

Chapter 3

Franchising in Australia

The Australian franchising sector

3.1 Although the franchising model has become increasingly popular in Australia, the absence of an official register of franchisors makes it difficult to glean highly accurate statistical information on the franchising sector. The limited available data on the franchising sector is primarily derived from willing respondents to industry surveys, meaning that estimating trends and patterns across the entire sector can be problematic. Another factor that needs to be considered is that the results from these surveys are composed only from information provided by franchisors, which can potentially skew the results on contentious issues, such as disputes.

3.2 The Australian Competition & Consumer Commission (ACCC) commented that the shortage of statistical data on franchising 'contrasts with the level of information available about general business demography in Australia', noting that more comprehensive data would improve the effectiveness of its enforcement role and allow for a more informed debate about the sector. The ACCC recommended that:

The committee consider the targeted collection and publication of information about the franchising sector to assist the ACCC, other government agencies, franchisees and prospective franchisees to better understand franchising.¹

3.3 Presently, the Australian Bureau of Statistics (ABS) collects only limited data on franchising in Australia through its survey on business characteristics. The information collected is restricted to the proportion of businesses surveyed that identify as being involved in franchising as either a franchisor or franchisee.² The committee makes a recommendation relating to the ABS's collection of data on franchising at paragraph 7.28, in the context of franchising dispute levels and mediation.

3.4 With that qualification, a brief statistical snapshot of the franchising sector in Australia is presented below. The majority of the information has been extracted from a biennial survey undertaken by the Asia-Pacific Centre for Franchising Excellence within Griffith University. The survey is sponsored by the Franchise Council of Australia.

1 ACCC, *Submission 60*, p. 18

2 This particular survey has only been undertaken since 2005-06. Australian Bureau of Statistics, *8167.0 - Selected Characteristics of Australian Business, 2006-07*, 'Business structure and arrangements', accessed on 17 November 2008 at: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/8167.0Main%20Features22006-07?opendocument&tabname=Summary&prodno=8167.0&issue=2006-07&num=&view=>

Franchise numbers and size

3.5 As indicated in the previous chapter (paragraph 2.4), the Franchising Australia 2008 Survey reported that there were approximately 1100 business format franchisors in Australia. This has been estimated as being one franchise for every 20,000 citizens, around five times the density of franchise systems as exists in the United States.³ Sizes of franchise systems in Australia ranged from one to 2950 units. They vary in size from multinational franchise systems with thousands of franchisees, such as McDonald's, through to fledgling operations with just one or a handful of units operating under the franchise system. Survey responses indicated that the median number of franchise units per franchise was 20. According to the survey authors:

This means that half the sample of franchisor respondents holds very small systems which will not be economically sustainable unless the systems continue to grow.⁴

3.6 The ABS business characteristics survey indicates that five per cent of businesses identified themselves as franchisees, and one per cent identified themselves as franchisors. Businesses employing between 20 and 199 people were most likely to be franchisees (10 per cent), and four per cent of businesses employing over 200 people identified as franchisors.⁵

Types of businesses

3.7 The Franchising Australia 2008 Survey indicates that 28 per cent of franchisors are involved in retail trade, followed by 16 per cent in accommodation and food services, and 15 per cent in administration and support services. From a franchise unit perspective, the survey indicates that there are more units per franchisor in the accommodation and food services industry than the other two categories. It should be noted, however, that the arbitrariness and breadth of business types within each industry classification diminishes the value of these figures. For instance, cleaning and gardening services are categorised with travel agents, while pet services and mechanics find themselves situated together in a separate category called 'other'.⁶

3 Gehrke, J. 'An Overview of the Franchise Sector of Australia', Franchise Advisory Centre, 2008, p. 5, included as an attachment in Franchise Advisory Centre, *Submission 132*

4 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 24

5 Australian Bureau of Statistics, 8167.0 - *Selected Characteristics of Australian Business, 2006-07*, 'Business structure and arrangements', accessed on 17 November 2008 at: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/8167.0Main%20Features22006-07?opendocument&tabname=Summary&prodno=8167.0&issue=2006-07&num=&view=>

6 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 20

Age of franchise systems

3.8 Offering more clarity are the survey's figures on the length of time franchise systems had been in existence. Approximately one third commenced franchising in the 1990s, one third from 2000-2005 and one fifth since 2006.

