the Code and notes the investigative and enforcement role of the Australian Competition & Consumer Commission (ACCC). It identifies barriers to effective enforcement, including the level of ACCC activity, and presents some suggestions for improving enforcement tools. In this chapter, the committee recommends the introduction of pecuniary penalties for breaches of the Code and, potentially, other relevant parts of the *Trade Practices Act 1974*. The committee also recommends that the ACCC be given powers to investigate where it has reason to believe that a party to a franchise agreement is acting contrary to the Code.

Privilege issue

1.18 During the course of the inquiry, a matter of parliamentary privilege arose. A person who had made a submission to the inquiry drew the committee's attention to a letter in which they were threatened with a penalty as a direct result of making that submission.

1.19 The committee considered this to be a serious incident and took immediate action to address the matter, as detailed in Appendix 3.