



Law Council
OF AUSTRALIA

Business Law Section

Future of Franchising
The Treasury
Parkes Place ACT 2600
Via email: FranchisingCode@TREASURY.GOV.AU

5 May 2014

Attention: Mr Michael Azize

Dear Mr Azize,

Amendments to the Franchising Code of Conduct and the Competition and Consumer Act

I have pleasure in enclosing a submission regarding amendments to the Franchising Code of Conduct and the Competition and Consumer Act. The submission has been prepared by the Competition and Consumer Committee of the Business Law Section of the Law Council of Australia.

If you require any additional information regarding the submission, in the first instance please contact the Deputy Chairman, Josh Simons, either by phone on 08-8236 1122 or via email: jsimons@tqlaw.com.au.

Yours sincerely,

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Review of the Franchising Code of Conduct

Submission by the Competition and Consumer
Committee of the Business Law Section of the Law
Council of Australia

5 May 2014

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Introduction

The Law Council of Australia is the peak national body representing the legal profession in Australia.

The Competition and Consumer Committee (**Committee**) of the Business Law Section of the Law Council of Australia offers the following comments on issues covered by the April 2014 'Future of Franchising' reforms.

The Committee welcomes the government's review of the Franchising Code of Conduct, and the implementation of many of the recommendations made in the report of Alan Wein on 17 May 2013 (**Wein Report**). However, there are a number of issues that the Committee wishes to raise in relation to the specific changes now proposed to the Franchising Code of Conduct (**Code**) and the *Competition and Consumer Act 2010* (**CCA**).

The Committee notes that comments are sought only on the technical aspects of implementing the law, and that there is no intention for this process to reconsider the policy underpinning these reforms. Accordingly, we have not sought to revisit the broader policy concerns raised by the Committee in its submission of 8 July 2013 responding to the Wein Report. However, to the extent that they have not been addressed in the proposed Code, the Committee continues to hold the concerns expressed in that submission.

In preparing this submission, the Committee has also had regard to the *'Regulation Impact Statement : Proposed changes to franchising regulation'* released by Treasury in March 2014 (**Regulation Impact Statement**).

Preliminary remarks

The Committee wishes to raise a preliminary matter regarding the timing of the 'Future in Franchising' reforms, and their relevance to other, ongoing areas of law reform.

The review of the Code is clearly very important, but it is occurring in the same/ similar time frame as two other very important policy initiatives which involve issues linked in no small measure to some of the matters raised by the proposed reforms to the Code. The 'root and branch' review of competition policy and law underway raises vital questions that impact on the position of those in the small business community largely affected by the Code; this work will not be completed until 2015 and there may be inconsistencies or variations in approach to the issues raised in that broader review which will impact on the proposed Code reforms. Furthermore, the Government has clearly identified 'unfair contract' reform vis a vis small business as a project it wishes to pursue. Again, this proposed area of reform may well cut across some of the initiatives proposed in the work on the Code,

Steps need to be taken in our view to ensure that any overlap or other inconsistencies that may arise in these three areas are taken into account and 'isolated'. This may wisely require a delay in the implementation of some measures proposed under the Code reforms.

Executive summary

The Committee seeks to raise issues with the proposed changes in relation to the following substantive areas of reform:

- (a) The proposed amendments to the CCA, enabling civil penalties to be awarded for breach of specified provisions of industry codes, and for the Australian Competition and Consumer Commission (**ACCC**) to issue infringement notices in respect of any such provision.
- (b) A new definition of 'extend', which is proposed to be introduced into clause 4(1) of the Code.
- (c) A new definition of 'transfer', which is proposed to be introduced into clause 4(1) of the Code, and absence of any definition of 'renew'.
- (d) A proposed new clause 24 of the Code, which would have the effect of rendering restraint of trade provisions in a franchise agreement unenforceable in certain circumstances.
- (e) Aspects of a proposed new clause 7 of the Code, which define a duty of good faith.
- (f) A new clause 31 of the proposed Code, which introduces a restriction on requiring a franchisee to undertake capital expenditure for the franchise business
- (g) Item 12 of the required form of Disclosure Document set out in Annexure 1 of the proposed Code, requiring disclosure of various information relating to online sales.
- (h) Problems with the transitional arrangements for franchise agreements entered into prior to 1 January 2015.
- (i) Various minor drafting issues identified with the proposed Code (which are set out in tables contained within Schedule 1 and Schedule 2 to this submission).

The Committee is concerned that the changes proposed in these areas go beyond recommendations made in the Wein Report, and may have undesirable and unintended effects.

Additionally, the Committee has identified a number of specific drafting issues or errors in the proposed amendments. These issues are identified in two enclosed Schedules to this submission.

1. Civil penalties and infringement notices

The Exposure Draft of the *Competition and Consumer Amendment Bill 2014* (**Exposure Draft**) includes provisions for:

- (a) the introduction of civil penalty provisions for industry codes prescribed under section 51AC of the CCA; and
- (b) the issuing of infringement notices by the ACCC where it has reasonable grounds to believe that a person has contravened a civil penalty provision of a prescribed industry code.

The Committee has a number of concerns about the drafting of the proposed new provisions. The Committee is concerned that, if implemented as drafted, the amendments will create considerable uncertainty, increased compliance costs and potentially unintended and undesirable outcomes.

Our specific concerns are set out below.

1.1 Penalties where Code provisions are ambiguous

It is well recognised that the Code has some technical flaws that render the meaning of certain provisions uncertain (see Wein Report, page 163, and submissions referenced therein).

Ambiguity and uncertainty is undesirable, particularly in the case of penalty provisions, because those governed by a civil penalty regime need to know the exact nature of their responsibilities (see Competition & Consumer Committee of the Business Law Section of the Law Council of Australia submission to Government on the Code review dated 8 July 2013, page 6).

The Exposure Draft includes amendments designed to rectify Code ambiguities, but some remain. Some examples are:

- (a) **Clause 4(1)(d)** of the existing Code forms part of the definition of 'franchise agreement' in clause 4, and is proposed to be amended in the new clause 5(1) by removing the words 'usual wholesale price' and replacing them with the phrase 'supplied on a genuine wholesale basis' in the case of goods supplied by the franchisor (or associate) to the franchisee.

The definition of 'franchise agreement' is a critical part of the Code, and the penalties of entering into an agreement that is subsequently considered to be a franchise agreement may be very substantial. However, the phrase 'supplied on a genuine wholesale basis' is not clear: does it mean that the supplier must supply its distributors at the same 'wholesale' price? Must the supplier be able to point to both wholesale and retail customers, so that it can establish that its wholesale price is 'genuine'? Does the supplier have to be able to point to a similar product supplied by a third party for a similar price?

- (b) **Clause 7** imposes a new obligation to act in good faith. The law around good faith is not settled, and the codification of the obligation in the draft Code will also create uncertainty until and when the Courts clarify the provision.

In particular, **clause 7(3)(a)** requires the parties to act in good faith in relation to a 'dispute relating to the proposed agreement' in the case of parties who propose to enter into a franchise relationship. It is unclear what is meant by 'dispute' – this must be more than negotiations regarding the proposed terms (see clause 7(3)(b)), but what is envisaged?

Further, **clause 7(3)(c)** requires negotiating parties to act in good faith in respect of the Code. However, pre-franchise agreement obligations are already covered by clauses 9, 10, 11, 12, 21 – 23. It is unclear what additional obligation clause 7(3)(c) imposes.

- (c) **Clause 10** requires the franchisor to give a prospective franchisee a copy of the Code, disclosure document and franchise agreement 14 days before signing.

The Wein Report recommended that clause 10 be amended to ensure that the franchise agreement provided be an agreement in the form it is 'intended' to be executed, since this would ensure that minor changes to a franchise agreement made after the franchise agreement was provided to the franchisee did not create the need to re-start the disclosure process under clause 10. This change was not adopted.