3.9 A conclusion that may be drawn from these statistics is that the vast majority of extant franchise systems in Australia have commenced operation during a period of economic prosperity. They have also commenced in a period during which franchising regulation has been in place.⁷

3.10 The survey further found that a substantial portion (nearly one third) of franchisors begin franchising very early in the life of their business. Some 14 per cent of survey respondents operated for just one year before launching their franchise system, and a further 17 per cent franchised either immediately or within their first year of operation.⁸

Franchise system exit data

3.11 A contentious aspect of statistical information on the sector is the extent to which franchisors exit franchising. Few statistics are available on this given that the Franchising Australia survey does not specifically outline the number of new entrants in the survey, from which the number that have exited since the previous survey could be determined. Ms Jenny Buchan has noted that:

Griffith University conducts the biannual [sic] franchising Australia survey. The Griffith database records the former franchisors that are no longer contactable two years later but this is not a matter of public record.⁹

3.12 Mr Jason Gehrke of the Franchise Advisory Centre has commented that the rate of exits may be significant:

When releasing the Franchising Australia 2006 survey findings at the Franchise Council national conference on October 21 that year, the authors specifically commented on the number of entrants and exits when compared with the previous survey. While the overall number of franchise systems in Australia had increased by approximately 100 from 2004 to 2006, this increase was made up of 200 new entrants and 100 franchisors that had ceased franchising since the 2004 survey. In other words, for every two new franchisors, one franchisor exited over a two-year period, accounting for a loss of almost 12% of the 850 franchisors identified in the 2004 survey.¹⁰

7 The mandatory Franchising Code of Conduct was first introduced in 1998.

8 Frazer, L et al. *Franchising Australia 2008 Survey*, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, pp. 21-22

9 Ms Jenny Buchan, *Submission 89*, p. 9

10 Gehrke, J. 'An Overview of the Franchise Sector of Australia', Franchise Advisory Centre, 2008, p. 7, included as an attachment in Franchise Advisory Centre, *Submission 132*

3.13 A possible explanation for franchisor exit is that, particularly for those who may have entered franchising without significant experience of brand development, success proved more difficult to attain than they had initially expected.

3.14 Using a comparison between franchisors listed in a franchising publication from 1998 and the Franchise Advisory Centre's current database, Gehrke estimated that 30 per cent of the 1998 franchisors had ceased to franchise, and most appeared not to be operating in any capacity any more.¹¹

Franchisee characteristics

3.15 Franchisees are mostly aged between 30 and 50, with just fewer than half being sole owners and a similar figure being husband and wife operators.¹² Only 43 per cent were reported to have independent business experience, half of these in the same industry. Prior to becoming franchisees, around 40 per cent had no salaried experience in the same industry or business experience of any kind.¹³

3.16 These findings are consistent with anecdotal evidence put to the committee. Typically, franchising attracts so-called mum and dad investors who want to get into business but, lacking relevant experience, feel a sense of security from having an established franchise brand and system behind them.

Franchisee turnover

3.17 The Franchising Australia survey reported that most initial terms of agreement are for fixed five (67 per cent) or ten (17 per cent) year terms.¹⁴ These agreements carried a median initial fee for accessing the system of \$30,000.¹⁵ With respect to agreement renewal, the Franchising Australia survey reported that:

Over half the franchisors (52 per cent) reported that 98 per cent of their franchisees had renewed their agreements upon expiration of the initial term. Only 5 per cent of franchisors indicated that none of their eligible

11 Gehrke, J. 'An Overview of the Franchise Sector of Australia', Franchise Advisory Centre, 2008, p. 7, included as an attachment in Franchise Advisory Centre, *Submission 132*

12 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, pp 32-33

13 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 35

14 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 23. The figures refer to the proportion of fixed term agreements, which were used by 94 cent of total respondents.

15 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 29. Total median start-up costs were reported to be \$100,000.

franchisees had renewed. Overall, franchise agreement renewal was standard practice in the sector.¹⁶

3.18 The survey did not provide information on the 43 per cent of franchisors that fell somewhere in the middle of having almost all their eligible agreements renewed and those that had none.

3.19 The Franchising Australia 2008 Survey also reported that the median time franchisees remained in a system was seven years, which could indicate that a significant proportion of franchise agreements are not being renewed.¹⁷ Interestingly, the committee heard from one witness that seven years also equates to the amount of time it takes to recoup a franchisee's initial investment: '... seven years is the standard payback period'.¹⁸

3.20 By way of comparison, the 1998 franchising survey stated that 55 per cent of fixed term agreements were for five years and 27 per cent for ten, suggesting that a shift in preference for five instead of ten year terms has occurred in the past decade. The proportion of franchisors using perpetual agreements was virtually unchanged at below ten per cent.¹⁹ Data from earlier periods was unavailable. From an anecdotal perspective, Mr Robert Gardini told the committee that previously in the motor vehicle dealership sector franchise agreements were often evergreen; they had no fixed terms. He indicated a trend over time such that these agreements have now been replaced with fixed term agreements, some of which are as short as 12 months in duration.²⁰

Dispute levels

3.21 A relatively high 17 per cent of franchisors reported having been in a dispute with at least one franchisee that was referred to an external adviser, though this was down from 35 per cent in 2006.²¹ The survey stated:

Major causes of substantial disputes were compliance with the system (66 per cent), profitability (37 per cent), territorial issues (21 per cent), communication problems (18 per cent) and fees (16 per cent).²²

16 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 22

17 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 37. It should be noted that non-renewal can be a decision by either the franchisor or franchisee.

