



# **An Australian Consumer Law Fair markets – Confident consumers**

**Standing committee of Officials of Consumer Affairs**

Submission from

**FRANCHISE COUNCIL OF AUSTRALIA**

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## 1. Executive summary

The Franchise Council of Australia supports the reform of Australia's state based consumer protection laws, and the introduction of a national scheme. The Franchise Council of Australia endorses the aim of the reforms as stated in the '*An Australian Consumer Law: Fair markets - Confident consumers*' consultation paper (**Paper**), and agrees that the implementation of a national system would, '...enhance consumer protection, reduce regulatory complexity for businesses and encourage the development of a seamless national economy'.

However, the Franchise Council of Australia is concerned as to the scope of the proposed reform and the encroachment of the proposed laws into business-to-business transactions. Specifically, the Franchise Council of Australia considers that the:

- (1) **definition of "consumer" should not be extended in order to capture business-to-business transactions** (see Chapter 10 of the Paper) (**Submission 1**); and
- (2) **prohibition on the use of standard form contracts should not apply to transactions between franchisors and franchisees** (see Chapter 6 of the Paper) (**Submission 2**).

Franchising is essentially a contractual relationship. The cornerstone of the franchise relationship is the franchise agreement. The terms of the franchise agreement are by necessity standard form, as they are designed to ensure consistency throughout a franchise network. An amendment to extend the definition of "consumer" to capture business-to-business transactions will capture many franchise agreements. If this occurs, the franchise sector will be thrown into turmoil, placing at risk the substantial economic contribution that the sector makes to the Australian economy.

The franchise relationship is already subject to specific regulation. The disclosure process contained in the Franchising Code of Conduct provides the necessary framework to ensure franchisees make an informed decision when entering into a franchise agreement. This process is supplemented by the prohibition on unconscionable conduct contained in s.51AC of the *Trade Practices Act*, and indeed the general prohibition on misleading or deceptive conduct contained in s.52 of the Act. The regulatory framework is overseen by the Australian Competition and Consumer Commission, and operates very effectively.

Although the proposed national consumer laws are clearly not intended to regulate franchising, the extension of the definition of "consumer" to business-to-business transactions will create substantial uncertainty that must be addressed.

**The Franchise Council of Australia requires either:-**

- (1) **confirmation that the definition of "consumer" will not be extended to capture business-to-business transactions; or**
- (2) **the creation of a specific exemption from the application of the legislation for a franchise agreement as defined in the Franchising Code of Conduct.**

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## 2. Overview of franchising

### 2.1 The Franchise Council of Australia

The Franchise Council of Australia is the peak industry body for the franchise sector. The majority of franchisors, franchisees, advisors and suppliers involved in franchising in Australia are members of the Franchise Council of Australia.

The Franchise Council of Australia is charged with representing the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. Details of the Franchise Council of Australia's activities can be found at [www.franchise.org.au](http://www.franchise.org.au).

The aim of the Franchise Council of Australia is the promotion of the growth and development of franchising in Australia and it is committed to working collaboratively with Government in order to achieve this.

### 2.2 The size of the franchising sector

According to the most recent empirical survey of Franchising in Australia<sup>1</sup>, the per annum sales turnover of the franchising sector is estimated at \$130 billion.

The sector comprises over 63,500 business format franchises, which are mostly engaged in the retail sector. There are currently approximately 1,100 franchisors in Australia, and whilst there are some very large and well known systems, half of the sector comprises 20 or fewer franchise units.

The franchising sector employs more than 600,000 people across the nation.

### 2.3 Current regulation

Franchising in Australia is a highly regulated industry. Indeed Australia leads the way in terms of the development of industry standards and franchising regulation. This has resulted in the exponential growth of the industry, and the low levels of disputation.<sup>2</sup>

All participants must comply with the *Franchising Code of Conduct (Code)*, which is a prescribed industry code under section 51AE, Part IVB of the *Trade Practices Act*. The costs of complying with the regulations are significant for franchisors, both in terms of time and money.

The Code provides a comprehensive regulatory framework that includes the following features:-

- (1) All franchisors must maintain a "disclosure document" that summarises the key terms of the franchise agreement in a "user friendly format". The Code prescribes the content of the document, and requires that the franchisor provide extensive disclosure in relation to product supply, the franchisee's rights and obligations under the agreement, and details of all related agreements.
- (2) Franchisors must provide a copy of the disclosure document, the franchise agreement, and the Code to a prospective franchisee at least 14 days before they enter into a franchise agreement.
- (3) In the event of a dispute, the parties to a franchise agreement must comply with the dispute resolution procedures set out in the Code, which include mediation.

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<sup>1</sup> L Frazer, S Weaven, O Wright, *Franchising Australia 2008*, Griffith University.

<sup>2</sup> According to *Franchising Australia 2008*, the franchise sector experienced a growth rate (in terms of franchise units) of 15.4% between 2006 and 2008 and only 2% of franchisees were estimated to be in dispute in 2007.