Proposed clause 10(3) provides that re-disclosure is not necessary in certain specified circumstances, but the meaning of terms such as 'clarification of a minor nature' (10(3)(d)) are inherently ambiguous.

Further, it is unclear whether negotiated changes to the franchise agreement will fall outside the scope of the exception for changes made 'to give effect to a franchisee's request'. For instance, if a franchisee requests that a clause be added, but the wording of the new clause is developed and proposed by the franchisor, is this a change that the franchisee has requested, or is it a new provision that has been negotiated?

- (d) **Clause 10(2)(b)** uses the expression 'extend the scope of the franchise agreement'. A new definition of 'extend' has been included in clause 4(1) of the proposed Code, but there remains considerable uncertainty as to the meaning of this expression (and, accordingly, the civil penalty obligations which are raised under clause 10(2) of the proposed Code).

[Further discussion of this issue is set out in section 2 of this submission.]

- (e) **Item 17.1 of Annexure 1** requires a franchisor to disclose prior unilateral variations to a franchise agreement, other than variations of a 'minor nature'.

The Wein Report recommended that Item 17.1 be amended to clarify whether unilateral variations included, for example, amendments to operations manuals (which are often incorporated into franchise agreements). The proposed amendment to Item 17.1 requires the franchisor to make a judgement call about whether a unilateral variation is minor or not.

The Committee recommends that Code provisions that attract penalties be clarified so that the obligations imposed on the franchising industry are unambiguous.

1.2 Are multiple penalties possible for breach of a specific clause?

Franchising is a network based business. There may be many occasions where prohibited conduct could be repeated across the network, such as:

- (a) an error in a disclosure document (clause 9);
- (b) a distributor acting on the mistaken belief that the relevant agreement was a distribution agreement and not a franchise agreement (breach of Code generally);
or
- (c) a failure to disclose relevant facts to franchisees within 14 days (clause 18).

However, most of the penalty provisions in the Exposure Draft clearly reference one-off conduct between the franchisor and franchisee as the prohibited conduct, such as:

- (a) failing to provide a copy of the relevant lease in time (clause 14(1));
- (b) failing to provide notice regarding end of term arrangements (clause 19(2)); or
- (c) failing to give the franchisee sufficient time to remedy a breach (clause 28(2)).

The Code or Part IVA of the CCA should make it clear what penalties can apply where a network wide breach occurs. For example, is such a breach one offence, or is the offence repeated across the whole network (for example for every occasion where an inaccurate disclosure document is provided?). Should the Code or CCA set out a cap on the total penalty that can be imposed where the offence arose out of the same course of conduct?

Clarification is particularly important in the case of infringement notices, which can be up to \$8,500 per notice. If multiple infringement notices can be issued for the same conduct then the total payable could equal or exceed the 300 penalty units prescribed as the maximum civil penalty for a breach.

Legislative guidance is desirable so that the ACCC is given proper guidance as to the appropriate use of infringement notices, and parties are able to properly understand their potential exposure.

1.3 Are double penalties possible where conduct may breach more than one provision?

Some conduct may breach more than one penalty provision in the Exposure Draft. For example, a non-complying disclosure document could also be a breach of the obligation to act in good faith. It is unclear whether it is intended that two different penalties could apply to one single act.

1.4 The burden of regulatory uncertainty falls largely on franchisors

Eighteen out of the twenty proposed new penalties apply to obligations that are imposed only on franchisors. It follows that uncertainty in the application of the regime falls disproportionately on the franchisor. This will lead to inefficient compliance costs and increase the impact of the regulatory regime, with no benefit to either the parties involved or the industry at large.

A possible franchisor response will be to over-provide information to the franchisee in a way which confuses a potential franchisee. For example:

- (a) a franchisor may provide details of every unilateral variation to its franchise agreement (including amendments to operations manuals) in order to minimise the risk of omitting a non-minor variation. This would not assist either party.
- (b) franchisors may choose to always re-disclose under clause 10, delaying the commencement of the franchisee's business, and increasing the franchisor's costs (which it is entitled to pass on to the franchisee under clause). Such re-disclosures are unlikely to benefit either party since a negotiated provision is more likely to be understood by the franchisee than other provisions.

Committee suggestions

In order to give the penalty regime more coherence and to address the burden of regulatory uncertainty on franchisors, the Committee recommends that:

- (a) the remaining areas of ambiguity in the Code be clarified, and
- (b) the exposure to penalties / infringement notices in the event of a breach by a franchisor be clarified.

2. Definition of 'extend'

A new definition of 'extend' has been included in the proposed Code, as follows:

extend, in relation to the scope of a franchise agreement, means a material change to:

- (a) the terms and conditions of the agreement; or
- (b) circumstances that affect the agreement; or
- (c) the rights of a person under or in relation to the agreement; or
- (d) the liabilities that would be imposed on a person under or in relation to the agreement.

The term 'extend' in relation to the scope of a franchise agreement is included in various clauses of the Code, but was previously not defined. This change was made in response to the finding in the Wein Report that clarity was needed as to the meaning of the term 'extend' in this context.

Regrettably, the definition which has been suggested does not provide further clarity or certainty. In fact, the Committee is concerned that the definition will create even greater uncertainty than presently exists.

The Committee understands references to 'extension of scope' of a franchise agreement in the Code are currently understood to mean situations where the rights granted to a franchisee are somehow increased under the franchise agreement, such as where:

- (a) the territory of the franchisee is extended;
- (b) the range of goods or services that the franchisee is entitled to make available through the franchise is increased;

- (c) where the franchise is limited to supplying approved customers, the franchisee is allocated additional customers by the franchisor; or
- (d) the franchisee is granted the right to conduct the franchised business from additional locations.

The new proposed definition, however, changes the meaning entirely from the ordinary meaning of 'extend' to include any material change to the rights, obligations, liabilities or circumstances affecting the franchise agreement. For instance, in addition to an extension (in the ordinary sense) of the scope of a franchise, the definition would capture a material reduction in the scope of the franchise.

The Committee is concerned that this change will create uncertainty in relation to some of the provisions of the Code where the term 'extend' is used.

For example, Item 18.2 of the Disclosure Document contained in Annexure 1 to the proposed Code requires the franchisor to disclose whether the franchisee will have any right to 'extend the term or scope of the franchise agreement'. A franchisee is likely to understand this to mean extend in the ordinary sense of the word. This could result in the warning notice specified in Item 18.3 either not being included in circumstances where it otherwise should, or included but conveying a misleading impression (because of the fact that the word 'extend' contained in the warning notice is being used to reflect the defined term, rather than the ordinary meaning of the word).

The Committee requests that an alternative definition of provided, which aligns more closely with the ordinary meaning of the word, but provides greater certainty as to the precise meaning. To achieve this, the Committee suggests omitting paragraph (b) of the definition, and changing the word 'change' to 'increase', such that the definition might read as follows:

extend, in relation to the scope of a franchise agreement, means a material increase to:

- (a) the rights of a person under or in relation to the agreement; or
- (b) the liabilities that would be imposed on a person under or in relation to the agreement.

3. Definitions of 'transfer' and 'renew'

There are various references within the Code to the acts of 'transferring' or 'renewing' a franchise agreement.

The Committee is concerned that the use of these terms is inconsistent.

The meaning of 'renew' (which is not defined) is also ambiguous, while the new definition of 'transfer' that has been included within clause 4(1) is unclear.

The Committee's specific concerns are as follows.

3.1 Definition of 'renew'

The term 'renew' is not defined.

The Committee is concerned that the absence of a definition of 'renew', the use of that term in the Code is unclear. In particular, the Committee is concerned that a reference to 'renew' will not capture a situation where an existing franchisee enters into a new agreement to continue the same *franchise*, rather than renewing (in a legal sense) its existing *franchise agreement*.