18 Mr Greg Fisher, *Proof Committee Hansard*, Brisbane, 10 October 2008, p. 84

19 Franchising Australia 1998 Survey, p. 6; Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 22

20 Mr Robert Gardini, *Proof Committee Hansard*, Sydney, 9 October 2008, pp 6-7

21 Frazer, L et al. Franchising Australia 2008 Survey, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 40

3.22 The strong possibility that non-respondents to this survey are more likely to be involved in disputes with franchisees must be considered. Further, 62 of 286 franchisor respondents to the survey did not answer the question about disputes, which would suggest an underestimation of the level of disputes within the sector.²³

Regulatory and representative bodies in Australian franchising

3.23 Following is a list of the regulatory and representative bodies for the franchising sector in Australia who were involved in this inquiry.²⁴

Australian Competition & Consumer Commission (ACCC)

3.24 The ACCC is an independent statutory authority responsible for enforcing the *Trade Practices Act 1974* as it applies to the franchising sector. Its role is to ensure compliance with the Franchising Code of Conduct (the Code) and the TPA through education, liaison and, where necessary, enforcement action. To this end, it develops educational and compliance materials such as guidelines, articles and fact sheets, and gives presentations in each state and territory.²⁵

Office of the Mediation Adviser (OMA)

3.25 The OMA is a government funded body established in 1998, when the Code first came into effect. The role of the OMA is to appoint mediators to assist franchisors and franchisees in resolving their disputes without going to court.²⁶ However, franchising parties in dispute do not have to use an OMA mediator; they can use an alternative mediator if both parties agree.

Department of Innovation, Industry, Science and Research (DIISR)

3.26 DIISR provides policy advice to the Minister for Small Business, Independent Contractors and the Service Economy on franchising matters. As part of its role, DIISR monitors industry representations and statistics produced by the OMA, with the objective of identifying any systemic problems in the franchising sector that impede the operation of the Code.²⁷

22 Frazer, L et al. *Franchising Australia 2008 Survey*, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 40

23 Frazer, L et al. *Franchising Australia 2008 Survey*, Asia-Pacific Centre for Franchising Excellence, Griffith University, 2008, p. 41

24 The International Franchise Association based in Washington DC also made a submission to the inquiry; see *Submission 120*.

25 ACCC, *Submission 60*, pp 5, 7-8

26 OMA website, accessed 20 November 2008 at: <http://www.mediationadviser.com.au/>

27 DIISR, *Submission 137*, p. 2

Franchise Council of Australia (FCA)

3.27 According to its website, the FCA is the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising. It is a nationally incorporated not-for-profit association which was established in 1983. Membership of the FCA is voluntary and is open to any organisation or individual involved in the franchise sector, including franchisees, franchisors, lawyers, accountants, banks, consultants, academics and publishers.²⁸

Franchisees Association of Australia Inc (FAAI)

3.28 The FAAI is a voluntary organisation which exclusively represents franchisees. The majority of FAAI board members are either current or past franchisees or are representatives of organisations that have franchisees as members. The FAAI is a collective organisation, with a number of affiliated organisations.²⁹

3.29 A number of industry-specific representative bodies also participated in the inquiry, including:

- Australian Retail Association (<http://www.retail.org.au/>)
- National Retailers Association (<http://www.nra.net.au/>)
- Retail Traders' Association of Western Australia (<http://www.cciwa.com/default.aspx?MenuID=192>)
- Shopping Centre Council of Australia (http://www.icsc.org/about/affiliates_australia.php)
- Motor Trades Association of Australia (<http://www.mtaa.com.au/>)
- Motor Traders Association of Queensland (<http://www.mtaq.com.au/>)
- Motor Traders' Association of NSW (<http://www.mtansw.com.au/>)
- Federal Chamber of Automotive Industries (<http://www.fcai.com.au/>)
- Lottery Agents Association of Victoria (<http://www.laav.org.au/>)
- Post Office Agents Association Limited (<http://www.poaal.com.au/>)

Franchising regulation in Australia

3.30 Franchising in Australia is regulated under the *Trade Practices Act 1974* (TPA) and the *Trade Practices (Industry Codes – Franchising) Regulations 1998*, which contains the Franchising Code of Conduct. Section 51AD of the TPA prohibits

28 Franchise Council of Australia website, accessed 20 November 2008 at: <http://www.franchise.org.au/content/?id=2>,

29 Mr David Beddall, *Proof Committee Hansard*, Brisbane, 10 October 2008, pp. 22-23. See also FAAI website, accessed 20 November 2008 at: <http://www.faa.com.au/>

corporations from contravening an applicable industry code. Section 51AE of the TPA provides for the making of regulations to prescribe an industry code and to declare an industry code as mandatory or voluntary. The *Trade Practices (Industry Codes – Franchising) Regulations 1998* establishes the Franchising Code of Conduct as a mandatory industry code that binds parties to franchise agreements.

