

Chapter 9

Enforcement of the Franchising Code of Conduct

Enforcement framework

9.1 As outlined in Chapter 3, the Franchising Code of Conduct (the Code) is a mandatory industry code enforceable under section 51AD of the *Trade Practices Act 1974* (TPA). In addition to the Code, franchisees and franchisors are also protected by other relevant provisions in the TPA, including the unconscionable conduct provisions relating to small business transactions in section 51AC and the misleading and deceptive conduct provisions in section 52.

9.2 The TPA sets out a range of remedies for breaches of these sections. These include injunctions, compensation orders, damages, setting aside or varying contracts, and corrective advertising orders.¹ Access to these remedies is via legal action and judicial enforcement.

9.3 The ACCC is responsible for administration of the TPA, and this role extends to litigating in circumstances where it can substantiate evidence that the TPA, including the Code, has been breached.² The ACCC is not, however, responsible for prosecuting franchising disputes that relate to contractual disputes, though this distinction is not always clear to complainants (as described below at paragraph 9.15). Franchisees and franchisors also have the option to take independent legal action in relation to alleged breaches of the Code or other sections of the TPA.

ACCC investigation and enforcement activities

9.4 In its appearance before the committee, the ACCC indicated that franchising-related complaints within its Code compliance and enforcement role fall broadly into three categories:

- a relevant complaint is lodged but the complainant does not want to be involved in taking the complaint further;
- a relevant complaint is lodged and the complainant assists the ACCC investigation, but insufficient evidence is uncovered to substantiate the complaint; or
- a relevant complaint is lodged, the complainant is able to provide evidence that substantiates the complaint, and the matter is suitable for taking forward.³

1 These remedies are found in section 80, section 82 and section 87 of the TPA.

2 ACCC, *Submission 60*, p. 5

3 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, pp 81-82

9.5 While stressing that complaints in all three categories may involve 'great hardship', Mr Samuel explained that only cases in the third category can be taken forward by the ACCC.⁴ Mr Samuel emphasised that the majority of relevant franchising-related complaints they received actually fall into the first and second categories.⁵

9.6 For complaints that fall into the third category, the ACCC has three general avenues of investigation and action available to it:

- demonstrating misleading and deceptive conduct under part V of the Trade Practices Act;
- demonstrating a breach of the Code; and
- pursuing a case of unconscionable conduct.⁶

9.7 The ACCC indicated a preference for pursuing matters under the misleading and deceptive conduct provisions or as breaches of the Code, rather than for unconscionable conduct, in order to achieve timely outcomes.⁷

9.8 The ACCC also highlighted to the committee:

...as the law currently stands, whether it is a breach of part IVA, which is unconscionable conduct, or part IVB, a breach of the Franchising Code, or part V, a breach of the misleading and deceptive conduct provisions, except in a case where we proceed with a criminal prosecution under part VC—which is quite unusual—it is not possible for us to get any pecuniary penalties.⁸

9.9 In its written submission to the committee, the ACCC detailed the 15 franchising-related matters it has taken to court since the Code came into force, and a further five matters in which it has obtained court-enforceable undertakings.⁹ Of the matters taken to court, five were contested and 10 were settled by consent.¹⁰

Barriers to effective enforcement

Level of ACCC activity

9.10 The committee received many submissions that were highly critical of the ACCC's responsiveness and effectiveness as the regulator for Code compliance. The

4 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 82

5 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 85

6 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 82

7 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 82

8 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 83

9 ACCC, *Submission 60*, pp 29-32

10 ACCC, *Submission 60*, p. 13

regulator was variously described by submitters and witnesses as 'toothless', a 'lame duck' and 'useless'. Representative examples of their claims are outlined below.¹¹

9.11 Mr Ray Borradale detailed a range of cases in which a lack of ACCC action, or failure of ACCC litigation, seemed to be inconsistent with a body of evidence pointing to franchise churning or other poor franchisor behaviour. He suggested that, on the basis of this history of limited success:

Frustrated franchisees, for the most part, have lost faith in ACCC investigations and their unwillingness to pursue the most blatant breaches of the TPA and the Code.¹²

9.12 Mr Garry Clarke referred what he described as 'a blatant breach of the law' to the ACCC and was disappointed to receive advice that the ACCC would not be pursuing the matter. He noted that this was contrary to other legal advice he had received and suggested:

...**the root cause of the issues** being created for franchisees and other small business's [sic] is not a result of significant deficiency in the Franchise Code of Conduct or the provisions in the TPA **but rather it is a direct result of the absolute and abhorrent refusal** by the Australian Competition & Consumer Commission...to take appropriate action against a larger business that has demonstrated a complete disregard for the TPA in relation to their dealings with a smaller business.¹³

9.13 Ms Heather Shearer outlined to the committee the steps she took in providing the ACCC with a detailed allegation of poor franchisor conduct, noting that the complaint she put forward was endorsed by a number of franchisees. Again, Ms Shearer was disappointed when advised that the ACCC would not be pursuing the matter. In particular, she questioned the ACCC's advice that, having raised the complaints directly with the franchisor, its concerns had been allayed:

Obviously, a company is not going to **admit** to the regulator that they engaged in misleading conduct, or misused franchisee marketing funds.

Due to such issues, and a general lack of action against rogue franchisors...by the ACCC, many franchisees have increasingly come to believe that the legislation (Trade Practices Act 1974) and the...body (the ACCC) aimed to protect small business owners such as themselves ... has failed them.¹⁴

11 Ms Sam Gow, *Submission 61*, p. 12; Mr Garry Clarke, *Submission 119*, p. 2; Ms Deanne de Leeuw, *Proof Committee Hansard*, Canberra, 17 October 2008, p. 69

12 Mr Ray Borradale, *Submission 16*, p. 17

13 Mr Garry Clarke, *Submission 119*, p. 2

14 Ms Heather Shearer, *Submission 79*, p. 2

9.14 Ms Samantha Gow, who wrote to the committee of her experiences of incomplete disclosure and third line forcing while she was a franchisee, summed up the feelings of many:

The ACCC is another body that I have largely realised is a toothless tiger. They have failed the Franchisee's [sic] in this industry time after time, incident after incident. There is not a franchisee in this country who hasn't written to this organisation for help. In the vast majority of cases disappointment and neglect is unfortunately the forthcoming response to those so desperately in need.¹⁵

9.15 Some submitters and witnesses expressed frustration at the limitations of the ACCC's role and the fact that they were left with nowhere to turn if the regulator found their dispute to be a contractual matter, rather than a breach of the Code per se. Ms Deanne de Leeuw told the committee:

Every argument on which they [the ACCC] would come back to us was about the contract rather than the conduct. Yes, we all knew that we had signed a contract, but the contract that we signed did not cover the conduct we all experienced once we were franchisees. There are no protections ... once you have signed.¹⁶

9.16 Ms de Leeuw further explained:

The biggest problem was that we felt there was nowhere to go and that the ACCC was useless.¹⁷

9.17 Franchisees also articulated concern about the slow pace of ACCC investigations, describing situations where they were led to believe that action was likely to be taken, only to eventually be told that there was insufficient evidence against the franchisor to mount a legal case.¹⁸

9.18 Mr Scott Cooper acknowledged that, given the expense and time required to mount successful litigation, it may not be possible for the ACCC to act against all franchisee complaints. However, he pointed out that this leaves many franchisees unsupported and suggested it would be useful to have a better understanding of the types of cases the ACCC is likely to take forward:

Franchisees would greatly benefit from further clarification of how severe a situation has to be in relation to breaches of the Franchising Code or the Trade Practices Act by a franchisor, before the assistance of the ACCC can be relied upon with any degree of certainty.¹⁹

15 Ms Sam Gow, *Submission 61*, p. 12

16 Ms Deanne de Leeuw, *Proof Committee Hansard*, Canberra, 17 October 2008, p. 62

17 Ms Deanne de Leeuw, *Proof Committee Hansard*, Canberra, 17 October 2008, p. 69

18 See, for example, Ms Suzanne Brown, *Submission 84* and Ms Deanne de Leeuw, *Submission 114*.

19 Mr Scott Cooper, *Submission 15*, p. 17

9.19 Some of the criticism of ACCC inaction may stem from a lack of understanding about the extent of its enforcement role. Ms Nicole Hoy acknowledged that she was initially unclear about what part the ACCC could properly play in taking her dispute forward:

At the time I thought the ACCC were not doing their job and my solicitor was incapable of protecting my rights. It has taken some time for me to accept that the people dispensing this information were not trying to be difficult and unsupportive but they have to work within a system that does not provide for immediate relief that is affordable.²⁰

9.20 The ACCC itself expressed concern about the 'expectation gap' in what franchisees believed the ACCC should be able to do to assist them:

We have been very concerned about the expectation gap, and the fact that there are suggestions that the ACCC is not investigating thoroughly, or is not proceeding to an enforcement...