The Committee understands that common industry practice is for a franchisor to require that the 'renewal' of a franchisee's franchise agreement be on the basis of the franchisor's then-current franchise agreement (i.e. a new agreement). It is therefore critical that the meaning of 'renew' in the Code is defined to make clear how such a 'renewal' is treated under the Code.

The Committee suggests that a new definition of 'renew' be included in the Code as follows:

renewal, in relation to a franchise agreement, means:

- (a) a franchise agreement between a franchisor and a franchisee is renewed in accordance with its terms; or
- (b) a franchise is renewed on the basis that a new franchise agreement is entered into between a franchisor and a franchisee:
 - (i) to replace an existing franchise agreement between the same franchisor and franchisee; and
 - (ii) in respect of the same franchise as the existing franchise agreement.

3.2 Does a 'transfer' include a 'renewal'?

The new definition of 'transfer' which is contained in clause 4(1) of the Code is as follows:

transfer, in relation to a franchise agreement, includes a situation in which:

- (a) the agreement is terminated on the basis that a new franchise agreement is entered into between the franchisor and prospective transferee; or
- (b) the franchisee's rights and obligations under the agreement are assigned to a prospective transferee; or
- (c) the agreement contemplates a transfer in specified circumstances and those circumstances happen.

The Committee understands that the purpose of paragraph (a) of this definition is to capture the situation where a franchisee sells its franchised business, but to effect this the outgoing franchisee's franchise agreement is terminated and the incoming franchisee enters into a new franchise agreement directly with the franchisor.

The Committee is concerned that paragraph (a) may also capture the situation where an existing franchise agreement is replaced by a new franchise agreement with the same franchisee. If the intent of paragraph (a) of the definition of 'transfer' is to capture this situation, the Committee does not support this approach. To define what is commonly

understood to be a 'renewal' (albeit on the basis of a new agreement) as a 'transfer', would be counterintuitive and confusing.

If the intent of paragraph (a) is not to capture a 'renewal' by the same franchisee in this sense, then the Committee suggests that:

- (a) a new definition of 'renewal' is included in the Code (as suggested in section 3.1 of this submission), which includes the situation where an existing franchisee renews its franchise on the terms of a new agreement; and
- (b) a statement is included within the definition of 'transfer' making clear that a transfer does not include a renewal. This could be achieved with the following amendment:

transfer, in relation to a franchise agreement, includes a situation in which:

- (a) the agreement is terminated on the basis that a new franchise agreement is entered into between the franchisor and prospective transferee; or*
- (b) the franchisee's rights and obligations under the agreement are assigned to a prospective transferee; or*
- (c) the agreement contemplates a transfer in specified circumstances and those circumstances happen.*

but, for the avoidance of doubt, does not include a renewal.

3.3 Clause 11 of the Code

A related issue arises under clause 11 of the proposed Code. The Committee considers that the use of the defined term 'transfer' within clause 11 is confusing, and should be clarified.

If the intent of references to 'transfer' in clause 11 is to capture the situation where an existing franchisee renews its franchise on the terms of a new agreement, rather than renewing an existing franchise agreement, then this should be addressed by introducing a new definition for 'renewal' (as suggested in section 3.1 of this submission). In that event, references to 'transfer' in clause 11 could simply be deleted (including clause 11(4) in its entirety).

If that is not the intent, then the Committee does not understand why paragraph 11(4) has been included, excluding the application of paragraph (b) of the definition of 'transfer'. In particular, why would the provisions of clause 11:

- (a) apply to a situation where an incoming franchisee takes over an existing franchise by entering into a new franchise agreement directly with the franchisor (as in paragraph (a) of the definition of 'transfer'); but
- (b) not apply in the situation where the incoming franchisee takes over an existing franchise by taking an assignment of the existing franchise agreement (as in paragraph (b) of the definition of transfer, which is excluded from clause 11 by operation of paragraph 11(4))?

The Committee submits that clause 11 should either apply to a 'transfer' or not, and that paragraph 11(4) should be deleted in any event.

If 'transfer' is to be removed from clause 11 (such that a franchisor will not be required to provide a disclosure document to a 'proposed transferee'), then clause 26(3)(g) should also be deleted. Clause 26(3)(g) allows a franchisor to refuse a transfer if it has not received from the proposed transferee a written statement that the transferee has received, read and had a reasonable opportunity to understand the disclosure document.

3.4 Prospective transferees

If the term 'transfer' remains in clause 11, then there is a further problem which should be addressed.

Clause 11 makes various references to a '*prospective franchisee*', but it is not clear whether a 'prospective franchisee' includes a 'prospective transferee'. The term 'prospective transferee' is used in the definition of 'transfer' but is not otherwise defined.

If, as the Committee interprets the Code, a 'prospective franchisee' does not include a 'prospective transferee', then the various references to 'prospective franchisee' in Clause 11 will arguably be of no effect in the case of a transfer.

To address this, the Committee requests that a new subclause be added to clause 11 as follows:

For the purpose of this clause, a reference to a prospective franchisee includes a prospective transferee.

The Committee notes that such a change would not be appropriate if references to 'transfer' are removed from clause 11.

4. Removal of restraint of trade

The Wein Report identified a perceived inequity arising when a franchisor exercises a right not to renew a franchise agreement, in circumstances where the franchisee wishes to continue as a franchisee and is not in breach of the agreement.

To address this concern, the Wein Report included a recommendation that restraint of trade provisions in a franchise agreement should have no effect in certain circumstances. Specifically, Recommendation 12 of the Wein Report (**Recommendation 12**) was as follows:

The Code be amended to state that, if all of the following conditions are satisfied:

- a. the franchisee wishes to have the franchise agreement renewed on substantially the same terms;*
- b. the franchisee is not in breach of the agreement;*
- c. the agreement does not contain provisions allowing a franchisee to make a claim for compensation in the event that the franchise is not renewed;*
- d. the franchisee abides by all confidentiality clauses in the agreement and does not infringe the intellectual property of the franchisor; and*
- e. the franchisor does not renew the franchise agreement;*

any restraint of trade clauses in the franchise agreement which prevent the franchisee from carrying on a similar business in competition with the franchisor, are not enforceable by the franchisor against the franchisee.’¹

In response to Recommendation 12, the Exposure Draft proposes that a new clause 24 be inserted into the Code (**Clause 24**). However, the language that has been used in Clause 24 differs significantly from the Wein Report recommendation. The proposed Clause 24 (with the key differences from the Wein Report recommendation highlighted in **bold**) is as follows:

*A **restraint of trade clause** in a franchise agreement has no effect after the agreement ends if:*

- (a) the franchisee had sought to renew the agreement on substantially the same terms; and*
- (b) the franchisee was not in breach of the agreement; and*
- (c) **the franchisee had not infringed the intellectual property of the franchisor during the term of the agreement; and***
- (d) the franchisor does not renew the agreement; and*
- (e) either:*
 - (i) the franchisee claimed compensation because the agreement was not renewed, but the compensation given was merely a nominal amount and **did not genuinely compensate the franchisee; or***
 - (ii) the agreement did not allow the franchisee to claim compensation in the event that it was not renewed.*

The Committee considers that these differences will result in unintended and undesirable consequences. The Committee’s specific concerns are outlined below.

4.1 Restraints which do not prevent the franchisee from carrying on a similar business in competition with the franchisor

The exclusion of restraint provisions effected by Recommendation 12 applied to:

... any restraint of trade clauses in the franchise agreement which prevent the franchisee from carrying on a similar business in competition with the franchisor...

By contrast, Clause 24 commences ‘*A **restraint of trade clause** in a franchise agreement has no effect after the agreement ends if: ...*’.

The effect of this difference is that Clause 24 will apply to exclude the application of any restraint provisions under the franchise agreement, rather than just those preventing the franchisee from commencing its own competitive business. Examples of other restraints likely to apply include restraints on soliciting employees of the franchisor to leave their employment or to use confidential information of the franchisor which was provided to the franchisee for the operation of the franchised business.