Franchising Code of Conduct

3.31 The Franchising Code of Conduct (the Code) came into effect as a mandatory code, enforceable under section 51AD of the TPA, on 1 July 1998. Its purpose 'is to regulate the conduct of participants in franchising towards other participants in franchising'.³⁰ The provisions of the Code are described briefly as follows.

Disclosure

3.32 Part 2 of the Code establishes the requirement for franchisors to provide certain information to prospective or renewing franchisees in a disclosure document, no less than 14 days before the agreement is entered into or renewed. This material must be read and understood by the franchisee. The franchisor must also provide to the franchisee a copy of the Code and a copy of the franchise agreement in the form in which it is to be executed. In turn, the franchisor must receive a written statement from franchisees that the disclosure document has been read and understood, and a written statement from prospective franchisees that they have sought independent expert advice (or have been told that such advice should be sought but have elected not to seek it).³¹

3.33 Information that must be disclosed in accordance with Part 2 of the Code includes:

- details of the franchisor's business experience;
- history of litigation relating to the franchisor's business dealings;
- existing franchisees operating within the franchise network;
- the details of franchises that have ceased to operate or changed hands in the past three years;
- intellectual property rights;
- exclusivity of territory;
- rights and obligations concerning the supply of goods or services;
- history of the franchise business in that location/area;
- details of compulsory marketing funds;

30 *Trade Practices (Industry Codes – Franchising) Regulations 1998*, pp. 15-16

31 This may be from a legal or business adviser, or accountant; *Trade Practices (Industry Codes – Franchising) Regulations 1998*, sections 6 to 11, pp. 13-15

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- various payments the franchisee is required to make;
 - financing arrangements;
 - obligations of both parties; and
 - financial details of the franchisor.³²

Conditions of the agreement

3.34 Part 3 of the Code stipulates certain conditions relating to the franchise agreement. It establishes a cooling off period, ensures that franchisees are allowed to form associations with other franchisees, and sets out disclosure requirements concerning marketing funds and change of franchisor ownership. Part 3 also addresses the rights and obligations of the parties with respect to transferring the franchise and terminating the franchise agreement.³³

Dispute resolution

3.35 Part 4 sets out the procedures for resolving franchising disputes. The Code states that mediation must take place where a dispute cannot be resolved between the parties themselves and either party refers the matter to a mediator. The mediation adviser, appointed by the Minister in accordance with section 25 of the Code, appoints a mediator of their choice where the parties cannot agree to a mediator on their own. The parties (or their representatives) must attend mediation to attempt to resolve the dispute, though no requirement to participate in good faith exists within the Code. If, after 30 days of unsuccessful mediation, either party asks the mediator to terminate the mediation, this must occur. The Code does not provide for the mediator to make a determination about the merits of each party's case in the event of failed mediation.³⁴

Relevant Trade Practices Act provisions

3.36 The conduct of parties to franchise agreements is also regulated by relevant provisions of the TPA governing conduct in commercial activities. These are:

- section 51AC prohibiting unconscionable conduct;
- section 52 prohibiting misleading or deceptive conduct;
- section 53 prohibiting making false or misleading representations about the supply of goods or services; and
- section 59 making false or misleading representations about the profitability or risk or other material aspect of any business activity.

32 *Trade Practices (Industry Codes – Franchising) Regulations 1998*, Annexure 1, from p. 27

33 *Trade Practices (Industry Codes – Franchising) Regulations 1998*, sections 13 to 23, pp. 16-23

34 *Trade Practices (Industry Codes – Franchising) Regulations 1998*, sections 24 to 31, pp. 24-26

3.37 Where the court is satisfied that any of these provisions have been contravened, the TPA provides for courts to grant an injunction (section 80), allow an action to recover the amount of loss or damage (section 82), or make an order to vary the contract (section 87).

3.38 Section 51AC governing unconscionable conduct prohibits parties in trade and commerce from engaging in 'conduct that is in all the circumstances, unconscionable'. The provision does not seek to define what constitutes unconscionable conduct in statute, though it does list a number of matters courts may have regard to in determining unconscionability. These include the requirements of an applicable industry code, the extent of negotiation of a contract and the extent to which the parties acted in good faith.

3.39 The committee notes that, at the time of tabling this report, the Senate Standing Committee on Economics was conducting an inquiry into the need for a statutory definition of unconscionable conduct and the scope and content of any such definition.

3.40 The ACCC is responsible for 'compliance with the Act and the code by education, liaison and, where necessary, enforcement action'.³⁵ The ACCC investigates potential breaches of the TPA and may commence proceedings in the Federal Court if it deems there is sufficient evidence to support successful litigation.³⁶ Private actions seeking remedy for alleged breaches of the TPA may also be taken to the Federal Court.

