

20 September 2019

Franchising Taskforce

By email: [franchising@employment.gov.au](mailto:franchising@employment.gov.au)

Dear Taskforce Secretary

**Developing the Government's response to the *Fairness in Franchising Report* of the Parliamentary Joint Committee on Corporations and Financial Services**

The Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (**the Committee**) is pleased to make this submission in response to the Franchising Taskforce's (**the Taskforce**) consultation for the purposes of developing the Government's response to the *Fairness in Franchising Report* of the Parliamentary Joint Committee on Corporations and Financial Services (**the Parliamentary Committee**).

The Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (**SMEs**) in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs.

Please note that the SME Committee's submission may differ from those made by other Committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs.

**Introductory comments**

Before addressing the specific questions listed in the Issues Paper, the Committee would like to make some preliminary comments.

First, the Committee has reservations regarding the composition of the Taskforce. While the Committee has no concerns about the knowledge and understanding of the current membership of the Taskforce, being senior officers from the Department of Employment, Skills, Small and Family Business, the Department of the Treasury and the Department of the Prime Minister and Cabinet, it feels that the Taskforce lacks relevant expertise in relation to the practical aspects of enforcing the Franchising Code of Conduct (**the Code**). Accordingly, the Committee would have preferred that a representative of the Australian Competition and Consumer Commission (**ACCC**) be included on the Taskforce.

The second concern is the decision not to publish responses to the Issues Paper. The Committee would prefer a more transparent process. It has no concerns about its comments being published.

The final concern relates to the scope of the Consultation. The Taskforce notes in the Issues Paper on pages 7 and 8 that a large number of issues are not within its terms of reference and will be subject to separate consultations in the future. In the Committee's view it would

be more efficient and timelier for the Taskforce to consider all of the 71 recommendations contained in the *Fairness in Franchising Report* at this time.

## Responses

The Committee notes the comment on page 7 of the Issues Paper that the Taskforce will be taking into account evidence already provided to the Parliamentary Committee and is not looking for information already on the public record. Accordingly, the Committee will not repeat the submissions made to that Parliamentary Committee both in writing and orally, on the understanding that the Taskforce will have regard to the earlier submissions as part of this Consultation.

The Committee has also chosen not to comment in relation to a number of questions which appear specifically directed to franchisors and franchisees.

## General questions

- **How has franchising changed since the new Code was introduced in 2015 and how have those changes affected your business?**

Franchising has grown considerably in the last few years. As practitioners we have noticed a rise in the number of disputes within the franchising sector. We have also perceived an increase in the number of a high-profile franchisors being exposed for engaging in illegal and questionable behaviours.

- **What action could the franchising sector take to raise standards and conduct across the sector and what could government do to help?**

In oral evidence before the Parliamentary Committee, the Committee advocated for a new Small Business Tribunal modelled on the then newly created Australian Financial Complaints Authority (**ACFA**). It advocated that the new body have arbitral powers to finally determine and resolve disputes in the franchising sector, subject to any Constitutional limitations.

- **Are the problems identified by the Committee widespread or are they localised to particular areas of the franchising sector?**

The Committee considers that the problems identified by the Parliamentary Committee are widespread and are occurring in a number of high-profile franchise groups.

- **Where the Report recommends changes to the Code, are the problems identified by the Committee significant enough that government action is needed or can it be dealt with another way (that is, without changing the Code)?**

The Committee submitted to the Parliamentary Committee that the ACCC has not been a vigorous and effective enforcer of the Code. Accordingly, the Committee believe that the Government needs to intervene to introduce an additional and more cost-effective dispute resolution system.

- **What factors need to be addressed if a recommendation or other proposal is to be implemented effectively, so that the benefits outweigh potential risks**

## **and costs?**

The primary factor which would need to be addressed is the funding for any new complaints handling body. Given the significance of the franchising sector to the Australian economy both in terms of turnover and employment, the Committee believes that any investment by Government in this area would be money well spent.