This appears to have been an oversight in the drafting of Clause 24. It is clear from the Wein Report and the Regulation Impact Statement that the intent is to provide relief only

¹ Wein Report, page 109.

from those restraints that would otherwise prevent the franchisee from carrying on a competing business.

Accordingly, the Committee requests that the wording at the commencement of Clause 24 be amended by inserting the underlined text as follows:

A restraint of trade clause in a franchise agreement which prevents the franchisee from carrying on a similar business in competition with the franchisor has no effect after the agreement ends if:

4.2 Compensation must ‘genuinely compensate the franchisee’

Sub-paragraph (e)(i) of the propose Clause 24 introduces an additional condition which was not contained in the Wein Report recommendation. Whereas Recommendation 12 required that a franchise agreement contain provisions allowing a franchisee to make a claim for compensation, Clause 24 effectively requires that such compensation must ‘genuinely compensate the franchisee’.

The Committee is concerned that Clause 24 introduces uncertainty in two ways:

- (a) first, it suggests that a franchisee will be entitled to ‘*compensation*’ in the event of non-renewal by the franchisor; and
- (b) second, it introduces a qualitative element, requiring that such compensation be ‘genuine’, without providing any guidance as to the appropriate basis to calculate such compensation.

Non-renewal of a franchise agreement will not always warrant compensation

As was acknowledged in the Wein Report and the Regulation Impact Statement, there are vastly differing views as to the extent of goodwill that a franchisee holds in a franchised business, given that the business is founded on use of the franchisor’s brand and system. For this reason, some will undoubtedly form the view that very little compensation would be needed to ‘genuinely compensate the franchisee’ (as the franchisee has already enjoyed the benefit of the franchise system during the term of their agreement), while others will consider that very significant compensation would be required (given that the franchisee is effectively prevented from continuing to operate ‘its’ business).

Equally, there may be circumstances where compensation is simply not appropriate. For example, if a franchisee takes over an existing franchised business, any ‘initial fees’ are waived by the franchisor and, during the life of the franchise agreement, the performance of the franchised business deteriorates under the management of the franchisee. In that situation, the goodwill associated with the franchise has arguably diminished rather than increased as a result of the actions of the franchisee, and it is questionable whether the non-renewal of the franchise could be considered unfair (notwithstanding the application of restraint of trade provisions).

This does not mean to say that in such circumstances the restraint of trade provisions applicable to the franchisee should always apply, but the Committee considers that the existing common law restraint of trade doctrine is the appropriate way for such restraints to be assessed. Considerations such as whether there is an adequate mechanism for payment of compensation in the case of non-renewal is precisely the kind of factor that

would be considered in assessing whether a restraint of trade provision contained in a franchise agreement is reasonable under the common law doctrine.

The Committee considers that imposing what is effectively a mandatory payment of compensation to outgoing franchisees in order to preserve the important protections afforded to a franchisor by a reasonable restraint of trade is not appropriate.

What will constitute ‘genuine compensation’ is unclear

If ‘genuine compensation’ is required to be paid, then there could be a number of different ways that compensation might be assessed, including:

- (a) by reference to any actual losses that the franchisee will incur arising from existing contractual obligations with third parties as a result of the franchise agreement not being renewed;
- (b) by reference to the capital contribution the franchisee has made to the franchised business, and their ability to recoup that investment;
- (c) by reference to the additional profit the franchisor might obtain through the sale of the franchise to a third party, compared to if the franchise had been sold prior to the contribution made by the outgoing franchisee;
- (d) if the franchisee took over an operating business, the increase (or decrease) in turnover or profits generated by the business during the period it was operated by the franchisee; or
- (e) by reference to the value of goodwill associated with the business (which, as noted, would be calculated differently depending on whether the goodwill was seen to be the franchisor’s, the franchisee’s, or a combination of both).

Requiring the payment of such compensation without any guidance as to how it should be assessed, will inevitably result in disagreement and dispute between franchisor and franchisee.

Compensation provisions set out in the franchise agreement are already subject to other protections

The Regulatory Impact Statement explains the basis for Clause 24 as follows:

... it is [appropriate²] to put in place adequate safeguards to avoid grossly unfair outcomes for the franchisee at the end of the franchise agreement.

The Committee considers that this overstates the potential harm to franchisees.

In assessing the need for additional protection, it is important to remember that:

- (a) restraint of trade provisions are already required to be ‘reasonable’ in order to be enforced under the common law (and assessing the reasonableness of the restraint will include assessment of any agreement regarding associated compensation to be paid to the franchisee); and

² Note that the Regulatory Impact Statement states ‘inappropriate’, but the Committee understands this to be a typographical error.

- (b) the new duty of good faith to be introduced into clause 7 of the Code (as well as any existing common law duty of good faith) will require that franchisors make any decision not to renew a franchisee's agreement on a proper basis.

If a restraint provision is 'reasonable' and the decision not to renew a franchise agreement is made in good faith, it is difficult to see how a 'grossly unfair' outcome could result.

The greater risk would appear to be that franchisees are not properly aware of the potential for their franchise agreement to not be renewed at the time they first enter into the agreement.

The preferred approach

For the reasons discussed, the Committee's view is that Clause 24 as proposed is likely to increase uncertainty and disputes between franchisees.

In the Committee's view, the parties to a franchise agreement should be entitled to agree the terms of any compensation to be paid in the event of non-renewal at the time of entering into the agreement. This is consistent with the approach recommended by the Wein Report in Recommendation 12.

The requirements of Item 18.1(b) of the Disclosure Document (as specified in Annexure 1 of the proposed Code) already provide for disclosure to franchisees as to the nature and extent of any compensation provisions that apply at the end of the term of their franchise agreement. However, this protection could be bolstered by including a specific disclosure in the 'Information Statement' that will be required under clause 12 of the proposed Code.

4.3 Continuation of intellectual property and confidentiality obligations

Paragraph d. of Recommendation 12 stipulated that one of the conditions for a franchisee to be released from a restraint of trade provision was that:

- d. the franchisee abides by all confidentiality clauses in the agreement and does not infringe the intellectual property of the franchisor; and*

Clause 24 has included a different formulation of this subclause, as follows:

- (c) the franchisee had not infringed the intellectual property of the franchisor during the term of the agreement; and*

There are two significant distinctions between these provisions.

The first issue is that Clause 24 is expressed in the past tense. The effect is that the franchisee must have complied with its intellectual property and confidentiality obligations *prior* to the expiry of the franchise agreement. However, if the franchisee breaches those obligations after the expiry of the agreement, it will still be released from the restraint of trade provisions. By contrast, Recommendation 12 was expressed in the present tense. The effect, and apparent intent, of paragraph d. of Recommendation 12, was to ensure that the release from the restraint of trade provisions would not apply if the franchisee breached the confidentiality and intellectual property provisions during the period of the restraint. The Committee notes that subclause 24(b) already deals with

breaches of the agreement in existence prior to the expiry of the agreement (which would include breaches of confidence or intellectual property rights).

The second issue is that Clause 24 makes no reference to confidentiality clauses applying under the agreement. The basis for this omission is unclear; it is not referenced in the Regulation Impact Statement. What is of particular concern to the Committee is that because confidential information is a species of intellectual property which is protected by contract rather than statute, on one view it is a form of 'restraint of trade'. The Committee is concerned that the failure to reference confidential information specifically in Clause 24 may result in the franchisee being released from obligations of confidence that should legitimately apply.

To address these concerns, the Committee recommends that subclause (c) of Clause 24 be replaced with the text used in subclause d. of Recommendation 12.

4.4 Requirement to renew on substantially the same terms

Paragraph (a) of Clause 24 stipulates that one of the conditions for a franchisee to be released from a restraint of trade provision is that:

- (a) the franchisee had sought to renew the agreement on substantially the same terms; and*

The Committee is concerned that this clause will effectively prevent necessary changes being made by franchisors to their standard form franchise agreements. Franchise agreements may have terms of 10 years or more, in the course of which commercial and regulatory requirements would typically change. Amendments to reflect these changes are likely to be required.