Relevant case law

Ketchell v Master Education Services Pty Ltd

3.41 *Ketchell v Master Education Services Pty Ltd* (Ketchell) centred on whether or not a technical breach of clause 11 of the Franchising Code of Conduct rendered the agreement illegal and unenforceable. A requirement of clause 11 of the Code is that an agreement cannot be entered into until the franchisee has provided the franchisor with written acknowledgement that the disclosure document and the Code have been received, read and had an opportunity to be understood. In Ketchell, the franchisor failed to ensure the franchisee had provided this document before entering into their franchise agreement. The franchisee, Mrs Ketchell, argued that the franchisor was not entitled to receive disputed payments under the agreement because it had breached the Code.³⁷

35 ACCC, *Submission 60*, p. 5

36 ACCC, *Submission 60*, p. 11

37 Watts, K and Gordon, T. 'Recent case law on the remedies available under the Franchising Code', *Australia and New Zealand Trade Practices Law Bulletin*, Vol 24, No. 3, July 2008, pp. 34-35

3.42 On appeal to the NSW Court of Appeal, the court adopted the strict common law rule that courts cannot enforce a contract prohibited by statute, concluding that the clause 11 breach rendered the whole agreement illegal and void, making the terms of the agreement unenforceable.³⁸ However, the High Court subsequently reversed this decision, finding that it is not the intention of the TPA to automatically make void any franchise agreement in which there has been a technical breach of the Code. The court held that:

Section 51AD [of the TPA] does not in its terms prohibit the making of a franchise agreement where a franchisor has not complied with the Code. That section and the Code are concerned with the regulation of the conduct of participants in the franchising industry; in particular the conduct of franchisors. It is not to be inferred from a purpose which promotes or prescribes better and fairer business practices that contractual relations between parties will be affected.³⁹

Hoy Mobile Pty Limited v Allphones Pty Ltd

3.43 The High Court's decision had followed similar reasoning in *Hoy Mobile Pty Limited v Allphones Pty Ltd* (Allphones). In this case, the franchisor argued that, on the basis of the NSW Court of Appeal's judgement in *Ketchell*, the agreement should be considered void because it (the franchisor) had itself breached the Code. The rationale behind the franchisor's argument was to sidestep its obligations under the agreement through its own breach of clause 11. The court rejected this, stating that the purpose of the Code is to protect franchisees, rather than to prevent them from being able to enforce the terms of their franchise agreement because of a technical breach of the Code.⁴⁰

Implications for the franchising sector

3.44 The NSW Court of Appeal's strict approach in *Ketchell* seems to have been rejected, but uncertainty about the implication of technical breaches of the Code remains. While such breaches seemingly do not automatically render a franchise agreement illegal and void, it is still not clear as to the appropriate remedies, available through the TPA, to be applied for minor breaches of the Code.⁴¹ Franchisors that do not observe the letter of the law when complying with the Code, or do not retain

38 *Ketchell v Master of Education Services Pty Ltd* [2007] NSWCA 161

39 *Master Education Services Pty Limited v Ketchell* [2008] HCA 38

40 Watts, K and Gordon, T. 'Recent case law on the remedies available under the Franchising Code', *Australia and New Zealand Trade Practices Law Bulletin*, Vol 24, No. 3, July 2008, p. 35; *Hoy Mobile Pty Limited v Allphones Retail Pty Limited* [2008] FCA 810. Contributing to the different reasoning in *Hoy* was a 2001 amendment to the Code - the introduction of Clause 6A - that postdated the agreement in dispute in the *Ketchell* case.

41 The Franchising Code of Conduct does not prescribe penalties or remedies for breaches of its provisions.

appropriate evidence of same, are in a potentially vulnerable position in the event of a dispute with a franchisee.⁴²

Other mandatory industry codes

3.45 Two other prescribed mandatory industry codes have been established under section 51AE of the *Trade Practices Act 1974* (TPA). They are the Oilcode and the Horticulture Code.

Oilcode

3.46 The *Trade Practices (Industry Codes – Oilcode) Regulations 2006* (the Oilcode) came into effect on 1 March 2007. It operates as a mandatory industry code under section 51AE of the TPA and replaced the repealed *Petroleum Retail Marketing Sites Act 1980* and *Petroleum Retail Marketing Franchise Act 1980*.⁴³

3.47 The Oilcode regulates the conduct of suppliers, distributors and retailers in the downstream petroleum retail industry. It was implemented to establish the following:

- consistent and transparent approaches to terminal gate pricing and fuel re-selling agreements;
- standard contractual terms for supplier-retail re-selling agreements; and
- an independent dispute resolution scheme.⁴⁴

3.48 As with the Franchising Code of Conduct, the ACCC is responsible for administering the legislation under which the Oilcode operates. The Oilcode's effectiveness is also monitored by the ACCC.⁴⁵

3.49 The most relevant aspect of the Oilcode to this inquiry is the dispute resolution scheme. Under section 41 of the Oilcode, the Minister is required to appoint a Dispute Resolution Adviser (DRA). This person must arrange mediation or other assistance where the relevant parties cannot resolve the dispute themselves and is granted the authority to make a non-binding determination about the dispute.⁴⁶