**Questions re Draft Principle 1: Prospective franchisees should be able to make reasonable assessments of the value (including costs, obligations, benefits and risks) of a franchise before entering into a contract with a franchisor**

### **1. What information is of most value to prospective franchisees?**

- **How could it be made easier for franchisees to get and use this information, for example, through the disclosure document, a register of franchises or a franchising website?**

Reliable turnover figures are of most value to prospective franchisees. However, many franchisors opt to provide little or no meaningful financial information, preferring instead to refer prospective franchisees to existing or former franchisees for such information.

It may be worthwhile to consider mandating that a minimum amount of financial information be provided by franchisors to all prospective franchisees.

### **2. How could prospective franchisees develop greater awareness of the information they need to conduct due diligence?**

It is true that many prospective franchisees are their own worst enemies in terms of not undertaking appropriate due diligence. Members of the Committee are aware of many incidences of franchisees who simply ignore their legal advice not to enter into a particular franchise business. Having said that, it would be worthwhile to make it mandatory for all prospective franchisees to obtain both legal and financial advice before entering into a franchise agreement.

### **3. Do franchisees have a good understanding of costs and fees before entering into a franchise business? If not, why not?**

Many franchisees do not have a good understanding of costs as these figures are often presented as being within a particular range. The Committee believes that most franchisees understand the main fees associated with the franchise such as franchise fees and marketing fund fees.

### **4. When conducting due diligence have you been able to find the information you sought?**

As stated above, many franchisees do not undertake adequate due diligence. It is rare for a franchisee to spend a period of time observing the operation of a similar franchise business before making a decision to enter into a franchise agreement.

**Questions re Draft Principle 2: Franchisees and franchisors should have 'cooling off' time to consider whether the relationship is right for them after signing**

### **5. Are there changes to cooling off periods that could support better decision**

making?

The Committee believes that the existing cooling off periods are adequate. Having said that, the real problem is that franchisees do not use this cooling off period for its intended purpose – namely to reflect on the wisdom of entering into the franchise.

**6. Should franchisors also get the benefit of cooling off periods?**

The Committee does not believe that a cooling off period is required for franchisors.

**Questions re Draft Principle 3: Each party to a franchise agreement should be able to verify the other party is meeting its obligations and is generating value for both parties**

**7. What information in a marketing fund statement do franchisees find helpful to understand who contributed to the fund and how the money was spent?**

The Committee included a considerable amount of information in its initial submission about this issue. Accordingly, the Committee encourages the Taskforce to review its earlier submission. Needless to say, this is an area where considerably more guidance must be provided to both franchisors and the auditors charged with the task of auditing marketing fund statements.

**8. Are there examples that show how increased frequency of reporting (from annually to quarterly) would affect the use of marketing and cooperative funds by franchisors and the costs of administering funds?**

The Committee does not believe that more regular reporting is required. Rather the focus has to be on ensuring that existing annual marketing reports are meaningful.

**9. Would franchisors consider not having a marketing fund if the Committee's recommendations about accounting standards and more regular reporting are introduced?**

It is possible that some franchisors may elect not to have a marketing fund. Having said that, the Committee does not see any detriment arising from a franchisor choosing not to operate a marketing fund. The Committee is aware of a number of large and successful franchisors which do not operate a marketing fund.

**Questions re Draft Principle 4: A healthy franchising model fosters mutually beneficial cooperation between the franchisor and the franchisee, with shared risk and reward, free from exploitation and conflicts of interest**

**10. What benefits do supplier rebates offer that cannot be achieved in other ways?**

Often supplier rebates escalate with greater volumes of sales, so such rebates create strong incentives for franchisees to market particular products more actively to their customers. The performance-based nature of many supplier rebates is of significant benefit to franchisees.

**11. What kind of information about supply restrictions, rebates, volume supply and setting maximum prices would a prospective franchisee find helpful prior to entering into a franchise agreement?**

Franchisors would benefit from understanding how rebates actually operate. Some franchise agreements state that the payment of a supplier rebate to the franchisee is at the franchisor's discretion. While it is arguable that a practice of paying these types of rebates to the franchisee over a period of time without question may create an estoppel, Committee members are aware of some franchisors which have made a unilateral decision to suspend the payment of supplier rebates to the franchisee in the context of a franchise dispute.