The Committee supports drafting that will prevent the policy intent of Clause 24 being undermined. However, the Committee is concerned that the present drafting will prevent franchisors from making necessary changes to their standard form franchise agreements, which may put them in breach of their legal obligations.

To address this concern, the Committee recommends that the language of Clause 24(a) be amended, so that it reads as follows:

- (a) the franchisee had sought to renew the agreement on the terms of the franchisor's then-current franchise agreement (or, if the expiring franchise agreement specifies that particular terms will apply in the case of a renewal, in accordance with those terms); and*

4.5 Other renewal requirements

Franchise agreements that contemplate renewal commonly include a renewal option exercisable by the franchisee subject to the franchisee complying with particular requirements. These requirements are often broader than those contemplated in Clause 24, typically including requirements such as:

- (a) the franchisee must give written notice to the franchisor seeking to exercise its renewal option within a particular time frame (for example, between 7 - 9 months prior to the end of the current term to enable the franchisor to comply with its obligations under clause 20A(1) of the Code);

- (b) the franchisee must agree new key performance indicators, or develop a new business plan, in connection with the franchisee's performance during the renewal period;
- (c) the franchisee (and any guarantors) must enter into the franchisor's then current franchise agreement and associated documentation in respect of the renewal term;
- (d) the franchisee must have secured a new lease or occupancy right from the landlord to continue to operate from the premises for the renewal term; and
- (e) the franchisee must sign and return to the franchisor the written statement required under clause 11 of the Code.

Generally, these requirements are included in the renewal provisions of the franchise agreement, and are considered necessary to practically manage the renewal process in accordance with the Code, and to protect the franchisor's legitimate business interests.

The Committee is concerned that, as presently drafted, Clause 24 could enable a franchisee to:

- (a) assert that it wishes to renew the its franchise agreement; but
- (b) fail to comply with the requirements specified by the franchisor in order to effect a renewal;
- (c) fail to comply with the requirements of the landlord for refurbishment required under the lease; and
- (d) nonetheless be released from the restraint of trade provisions when the agreement consequently expires (notwithstanding that the franchisor in fact wanted to renew the agreement, but could not do so due to the actions of the franchisee).

To address this concern, the Committee requests that paragraph (b) of Clause 24 be amended, by inserting the underlined text as follows:

(b) the franchisee was not in breach of the agreement and complied with all reasonable requirements of the franchisor to effect the renewal; and

5. Good faith

In its submission to the Wein inquiry, the Law Council opposed amending the Code to include an express obligation to act in good faith. The Law Council's main concern was that introducing an obligation to act in good faith would create unnecessary uncertainty and increase compliance costs for franchisees and franchisors.

Recommendation 9 in the Wein Report was to amend the Code to include an express obligation to act in good faith. However, the Wein Report recommended against defining good faith, instead stating that the unwritten law relating to good faith should be incorporated in a manner similar to the unconscionable conduct prohibition set out in section 20 of the *Australian Consumer Law*.

Clause 7 of the proposed Code introduces an obligation to act in good faith but departs from Recommendation 9 of the Wein Report in that the proposed clause contains a partial or inclusive definition of good faith at clause 7(2). As the Law Council has previously stated, attempting a Code definition of good faith will necessarily lead to parallel development of two distinct meanings of good faith, one in the Code and one under the common law. This would increase uncertainty and cost, because parties to franchise agreements will now need to seek advice on the meaning of good faith as an implied obligation in the agreement and the definition of good faith in the Code. As disputes eventuate, divergent lines of jurisprudence are bound to evolve. That is presumably why the Wein Report recommended against a Code definition of good faith.

The proposed clause 7 attempts to address some of these concerns by formulating an inclusive, rather than an exhaustive definition and by adding specific explanatory provisions at clauses 7(6) and 7(7). However, provisions of this kind will only serve a purpose to the extent that the Code definition of good faith diverges from the common law definition.

The inclusive definition employs concepts of 'honesty', 'arbitrary' and 'cooperation' from the common law of good faith. However, the choice of words and the manner of their deployment necessarily affects meaning. For example, the word 'honestly' is likely to have a different meaning when it is contrasted in the definition with 'arbitrarily'. Even as it is used in the common law of good faith, there is some controversy as to what is and is not honest in a commercial context. The linking of cooperation with the purpose of the agreement may lead to further controversy about the purpose of the agreement. The attempt to define good faith, even inclusively, does nothing to clarify these issues and may actually add to the confusion. At least reliance on the common law to define good faith would allow parties and advisers to examine concepts like honesty, arbitrariness and cooperation in the context of the facts and reasoning within which they were originally employed.

The proposed clause 7 may appear at first glance to maintain harmony with the common law, but the Committee's view is that it will in fact have the opposite effect. Clause 7(8), which purports to prevent clause 7 from limiting the common law good faith obligation, does not entirely address the problem, because it has no effect where the Code extends the definition of good faith beyond the common law definition.

The Committee's view is that if there is to be an express duty of good faith introduced into the Code, it should be limited to importing the common law duty into dealings between the parties to a franchise agreement, and should not seek to define the scope of that duty in any way.

6. Supply of goods or services – online sales

Item 12 of the proposed Disclosure Document set out in Annexure 1 of the proposed Code (as required by clause 9(3) of the Code) includes a new provision relating to online sales.

The revisions have clearly been drafted with the intention of providing (prospective) franchisees with information relevant to the assessment of the viability of the franchised

business, to allow for more informed decisions. The provision of further information regarding online sales is regarded as justifiable given the growth in online trading, and its potential impact on traditional bricks-and-mortar stores.

The Committee agrees with the concept and intention underlying Item 12 of the Disclosure Document, but has concerns regarding the breadth of the proposed wording of this section.

6.1 Concerns regarding Item 12 of the Disclosure Document

The Committee is concerned that the breadth of information required by the proposed Item 12 of the Disclosure Document specified in the Code is far wider than is necessary, and may place a significant burden on franchisors for no significant benefit to franchisees.

There are also a number of aspects of the proposed drafting which the Committee is concerned will create uncertainty, and increase the potential for disputes to develop between franchisors and franchisees.

The Committee's comments on its specific concerns with the proposed revisions are set out below. Some suggested revisions to address the concerns identified are then suggested in section 6.2 of this submission.

Details of availability of goods or services online

Item 12.1 of the Disclosure Document specified in the proposed Code describes the information that is required to be disclosed as follows:

12.1 Details of whether:

- (a) the franchisor or an associate of the franchisor; and*
 - (b) the franchisee; and*
 - (c) other franchisees;*
- may make goods or services available online.*

The use of the word 'may' appears to require disclosure of any possibility of online sales, regardless of how unlikely or remote.

The Committee is concerned that the breadth of this obligation will make it difficult to comply with. A franchisor's approach to online trading could change significantly during the term of a franchise agreement. For instance, a franchisor may be considering the implementation of an online sales facility at the time of disclosure, but later change its position for legitimate commercial reasons. There is potential for the franchisor to be exposed to a claim by franchisees, such as for misleading or deceptive conduct, in this kind of situation or the reverse (where a franchisor initially discloses no online sales mechanisms, but during the term of a franchise agreement legitimately changes its position and commences online sales).

A further issue with this language, is that it requires disclosure of where goods or services may be made available online, even in circumstances where those online sales would not compete with the franchisee (for example, online sales activity restricted to another state or another country). The Committee appreciates that this is dealt with in subclause 12.2(a), but if a franchisor has franchisees across the world who have the

ability to engage in online sales, clause 12.1 may impose a significantly onerous burden, for no benefit to the franchisee.