We put significant details of our investigation process and of the findings of those investigations on to our website, so that those who had complained, those who had been observing and others could observe the nature of the investigations that we undertook. It included what we found, what we did not find, why it was that enforcement action was not taken. It was all designed to try to bring a reality check to what is occurring in relation to these investigations.²¹

9.21 The ACCC suggested to the committee that the provision of misinformation by certain advisers active in the sector was a contributing factor to the 'expectation gap':

I will not name them, but there are certain people operating in the franchise sector as supposed advisers who I must say are more in the nature of carpetbaggers than genuine advisers. They show up, tell a franchisee who is out of pocket for whatever reason, 'Yes. This is a clear breach of the law. You have a right of action.'²²

9.22 Mr Samuel commented:

They are out there making extravagant and exaggerated comments. In my view, very often those comments are frankly dishonest. They are dishonest to the extent that they are misleading franchisees into believing that there are solutions to their problems, which are problems of extraordinary hardship, whereas in fact no law—and I would suggest—no judgement on the part of this committee would assess that what they have been subjected

20 Ms Nicole Hoy, *Submission 8*, p. 4

21 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 85

22 Mr Brian Cassidy, ACCC, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 97

to is either unconscionable conduct or dishonest conduct, but what has happened is that there has been misfortune in the conduct of the franchise.²³

9.23 The ACCC further indicated that such misleading behaviour could in itself constitute a breach of part V of the TPA.²⁴

Prohibitive costs of independent litigation

9.24 A recurring theme in submissions to the committee was that the expense of litigation, including time, severely limits the ability of many franchisees to take independent legal action even when they are confident of demonstrating clear breaches of the Code. Some submitters also put forward their belief that franchisors, or their legal representatives, deliberately draw out legal proceedings in order to exhaust any funds the franchisee may have available to finance the action. For example:

Given that many franchisees are in a parlous financial situation, they have virtually no recourse to private action against a large company. And in many cases, when a franchisee has commenced suit...the large franchisor practises delaying tactics until the franchisee can no longer afford the legal fees, and in some unfortunate cases, has had to sell their property and even declare bankruptcy.²⁵

9.25 Mr Scott Cooper wrote:

The gaping void...is the undeniable fact that the legal system is out of reach for the vast majority of franchisees. Most franchisees are not adequately resourced personally, emotionally or financially to confront a well financed and well practiced franchisor by engaging the legal system...All too common with the law, it is not the person with the strongest case that succeeds in litigation, but the person with the deepest pockets.²⁶

9.26 These sentiments were echoed by Ms Nicole Hoy:

I believe based on my experience with the Office of Mediation Advisors [sic], the ACCC and the legal system, that until there is a method put in place that can provide affordable and immediate relief, it is near impossible for the average franchisee to enforce their rights under their agreement or under the code. The average franchise agreement is usually 5 years. The average franchisee is a small business operator with limited resources. Justice is simply out of reach.²⁷

23 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 97

24 Mr Graeme Samuel, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 98

25 Ms Heather Shearer, *Submission 79*, p. 2

26 Mr Scott Cooper, *Submission 15*, p. 5

27 Ms Nicole Hoy, *Submission 8*, p. 1

Improving enforcement tools

Pecuniary penalties

9.27 Although the ACCC indicated to the committee that the current laws regulating conduct in franchising are largely sufficient and that it is exercising its powers appropriately, it suggested that the introduction of pecuniary penalties for breaches of the Code (as well as for breaches of section 51AC and section 52) would provide a useful deterrent to those who might otherwise fail to observe the conduct requirements imposed by the Code.²⁸ The ACCC further noted that the proposed introduction of such penalties is consistent with a recent Productivity Commission recommendation for the introduction of civil pecuniary penalties under Part V of the Act.²⁹

9.28 This suggestion is also consistent with the recommendation of the South Australian parliamentary inquiry:

...that the Franchising Code of Conduct be amended to introduce specific penalties for breaches of the disclosure requirements under the Code.³⁰