In its submission, the Committee referred to its concern about some franchisors setting the franchisee's Gross Profit Margins. The Committee will not repeat those comments in this submission, but rather refer the Taskforce to its earlier submission.

**12. How easy would it be for franchisors to provide the information required by recommendations 8.1 and 8.2?**

The Committee believes that it would be relatively straight-forward for franchisors to provide the information required by recommendations 8.1 and 8.2.

**13. How is co-investment and the sharing of risk and reward managed in your franchise system?**

The Committee has no comment.

**Questions re Draft Principle 5: Where disagreements turn into disputes, there is a resolution process that is fair, timely and cost effective for both parties**

**14. What options are available or could be introduced to more effectively resolve disputes between franchisees and franchisors, including the creation of a single body to manage dispute resolution processes?**

- **Are there ways to get a fairer, timely and/or more cost-effective outcome from mediation?**
- **Is there a role for mandatory arbitration when mediation does not resolve a dispute?**

The Committee canvassed this issue in some detail during oral evidence before the Parliamentary Committee. Accordingly, it refers the Taskforce to the transcript of evidence dated 21 September 2018.

**15. Should all dispute resolution services be supported by a levy paid by franchisors, if one is introduced, or only some services?**

The Committee does not consider it appropriate to comment on this issue.

**Questions re Draft Principle 6: Franchisees and franchisors should be able to exit in a way that is reasonable to both parties**

**16. Does your franchise agreement give you a fair way to exit your franchise agreement?**

- **If not, in what circumstances do you consider you should you be able to exit?**

The Committee has no comment.

**17. How do your franchise agreements provide for goodwill when the agreement ends?**

The Committee has no comment.

**18. If your franchise agreement has a restraint of trade clause, would it prevent you using skills you have developed in the franchise system in a new business?**

The Committee has no comment.

**19. What would be the overall effect on a franchise system, including other franchisees, if franchisees are able to leave a system in any of the scenarios in recommendation 11.1?**

Legislative changes along the lines proposed at recommendation 11.1 would increase the accountability of franchisors for the franchise businesses which they are selling. Franchisors should be expected to stand behind their brand and cover the franchisee's losses if the business model has proven to be flawed or if the franchise failure has occurred through no fault of the franchisee.

**Questions re Draft Principle 7: The framework for industry codes should support regulatory compliance, enforcement and appropriate consistency**

**20. What are the most common reasons for non-compliance with the Code?**

The Committee believes that there are a range of reasons for non-compliance. Minor non-compliance arises from a lack of knowledge and understanding of the Code. In addition, many franchisors do not dedicate sufficient resource to compliance activities or do not have a comprehensive compliance program in place. Major non-compliance can arise due to a belief that there is a low likelihood of the ACCC taking enforcement action against the franchisor.

**21. What would be the best mix of options that would address alleged breaches of the Code? For example, increased fines, more enforcement action, giving the ACCC power to prevent franchise sales, an industry wide ombudsman, more effective dispute resolution or any alternative ways to enforce the Code, in addition to enforcement by the ACCC.**

The Committee supports the creation of a new, more effective dispute resolution body with arbitral powers to make binding decisions. In addition, an industry wide ombudsman dedicated to the investigation and enforcement of mandatory Codes would be beneficial. The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) could fulfil this role.

Additional pecuniary penalties may also incentivise the ACCC to take more actions against larger national franchisors with a significant brand presence.

**22. Do franchisees have sufficient channels to represent your interests to government?**

The Committee is one means by which franchisees can have their interests represented to Government. The ASBFEO also serves a valuable role in representing franchisee's interests to government.

**23. What information is required to monitor the effectiveness of franchising regulation?**

- **How easy would it be to provide this information, and to ensure it is reliable?**

An independent body should be required to report annually on the ACCC's performance in terms of enforcing the Code. This body could review existing enforcement statistics, the length of investigations, and conduct interviews with franchisors and franchisees to determine whether ACCC enforcement actions are achieving general deterrence.

Please contact Meghan Warren, Chair of the Committee, on 0439 467 800 or at [mwarren@burkes-law.com](mailto:mwarren@burkes-law.com) in the first instance if you require further information or clarification.

Yours sincerely



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Chair, Business Law Section**