At a minimum, the Committee suggests that subclause 12.1 and 12.2 each be limited to persons that make goods or services *'available for purchase online by customers located within Australia'*. This amendment would ensure that no disclosure was required where a franchisor licenses a business to conduct online sales if that licensee is prevented from supplying customers located in Australia.

Information regarding online sales by franchisor, its associates and other franchisees

Item 12.2 of the Disclosure Document specified in the proposed Code describes the information that is required to be disclosed as follows:

- 12.2 If goods or services may be made available online by the franchisor, an associate of the franchisor or other franchisees, the following information:*
- (a) the extent to which those goods or services may be supplied in the territory of the franchise;*
 - (b) in the case of goods or services made available via a third party website—the domain name or URL of the third party website and full registration details of the domain name.*

Paragraph (a) suffers from similar ambiguity to that raised by Item 12.1. The requirement to describe 'the extent' to which goods or services 'may be supplied' appears to require a level of speculation on the part of the franchisor which will give rise to unnecessary risk, and raise the potential for disputes to arise where the franchisor's assessment proves incorrect.

In relation to paragraph (b), the requirement to provide 'full registration details' is broad, and in certain instances may go further than the information which is available through public searches. For example, AusRegistry makes registrant information available for '.com.au' domains through free Whois searches conducted via the AusRegistry website. The details available through this facility include details of the registrant, its eligibility name and identification number, and certain registrant and technical contact details, as well as date of last modification of the registration details. Though in certain instances date of last modification is the date of first registration, no specific information in the nature of the date of first registration, or date of expiry of the domain name is supplied for '.com.au' domain names (though it can be accessed for '.com' domains names). In addition, the registration details of many domain names is not publically available due to the use of privacy services by domain name registrants.

By requiring 'full details', paragraph (b) arguably require the supply of additional information that is largely irrelevant to franchisees, and which franchisors are unlikely to record and retain in relation to third party websites, particularly where those domain names are in the '.au' domain space.

Details of third party website and conditions/restrictions

Item 12.4 of the Disclosure Document specified in the proposed Code describes the information that is required to be disclosed as follows:

12.4 Details of whether goods or services may be made available online via a third party website, and if so, whether any conditions or restrictions apply to the use of the third party website.

The intent and requirements of this provision are not clear. Item 12.1 refers only to online sales by the franchisor, the franchisee, and other franchisees of the franchisor. Item 12.4 appears to also include additional third parties.

It is unclear what supplies the provision is intended to relate to. For instance, is the intent that the franchisor disclose:

- (a) what goods or services the franchisor supplies to third parties so that those third parties may make them available to online customers in competition with the franchisee?
- (b) what goods or services the franchisee will be able to source from third party websites itself, for use or re-sale in the conduct of the franchised business?
- (c) whether the franchisee may make goods or services available via a third party website?

The reference to conditions and restrictions is also ambiguous, as it can be interpreted as meaning either the relevant contractual restrictions and conditions in the franchise agreement, or the terms and conditions that the third party owner has attached to use of the website the disclosure relates to. If the latter, then the Committee is concerned that it would be an unduly onerous burden for franchisors to summarise the terms and conditions imposed by a third party on the use of their website (for example, if sales through a global site such as eBay were permitted by a franchise agreement, then potentially franchisors could be required to summarise all relevant aspects of eBay's terms, conditions, policies and procedures), and could potentially expose franchisors to claims of misleading or deceptive conduct, or misrepresentation, if those third party restrictions and requirements are misunderstood or misinterpreted and as a consequence incorrectly described in the Disclosure Document.

If (as the Committee anticipates) the intent of this provision is that the franchisor make clear any restrictions that it imposes on franchisee's ability to make its goods or services available via third party websites, then this should be more clearly expressed.

Details of agreements with third parties for online sales

Item 12.5 of the Disclosure Document specified in the proposed Code describes the information that is required to be disclosed as follows:

12.5 Details of whether the franchisor requires the franchisee to enter into an agreement with a third party in relation to making goods or services available online.

If present in a franchise agreement, a requirement of this kind this is likely to amount to third line forcing under the *Competition and Consumer Act 2010*. The Committee

therefore suggests that a note similar to that included in Item 11 of the Disclosure Document be included at this Item, stating that franchisors may notify or seek ACCC authorisation in relation to a requirement of this kind.

Profit sharing arrangements

Item 12.6 of the Disclosure Document specified in the proposed Code describes the information that is required to be disclosed as follows:

12.6 Details of any profit sharing arrangements that apply in relation to goods or services made available online and whether these arrangements may be unilaterally changed by the franchisor.

Because Item 12.1 refers to goods or services made available online by the franchisor or other franchisees (and not just goods or services made available online by the franchisee), this appears to capture profit sharing arrangements that have nothing to do with the franchisee.

The Committee presumes that this is not the intent, and that the only profit sharing arrangements that it is intended be disclosed are arrangements involving the franchisee. This should be more clearly stated.

6.2 The Committee's suggested approach

The Committee understands from the Regulation Impact Statement that the principal concerns sought to be addressed by the Code revisions in relation to online sales are to ensure that franchisees are aware of:

- (a) any limitations on their own rights to undertake online sales of franchised goods and services under the terms of their franchise agreement; and
- (b) the extent to which the franchisor, or others granted rights by the franchisor, may be permitted to engage in online sales activities in competition with the franchisee.

The Committee supports the Code being amended to address these concerns. However, the Committee considers that the drafting proposed goes well beyond what is necessary to meet these objectives. Of greater concern, as has been identified, the Committee considers that the disclosures sought to be required by the new Item 12 will create uncertainty, and place a significant burden on franchisors for no real benefit to franchisees.

The Committee suggests that Item 12 be simplified and expressed to confine itself to the core objectives referred to in paragraphs (a) and (b) above.

The Committee offers the following alternative wording for consideration:

12.1 Details of whether the franchisee is permitted to make goods or services available online.

12.2 If goods or services can be made available online by the franchisee, the following information:

- (a) any terms or conditions of the franchise agreement which restrict the ability of the franchisee to make goods or services available online; and*

- (b) details of whether the franchisee is permitted to make goods or services available online via a third party website (including whether the franchisor imposes any conditions or restrictions on the franchisee's use of such third party websites); and
- (c) the extent to which those goods or services are permitted to be supplied by the franchisee outside the territory of the franchise.

12.2 Details of whether:

- (a) the franchisor or an associate of the franchisor; and/or
- (c) other franchisees;

are permitted to make goods or services available online within Australia.

12.2 If goods or services are permitted to be made available online by the franchisor, an associate of the franchisor or other franchisees, the following information:

- (a) the extent to which those goods or services are permitted to be supplied in the territory of the franchise;
- (b) in the case of goods or services that are made available online via a third party website, the domain name or URL of the third party website.

7. Significant capital expenditure

The exposure draft of the revised Franchising Code of Conduct introduces a new restriction into the Code regarding requirements on a franchisee to undertake capital expenditure for the franchise business.

Under clause 31 of the proposed revised Code:

A franchisor must not require a franchisee to undertake significant capital expenditure in relation to a franchised business during the term of the franchise agreement.

However, subclause 31(2) of the proposed revised Code expressly excludes a number of categories of expenditure from “significant capital expenditure” covered by the restriction in subclause 31(1). Put briefly, subclause 31(2) excludes:

- (a) expenditure that is disclosed to the franchisee before the franchise agreement is entered into or renewed;
- (b) expenditure approved by a majority of franchisees;
- (c) expenditure incurred by the franchisee to comply with legal obligations;
- (d) expenditure agreed by the franchisee;
- (e) expenditure that the franchisor considers is necessary as capital investment in the franchised business, justified by a statement of the rationale, amount, anticipated outcomes and benefits and expected risks.

In the Committee’s view, the proposed new prohibition on capital expenditure represents a potentially very broad and serious constraint on the flexibility of franchise agreements and is drafted in terms that provide little certainty to either the franchisor or franchisee as to important terms in the franchise agreement.