42 Watts, K and Gordon, T. 'Recent case law on the remedies available under the Franchising Code', *Australia and New Zealand Trade Practices Law Bulletin*, Vol 24, No. 3, July 2008, pp. 35-36

43 ACCC, *The guide to the Oilcode for industry participants in the downstream petroleum industry*, p. iii, accessed on 7 November 2008 at: <http://www.accc.gov.au/content/item.phtml?itemId=771848&nodeId=fd100c294232594ec7b32c7bbb9ef606&fn=Guide%20to%20the%20Oilcode.pdf>

44 Department of Resources, Energy and Tourism, 'Downstream Petroleum Legislation', *DRET website*, accessed on 7 November 2008 at: http://www.ret.gov.au/resources/fuels/petroleum_refining_and_retail/downstream_petroleum_legislation/Pages/DownstreamPetroleumLegislation.aspx

45 *Trade Practices (Industry Codes - Oilcode) Regulations 2006*, section 3(1)

46 *Trade Practices (Industry Codes - Oilcode) Regulations 2006*, sections 44 and 45

Section 45(1) also stipulates that mediation and assistance provided in accordance with the Oilcode must be carried out in good faith.

3.50 These dispute resolution processes do not restrict parties to the dispute from making direct complaints to the ACCC or pursuing litigation.⁴⁷

Horticulture Code

3.51 *The Trade Practices (Horticulture Code of Conduct) Regulations 2006* (the Horticulture Code) came into effect on 14 May 2007. It regulates participants in the horticulture industry and was implemented to achieve the following objectives:

- provide greater clarity and commercial transparency between growers and wholesale traders; and
- establish a dispute resolution scheme.⁴⁸

3.52 The dispute resolution procedure provisions stipulate the circumstances in which a mediator may be appointed to resolve disputes. In contrast to the Oilcode, the Horticulture Code does not oblige the parties to mediate in good faith, and the appointed mediator may terminate the mediation if it is unlikely to resolve the dispute.⁴⁹

State regulation

3.53 Although franchising is directly regulated by Commonwealth legislation and regulation, redress where unfair contracts have been entered into has also been available in New South Wales under state legislation. Mr Gardini told the committee that difficulties for motor dealers accessing remedies under section 51AC of the TPA could until recently be circumvented using NSW industrial relations legislation:

Previously the issues of good faith and unconscionable conduct could be dealt with to some extent in the application of the unfair contracts provision in part 9 of the Industrial Relations Act 1996 of New South Wales. Remedies under section 106 of the IRA give the Industrial Relations Commission the power to vary or find void contracts which are deemed to be unfair. However, this avenue was significantly diminished when the High Court's decision in *Fish v Solution 6 Holdings* held that the jurisdiction of the commission only extended to contract disputes whereby a

47 ACCC, *The guide to the Oilcode for industry participants in the downstream petroleum industry*, pp. 20-22, accessed on 7 November 2008 at: <http://www.accc.gov.au/content/item.phtml?itemId=771848&nodeId=fd100c294232594ec7b32c7bbb9ef606&fn=Guide%20to%20the%20Oilcode.pdf>

48 ACCC, *The guide to the horticulture code for growers and wholesale traders in the horticulture industry*, p. iii, accessed on 7 November 2008 at: <http://www.accc.gov.au/content/item.phtml?itemId=778037&nodeId=758ea14dc281f3340b110396c743a3c8&fn=Horticulture%20code%20guide.pdf>

49 *Trade Practices (Horticulture Code of Conduct) Regulations 2006*, section 36

person performs work in an industry. Since this decision in 2006 the trend has been to exclude the application of section 106 to commercial contracts. This has meant that the majority of motor vehicle dealers in New South Wales who may once have been able to seek remedy through the commission will now have to use alternative recourse unless they can satisfy the requisite jurisdictional elements of section 106.⁵⁰

3.54 State-based retail tenancy laws are also relevant to franchising parties, outlining the rights and obligations of landlords and tenants entering into a tenancy agreement for designated retail premises. Provisions within these acts include disclosure requirements, end of term arrangements, minimum terms, the prohibition of certain conduct, rent negotiation, transfer arrangements and dispute resolution procedures.⁵¹

Committee view

3.55 Taking into consideration the fact that many franchise systems operate across multiple state jurisdictions, the committee believes that franchising is most appropriately and usefully regulated at the Commonwealth level.⁵²

Background to the current regulatory system

3.56 The following section contains a brief description of the various reviews, recommendations, guidelines, regulations and amendments that have preceded the regulatory framework governing franchise agreements extant in 2008. It is notable for the fact that some of the contentious issues raised during this inquiry were identified by the parliament as long as 30 years ago, when franchising was in its infancy.