9.29 Similarly, the recent Western Australian inquiry recommended that:

The Commonwealth Government amend the *Trade Practices Act 1974* to prescribe penalties for breaches of the Franchising Code of Conduct.³¹

9.30 The implementation of such penalties would also in part address concerns that the Code and/or the regulator lack teeth.³²

Investigative power

9.31 The ACCC further suggested that its ability to protect franchisee interests would be enhanced if it were given the power to conduct proactive checks of franchisors' records and activities.³³ Mr Cassidy described the potential benefits of such a power as follows:

We have talked about being able to undertake risk based audits, where we do get some indication that perhaps a franchisor is operating close to the wind, and not a hard allegation that gives us a basis for using our existing

28 Mr Graeme Samuel, ACCC, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 103; ACCC, *Submission 60*, pp 23-24

29 ACCC, *Submission 60*, p. 23. This is reference to Recommendation 10.1 of the Productivity Commission's recent report, *Review of Australia's Consumer Policy Framework*, vol. 2, p. 251

30 SA Parliamentary Economic and Finance Committee, *Franchises*, May 2008, p. 42

31 WA Small Business Development Corporation, *Inquiry into the Operation of Franchise Businesses in Western Australia*, April 2008, p. 49

32 For examples, see *Submission 49*, *Submission 61*, *Submission 114* and *Submission 119*.

33 ACCC, *Submission 60*, p. 24

formal investigative powers. You do get a bit of a sniff that maybe a particular franchisor is pushing the envelope, if you like. This goes to the ability to undertake what we call a risk based audit. In other words, look at the disclosure documents that are being used, see what other material is being put out by a particular franchisor, perhaps speak to other franchisees of that franchisor to see whether we can get a pattern of conduct occurring.³⁴

Committee view

9.32 The committee understands the deep and widespread frustration amongst franchisees over perceived inaction by, and ineffectiveness of, the ACCC in pursuing complaints against franchisors who are alleged to be in breach of the Code. Notwithstanding the limitations of the ACCC's role, there appears on the face of it to be room for improvement by the regulator in taking a more active role in dealing with franchising-related complaints. The committee encourages the ACCC to prioritise and actively pursue franchising-related complaints where breaches of the Code or other relevant parts of the TPA can be substantiated.

9.33 The committee also strongly encourages the ACCC to develop and distribute educational material to the sector that clearly explains the role and limitations of the ACCC in enforcing compliance with the Code. In order to address the existing 'expectation gap', there is a particular need for ongoing clarification that the ACCC's role does not extend to settling contractual disputes.

9.34 The committee agrees that the lack of pecuniary penalties for breaches of the Code means there is insufficient deterrence for conduct that contravenes the Code. Accordingly, the committee recommends that the TPA be amended to include pecuniary penalties for breaches of the Code.

Recommendation 9

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.

9.36 The committee recognises that such an amendment may also be desirable for the other mandatory industry codes operating under the TPA. It also notes the ACCC's suggestion that similar pecuniary penalties be enacted in relation to section 51AC breaches (unconscionable conduct) and section 52 breaches (misleading and deceptive conduct). These changes would have ramifications and applications beyond the franchising sector and, as such, are beyond the remit of the current inquiry. Although the committee stops short of directly recommending their enactment, the committee recommends that consideration also be given to further amending the *Trade Practices*

34 Mr Brian Cassidy, ACCC, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 99

Act 1974 to provide for pecuniary penalties in relation to breaches of these additional sections.

Recommendation 10

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.

9.38 The committee sees value in increasing the ACCC's powers to conduct proactive investigations, particularly in cases where franchisees fear retribution if they provide information directly to the regulator. Accordingly, the committee recommends that the ACCC be empowered to conduct investigations when it has credible information indicating a potential contravention of the Franchising Code of Conduct.

Recommendation 11

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.³⁵

9.40 The committee acknowledges the difficulties franchisees face in seeking remedy under the TPA due to the potentially high costs of taking legal action. Through recommendations made elsewhere in this report—in particular, Recommendation 8 to introduce an overarching obligation for all parties to a franchising agreement to act in good faith—it is the committee's intention to bring about an overall improvement in conduct in Australia's franchising sector, thereby reducing the need for legal action.

Mr Bernie Ripoll MP Chairman

35 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