Firstly, there is no definition or guidance on what might constitute “significant capital expenditure” for the purposes of subclause 31(1). There is also substantial uncertainty

about what requirements as to capital expenditure are permissible by virtue of subclause 31(2).

In particular, it is not clear from paragraph 31(2)(a) whether it is intended that that paragraph permits requirements as to expenditure of a general nature that are disclosed to the franchisee, or whether the specific amount and nature of the expenditure must be disclosed to avoid the prohibition in subclause 31(1).

The same uncertainty applies in relation to whether paragraph 31(2)(d) excludes expenditure which agreed to in the general (rather than specific) terms by the franchisee. It is also not clear whether paragraph 31(2)(d) excludes expenditure which merely described in the franchise agreement itself.

The Committee further submits that the exclusion of expenditure from the restriction expressed in paragraph 31(2)(e), that is, expenditure considered by the franchisor to be necessary and justified by a statement on the specified matters, is at best vague and uncertain in scope, and may be unduly restrictive if applied narrowly. It is not clear what to apply this exclusion the franchisor must consider the expenditure to be “necessary”, as opposed to being reasonable and appropriate.

There would also be uncertainty introduced by the proposed requirement that the expenditure excluded by paragraph 31(2)(e) must be “justified” by the specified statement as to its rationale, etc. In the Committee’s view, it will be very difficult for the franchisor or franchisee (or, for that matter, the ACCC as regulator) to judge whether the statement “justifies” the expenditure.

The Committee respectfully submits that further and careful consideration as to appropriate wording is required before a blanket restriction of such an important nature is introduced into the Code.

8. Transitional arrangements

The Committee understands that the Government's intent is that:

- (a) the current Code will apply to franchise agreements entered into prior to 1 January 2015; and
- (b) the proposed Code, once prescribed, will apply to franchise agreements entered into on or after 1 January 2015.

The Committee supports this intent. However, the Exposure Draft does not achieve this objective.

The Committee has three specific concerns, which are outlined below.

8.1 Franchise agreements will be subject to dual regulation

The current Code is prescribed under the *Trade Practices (Industry Codes – Franchising) Regulation 1998 (1998 Regulation)*.

Rather than amending the existing Regulation or the current Code, the Exposure Draft proposes to introduce the new Code under a new Regulation, named the *Competition and Consumer (Industry Codes – Franchising) Regulation 2014 (2014 Regulation)*.

The 2014 Regulation (if passed) will not repeal the 1998 Regulation, meaning that the 1998 Regulation and the current Code will continue to apply.

If the 2014 Regulation is passed in its current form, the effect will be that:

- (a) Pursuant to clause 3 of the new Code, the new Code will apply to all franchise agreements entered into on or after 1 January 2015; and
- (b) Pursuant to clause 5 of the current Code, the current Code will apply to any franchise agreement entered into on or after 1 October 1998 (with certain subsequent amendments to the Code applying, respectively, to agreements entered into on or after 1 March 2008 and 1 July 2010).

In the absence of an amendment to the current Code, it will continue to apply not only to existing franchise agreements, but to any franchise agreement entered into after the dates specified in clause 5. That is, franchise agreements entered into after 1 January 2015 will be subject to *dual regulation*, and would need to comply with *both* the current Code and the new Code.

This is clearly not the Government's intent. In order to avoid this situation, however, it is necessary for the current Code to be amended, so that it specifies that it does not apply to any franchise agreement entered into on or after 1 January 2015.

8.2 Existing Code will sunset on 1 April 2019

As the Regulatory Impact Statement notes, the 1998 Regulation will sunset on 1 April 2019 pursuant to section 50 of the *Legislative Instruments Act 2003*. There is no proposal to introduce legislation to extend that date.

As a result, unless subsequent amending legislation is passed, the current Code will cease to be of any effect on and from 1 April 2019.

In that event, any franchise agreement that is not subject to the new Code (i.e. potentially any franchise agreement entered into prior to 1 January 2015) will not be the subject of *any prescribed code*.

To address this, the sunset date either needs to be extended, or the new Code amended to deal with regulation of franchise agreements entered into prior to 1 January 2015.

Alternatively, the 1998 Regulation could be repealed, and the current Code re-prescribed under the 2014 Regulation (i.e. the 2014 Regulation would prescribe two forms of Code – one to apply to franchise agreements entered into prior to 1 January 2015, substantially in the same form as the current Code, and one to apply to franchise agreements entered into on or after 1 January 2015, in the form of the proposed Code).

8.3 Existing agreements where the scope is 'extended'

The Committee is concerned that a further unintended effect will arise by reason of the broad definition of 'extend' that has been included in the proposed Code.

Clause 5 of the proposed Code, which defines a 'franchise agreement', states at paragraph 5(2):

- (2) *For subclause (1), each of the following is taken to be a franchise agreement:*
- (a) *the transfer or renewal of a franchise agreement;*
 - (b) *the **extension of the term or the scope** of a franchise agreement;*
 - (c) *a motor vehicle dealership agreement.*

Clause 4(1) of the proposed Code contains a definition of 'extend' as follows:

- extend**, in relation to the scope of a franchise agreement, means a material change to:*
- (a) *the terms and conditions of the agreement; or*
 - (b) *circumstances that affect the agreement; or*
 - (c) *the rights of a person under or in relation to the agreement; or*
 - (d) *the liabilities that would be imposed on a person under or in relation to the agreement.*

Section 2 of this submission outlines various concerns that the Committee has with this definition. Additional to those comments, however, the Committee is concerned about the effect that this broad definition will have on transitional arrangements under the Code.

In particular, the Committee is concerned that paragraph (b) of this definition is unclear, and may capture events which are unrelated to any agreement that might be made between the franchisor and franchisee. For example, if a franchisor changes the goods supplied for the purpose of the franchise, or changes the supplier of such goods, will this constitute 'circumstances that affect the agreement'? If a landlord who is unrelated to franchisor imposes new conditions on the franchisee, or a director of the franchisee resigns, will these be 'circumstances that affect the agreement'?

The problem that this uncertainty creates, is that if the scope of the franchise is 'extended' within the meaning of this definition, it is deemed under clause 5(2)(b) of the proposed Code to be a new franchise agreement. This means that the agreement will thereafter be subject to the new Code (by operation of clause 3(1)(a)), notwithstanding that the contract itself has not been amended (and may therefore not comply with the requirements of the new Code).

To address this, the Committee suggests that either:

- (a) the definition of 'extend' is amended as outlined in section 2 of this submission; or
- (b) at a minimum, clause 3(2) be amended by adding an additional sub-paragraph, making clear that unless material amendments are made by written agreement between a franchisor and franchisee to a franchise agreement entered into prior to 1 January 2015, that the new Code will not apply to that agreement.

9. General drafting issues

In addition to the substantive issues raised by the Committee in this submission, a number of drafting errors and inconsistencies have been identified, which should be corrected or addressed.

The only error identified in the Exposure Draft for the 2014 Regulation, is that the reference in 51ACC(2)(b)(ii) to section 51ACF should refer to 51ACJ.

In relation to the proposed Code, identified errors and inconsistencies are summarised in two enclosed schedules to this submission, namely:

- (a) Schedule 1, which sets out issues identified in the main provisions of the proposed Code; and
- (b) Schedule 2, which sets out issues identified in the Disclosure Document contained in Annexure 1 to the proposed Code.

10. Further contact

The Committee would be pleased to discuss any of the matters outlined in this submission further should it be desired. Please contact Michael Corrigan of Clayton Utz on (02) 9353 4187 or by email mcorrigan@claytonutz.com or Josh Simons of Thomson Geer on (08) 8236 1122 or by email jsimons@tglaw.com.au to facilitate further discussions.