Swanson and Blunt reviews

3.57 Major reviews of the TPA in 1976 (Swanson Committee) and 1979 (Blunt Committee) identified problems in the regulation of franchise agreements.⁵³ The Swanson Committee focused primarily on the issue of compensation to franchisees for goodwill on termination or non-renewal of their agreement by the franchisor, recommending a right to fair and equitable compensation.⁵⁴ The Blunt Committee

50 Mr Robert Gardini, *Proof Committee Hansard*, Sydney, 9 October 2008, p. 9

51 See for example *Retail and Commercial Leases Act 1995 (SA)*

52 This view was shared by the 2008 Western Australian government inquiry into franchising. See WA Small Business Development Corporation, *Inquiry into the Operation of Franchise Businesses in Western Australia*, April 2008, p.45

53 Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs*, AGPS, Canberra, August 1976, chapter 5; Trade Practices Consultative Committee, *Small Business and the Trade Practices Act*, Vol 1, AGPS, Canberra, December 1979, chapter 11.

54 Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs*, AGPS, Canberra, August 1976, pp. 36-38

addressed a wider array of issues, identifying pre-agreement disclosure, compensation for unjustified termination and transfer between franchisees as 'principal problems'. It recommended amendments to the TPA to mandate certain disclosure; stipulate the circumstances in which agreements could be terminated; provide rights to franchisees with respect to transferring the franchise to another person; and apportion goodwill upon termination or non-renewal of an agreement by the franchisor.⁵⁵

Exposure drafts of a franchising bill

3.58 In 1986 two draft bills were prepared in an attempt to enact specific franchising legislation. The first draft contained a number of provisions that encapsulated and added to the recommendations contained in the Swanson and Blunt reviews. It sought to establish a comprehensive disclosure regime and cooling off period; prohibit unilateral contract variations; set out the right to transfer interests; and stipulate termination and non-renewal procedures (including minimum notice periods). It did not provide for automatic rights of renewal or entitlement to payments for goodwill at the end of an agreement, nor did it seek to prescribe the circumstances in which termination could occur.⁵⁶ The second draft bill pared back the provisions contained in the first, omitting the provisions on termination and non-renewal and curtailing the prohibition of unilateral variations of the agreement.⁵⁷ The bill was not enacted.

Beddall Committee report

3.59 In 1990, the House of Representatives Standing Committee on Industry, Science and Technology (Beddall Committee) conducted a broad inquiry into small business regulation.⁵⁸ The committee recommended that franchise-specific legislation be reconsidered to 'ensure fair dealing' between franchising parties, providing for pre-agreement disclosure, cooling off period, conditions applying to alterations of agreements and conditions for the termination/renewal or transfer of franchises.⁵⁹

Voluntary franchising code of practice

3.60 A voluntary franchising code of conduct was introduced in 1993. Administered by the Franchising Code Administration Council Ltd (composed of representatives of franchisors, franchisees and the government), it reflected the Beddall Committee recommendations by including provisions on disclosure to

55 Trade Practices Consultative Committee, *Small Business and the Trade Practices Act*, Vol 1, AGPS, Canberra, December 1979, pp. 102-110

56 Consultative Paper and Draft Franchise Agreements Bill, 1986, Part A, pp. 8-71

57 Second Exposure Drafts of the Franchise Agreements Bill 1986, Part A, p. 13 and Part B, p. 21

58 House of Representatives Standing Committee on Industry, Science and Technology, *Small Business in Australia: Challenges, problems and opportunities*, January 1990

59 House of Representatives Standing Committee on Industry, Science and Technology, *Small Business in Australia: Challenges, problems and opportunities*, January 1990, pp. 233-235

franchisees, a cooling off period, standards of conduct based on unconscionability, and dispute resolution procedures.⁶⁰

Reid Committee report

3.61 In 1997, the House of Representatives Standing Committee on Industry, Science and Technology (Reid Committee) held an inquiry into 'business conduct issues arising out of commercial dealings between firms'.⁶¹ The Reid Committee report recommended specific franchising legislation 'providing for compulsory registration of franchisors and compliance with codes of practice'.⁶² The committee made their recommendation on the basis that 'self-regulation has not worked in part because it does not provide a viable regulatory strategy when there is such a disparity in the powers of the parties'.⁶³ The following year, a Franchising Code of Conduct was introduced as a mandatory industry code enforceable under the TPA.

3.62 Another important recommendation was for a new provision within the TPA to extend the unconscionability protection available to consumers to small business, which later became section 51AC of the Act.⁶⁴ However, the section 51AC provision does not reflect the committee's suggestion that 'unfair' conduct be prohibited, instead retaining the more narrowly applicable term 'unconscionable'.

Mandatory code of conduct

3.63 The provisions of the Franchising Code of Conduct are described above starting at paragraph 3.32. As far as the transition from a voluntary to mandatory code is concerned, the most notable difference was the discarding of the standard of conduct provisions contained in clause 12 of the voluntary code when it became a mandatory code enforceable under section 51AD of the TPA in 1998.⁶⁵ It should be noted, though, that parties to a franchise agreement are subject to the unconscionability provisions under section 51AC of the TPA, also enacted in 1998.

Matthews Review and subsequent amendments to the Code

3.64 In June 2006, the then Minister for Small Business and Tourism, the Hon. Fran Bailey MP, announced a review into the disclosure provisions contained in

60 Franchising Code Administration Council Ltd, *Franchising Code of Practice*, 1 February 1993

61 House of Representatives Standing Committee on Industry, Science and Technology, *Finding a balance: Towards fair trading in Australia*, May 1997, p. 1

62 House of Representatives Standing Committee on Industry, Science and Technology, *Finding a balance: Towards fair trading in Australia*, May 1997, p. 120

63 House of Representatives Standing Committee on Industry, Science and Technology, *Finding a balance: Towards fair trading in Australia*, May 1997, p. 118

64 House of Representatives Standing Committee on Industry, Science and Technology, *Finding a balance: Towards fair trading in Australia*, May 1997, pp 157-182

65 Franchising Code Administration Council Ltd, *Franchising Code of Practice*, 1 February 1993

Part 2 of the Franchising Code of Conduct (Matthews Review). Completed in October 2006, the Matthews Review recommended a number of amendments to the Code. The government consequently amended the Code to require franchisors to:

- disclose materially relevant facts throughout the agreement within a shorter period (14 days instead of 60);
- provide a copy of the franchise agreement in the form it is to be executed;
- disclose the history of the franchise site;
- disclose the contact details of former franchisees for the last three financial years (except where a former franchisee has requested in writing that their details not be disclosed); and
- where the franchisor is a consolidated entity, provide audited financial reports for the last two years on request.⁶⁶

3.65 These amendments came in to force on 1 March 2008.

3.66 The government also rejected a number of the recommendations in the Matthews Review. The most notable of these were the recommendations for inserting a good faith clause in the Code; requiring franchisors to provide a risk statement in the disclosure document; amending the code to prevent unilateral changes to the agreement; and prescribing the registration of disclosure documents.⁶⁷

WA and SA inquiries

3.67 In April 2008 the Western Australian state government undertook an inquiry into the fairness of franchise agreements. The report included recommendations to improve franchisor disclosure and end of agreement arrangements, review mediation processes for resolving disputes, introduce specified penalties for breaches of the Code and establish a dedicated franchising enforcement branch within the ACCC.⁶⁸ In May 2008 the South Australian parliamentary Economics and Finance Committee also tabled a report on the efficacy of the laws regulating the franchisee/franchisor relationship. This adopted a stronger position on legislative reform than the WA government's report. The SA parliamentary committee concluded that a number of

66 ACCC, 'Franchising Code of Conduct amendments', *ACCC website*, accessed on 13 November 2008 at:
<http://www.accc.gov.au/content/item.phtml?itemId=815467&nodeId=9c74905234475e10f491a278e2901a25&fn=Franchising%20Code%20of%20Conduct%20amendments.pdf>

67 Australian government response to the review of the disclosure provisions of the Franchising Code of Conduct, February 2007, accessed on 13 November 2008 at:
[http://www.innovation.gov.au/Section/SmallBusiness/Documents/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.innovation.gov.au/Section/SmallBusiness/Documents/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)

68 WA Small Business Development Corporation, *Inquiry into the Operation of Franchise Businesses in Western Australia*, April 2008, Executive Summary

improvements to the regulation of franchising were needed, including the following recommendations:

- establishing a federal registration scheme for franchise disclosure documents;
- including risk statements in disclosure material;
- introducing specific penalties for breaches of the disclosure provisions in the Code;
- amending section 51AC of the Trade Practices Act to include a statutory definition of unconscionable conduct;
- mandating more effective mediation and providing alternative dispute resolution avenues;
- amending the Franchising Code of Conduct to include a requirement to act in good faith; and
- putting a requirement in the Code for franchise agreements to 'include the basis on which termination payments or goodwill or other such exit payments will be paid at the end of the agreement'.⁶⁹

Franchise-specific legislation

3.68 As referred to above, a specific act dealing with franchising has been proposed in the past to address the pressing regulatory issues affecting the franchising sector at the time (see paragraph 3.58). Rather than creating a new act, a mandatory industry code enforceable under the TPA was introduced to regulate franchising conduct. The committee does not propose to consider the potential for parliament to pass a new act to deal exclusively with franchising.

Committee view

3.69 The committee believes that, by making the improvements to the Code that are recommended in the remainder of this report and by allowing time for the 1 March 2008 amendments to the Code to have an impact, the existing regulatory framework is developing into the most appropriate mechanism for fostering franchising in Australia.

3.70 The committee further believes that the Code, and associated legislation (the TPA), will need to remain dynamic and subject to review as the franchising sector evolves.

69 SA Parliamentary Economic and Finance Committee, *Franchises*, May 2008, pp. 96-99