Schedule 1

Drafting issues identified in the proposed Code

Code reference	Comment
Definition of 'franchise'	<p>The definition of 'franchise' included in the proposed Code includes a paragraph (d) as follows:</p> <p><i>(d) an interest in a franchise;</i></p> <p>This Committee is unclear as to the intent of this paragraph. The clause will create uncertainty, because the meaning of 'an interest' is unclear. For example, does a landlord have 'an interest' in a franchise that operates from its leased premises? Does a bank who grants finance to a franchisee have 'an interest' in the franchise (particularly if they take security)?</p> <p>The Committee's view is that the preceding paragraphs of the definition are sufficient to capture what should properly be regarded as a 'franchise' for the purpose of the Code. Paragraph (d) should therefore be deleted.</p>
Definition of 'franchisee'	<p>The definition of 'franchisee' included in the proposed Code includes a paragraph (d) as follows:</p> <p><i>(b) a person who otherwise participates in a franchise as a franchisee;</i></p> <p>This clause is circular and unclear, given its reliance on the phrase 'as a franchisor'.</p> <p>The Committee is also concerned that the clause will create uncertainty, because the meaning of 'participate in a franchise' is unclear. For example, does an employee, shareholder or director of a franchisee 'participate in the franchise'?</p> <p>The Committee's view is that paragraphs (a), (c) and (d) of the definition are sufficient to capture what should properly be regarded as a 'franchisee' for the purpose of the Code. Paragraph (b) should therefore be deleted.</p>
Definition of 'franchisor'	<p>The definition of 'franchisor' included in the proposed Code includes a paragraph (b) as follows:</p> <p><i>(b) a person who otherwise participates in a franchise as a franchisor;</i></p> <p>This clause is circular and unclear, given its reliance on the phrase 'as a franchisor'. The paragraph should be deleted.</p>
Definition of 'motor vehicle'	<p>In the list of examples of motor vehicles, there is no item (b) (the numbering sequence is (a), (c), (d), etc).</p>
Clause 9(1)	<p>This should refer to both subclauses (3) and (4) (rather than just subclause (3)). Adding this second subclause reference is also consistent with the approach under the current Code.</p>

Clause 9(6)(a)	<p>As drafted, the franchisor would not need to update its disclosure document if it entered into 1 franchise agreement (and met the criteria in sub-paragraph(b)), but would not qualify for this exemption if it entered into no franchise agreements. To avoid this outcome, the Committee recommends that clause 9(6)(a) is amended to read as follows:</p> <p>'the franchisor entered into less than two franchise agreement during that financial year; and'</p>
Clause 9(7)	<p>For clarity the Committee recommends that the words 'a 3-year period' are replaced with 'any consecutive period of three financial years'</p>
Clause 10(3)	<p>Clause 10(3) provides some welcome flexibility to the otherwise stringent requirements of 10(1)(c), but there is now an inconsistency between this clause and Item 13.3 of Annexure 1 of the Code.</p> <p>Item 13.3 requires the franchisor to provide specific information about the site <i>at the same time as the disclosure document</i>. Accordingly, if there is a change of address of the premises at which the franchisee is to conduct the franchised business, a new disclosure document would need to be issued together with the site history document in order to comply with Item 13.3, notwithstanding that 'changes of address' are one of the circumstances listed under clause 10(3) as not requiring a re-issue of the disclosure document.</p>
Clause 16(2)	<p>The reference in 16(2) to paragraph (1)(b) is incorrect. This should read: 'A franchisor does not have to comply with paragraph (1)(c) in respect of a financial year if: ...'</p>
Clause 17(1)	<p>The rationale for the longer period under clause 17(1)(a) is not clear since this clause does not require the disclosure document to be updated.</p> <p>If the intent is that a disclosure document to which the exemption in subclause 9(6) of the Code applies must be updated in the event that a copy is requested by a franchisee pursuant to clause 17, then this should be stated in subclause 9(6). This could be done by amending subclause 9(6) as follows:</p> <p style="text-align: center;"><i>However, <u>unless and until a copy of the disclosure document is requested by an existing franchisee</u>, the franchisor need not...</i></p> <p>In that event, however, the Committee considers that the period of 28 days specified in clause 17(1)(a) is inadequate, and should be amended to 4 months, consistent with subclause 9(5).</p>
Clause 19	<p>The words 'The franchisor of a franchise agreement' should be replaced with 'A franchisor'.</p>
Clause 20(1)	<p>As drafted, this retention obligation is ongoing. This clause should be amended to impose a minimum time frame for retention (for example, 'for six years after the date upon which the franchisee ceases to be a franchisee of the franchisor'). Without a timeframe, this requirement is unduly onerous and will, over time, require significant storage capabilities</p>

	<p>on the part of the franchisor.</p> <p>The Code generally requires the franchisee to provide, or requires the franchisor to obtain from the franchisee, (rather than 'allows a franchisee to give to the franchisor (which could be broadly construed) particular written materials. For clarity to clause should be amended to read 'If this code requires the franchisee to provide, or requires the franchisor to obtain from the franchisee, something given by the franchisee to the franchisor in writing, then the franchisor must each keep the written thing or a copy of it.'</p>
Clause 21	<p>Clause 21 has been amended from the equivalent provision 16(1) and (1A) in the existing Code. However, the language has been changed from 'must not contain or require the franchisee to sign' to simply 'must not require the franchisee to sign'.</p> <p>The effect of this change would mean that if the franchise agreement itself contained a general release or waiver of the type described, as opposed to simply requiring the franchisee to sign such a release or waiver, it would fall outside the scope of the prohibition.</p> <p>The Committee assumes that this is not the intent and suggests that the previous wording be reinstated in the new proposed Code.</p>
Clause 32	<p>Clause 32 is not expressed to only apply where a franchisor operates a marketing fund to which franchisees contribute. Many franchise systems do not include such marketing funds, and the application of the clause in such circumstances is unclear and may lead to uncertainty.</p> <p>The Committee suggests that clause 32 is qualified to make clear that it only applies where the franchisor operates a marketing fund.</p>
Clause 33	<p>A written request as referred to in subclause 33(1) is often given while the person is still a franchisee. Similarly, influence as referred to in subclause 33(3) may be applied by the franchisor while the person is still a franchisee. The Committee suggests that the wording in both clauses should therefore be amended to enable this scenario.</p> <p>The Committee suggests that each reference to 'former franchisee' in clause 33 be amended to read 'franchisee or former franchisee'.</p>

Schedule 2

Drafting issues identified in Annexure 1 to the proposed Code

Annexure 1 reference	Comment
Item 7.5	<p>There are a number of references to ‘franchise agreement’ within item 7.5 that should refer to ‘master franchise agreement’. The language in paragraph (h) is also unclear.</p> <p>The Committee considers that the following amendments should be made:</p> <p><i>7.5 The following details about the master franchise:</i></p> <ul style="list-style-type: none"> (a) <i>the term of the <u>master franchise</u> agreement, including the date that it began;</i> (b) <i>the territory of the franchise;</i> (c) <i>whether the <u>master franchise</u> agreement may be renewed;</i> (d) <i>whether the term of the <u>master franchise</u> agreement may be extended and if so, any preconditions applying to an extension;</i> (e) <i>whether the scope of the <u>master franchise</u> agreement may be extended;</i> (f) <i>whether the <u>master franchise</u> agreement may be transferred, and if so, whether the franchisee is required to become a party to a franchise agreement with the transferee;</i> (g) <i>the grounds on which the <u>master franchise</u> agreement may be terminated;</i> (h) <i>if the <u>master franchise</u> agreement is terminated, how any franchise agreement entered into by <u>the terminated master franchisee between a subfranchisor’s franchise agreement with a franchisee</u> is affected.</i>
Item 18.1(a)	<p>The reference to ‘whether the prospective franchisee will have any options...’ is vague and uncertain. The Committee suggests that the word ‘options’ be replaced with the word ‘right’.</p>
Item 18.3	<p>For the same reasons described in relation to Item 18.1(a), the Committee suggests that the word ‘option’ be replaced with the word ‘right’.</p>