- (4) Franchisees have a period of 7 days after signing a franchise agreement in which to “cool off”. If the franchisee changes its mind about the purchase of a franchised business, the franchisor must return to the franchisee all moneys paid by it, less the franchisor’s reasonable costs.
- (5) Prior to entering into a franchise agreement, the franchisor must advise the franchisee to obtain independent legal, business and accounting advice in relation to the franchise, and receive a signed statement from the franchisee to this effect.

The current framework offers significant protection to franchisees. There have been three recent inquiries (two State, one Federal) into the effectiveness of the Code. Although some improvements have been suggested, all inquiries have endorsed the fundamental effectiveness of the regulatory framework.

The Australian Competition and Consumer Commission also considers the regulatory regime to be operating effectively.

The success of the Code is essentially based on two fundamental principles – responsible franchisor behaviour, and effective franchisee due diligence. The second limb is important, as it requires franchisees to use the disclosure document information to undertake due diligence and to obtain expert advice. This is a far cry from the typical consumer transaction where customers are presented with a *fait accompli* standard form contract with little or no opportunity for negotiation, consideration or advice.

## 2.4 The franchise relationship

Franchising is essentially a contractual relationship. Franchisors and franchisees collaborate to sell goods or services to consumers in a consistent manner. It is important that every store looks and feels the same, as this provides the consistency consumers demand. Trade marks must be used in the same way, the range of goods or services need to be the same, the customer must feel part of a large network. Through franchising, this consistency can be accomplished, and all parties can achieve the purchasing economies and other efficiencies not otherwise available to small businesses.

The cornerstone of the franchise relationship is the franchise agreement. This needs to be a detailed document. Importantly in the context of the proposed changes to the consumer laws, the terms of the franchise agreement are by necessity standard form. This is essential to ensure consistency across a franchise network. An amendment to extend the definition of consumer to encompass business-to-business transactions will capture many franchise agreements. If this occurs, the franchise sector will be thrown into turmoil, placing at risk the substantial economic contribution the sector makes to the Australian economy. The change will essentially create a duplicate regulatory regime in a way that will create massive uncertainty and unnecessary cost and threaten the framework of franchising.

The franchise relationship is already subject to specific and comprehensive regulation. The disclosure process contained in the Franchising Code of Conduct provides the necessary framework to ensure that franchisees make an informed decision to enter into a franchise agreement. It ensures that franchisees receive extensive information, have ample time to make a considered decision, have access to other sources of information and are able to take expert advice. The Code process is supplemented by the prohibition on unconscionable conduct contained in s.51AC of the *Trade Practices Act*, and indeed the general prohibition on misleading or deceptive conduct contained in s.52 of the *Trade Practices Act*. The regulatory framework is overseen by the Australian Competition and Consumer Commission, and operates very effectively.

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### 3. Submissions

#### 3.1 Submission 1: prohibition on standard form contracts

The Paper states that COAG agreed to a legislative model that would include a prohibition on “unfair” contract terms, and provided an extensive list of the kinds of terms that may be “unfair” (refer to pages 32 and 33 of the Paper).

The Franchise Council of Australia supports the prohibition of unfair contract terms in the consumer context. However, the paper goes on to state that:

*The scope of the provision will extend to standard form contracts entered into by businesses, including small businesses, and would not be confined to individual consumers. This recognises that many businesses are required to use standard form agreements in the same way as individual consumers, and their interests are essentially the same in respect of the potential for unfair contract terms.*

The extension of principles of fairness into business contracts has long been resisted. Indeed in the recent report of the Senate Standing Committee on Economics in relation to the need, scope and content of a definition of “unconscionable conduct”, the Committee specifically declined to recommend the insertion of good faith into the *Trade Practices Act*, commenting that to do so “would only add uncertainty.”<sup>3</sup>

The extension of the definition of “consumer” as contemplated above may capture transactions with franchisees. At a minimum, the definitional change would create considerable uncertainty, as franchise agreements are likely to be considered “standard form agreements”. Franchisees are not required to sign standard form agreements in the same way as consumers and the potential for unfair contract terms is not the same. Further, franchisees have the extensive protection provided by the Code and the *Trade Practices Act*. Nevertheless, the extended definition is likely to catch many franchise arrangements unless a specific exemption is created.

The Franchise Council of Australia is concerned that franchisees, and their entry into franchise agreements, will be regulated by the new legislations’ provisions regarding “unfair” contract terms.

#### 3.2 Submission 2: extension of definition of “consumer”

The paper poses the following questions, to which the Franchise Council of Australia responds in the manner set out below:-

*Should the scope of the Trade Practices Act’s existing definition of ‘consumer’ be expanded to cover a wider range of circumstances, such as goods used in business contexts?*

Franchise Council of Australia response: **No**

*Should a new definition of ‘consumer’ specifically deal with small businesses and farming undertakings?*

Franchise Council of Australia response: **No**

*Should a new definition of ‘consumer’ retain the monetary limit of \$40,000 or should the limit be increased? If it were increased, what would be an appropriate amount?*

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<sup>3</sup> See paragraph 5.43

Franchise Council of Australia response: **No opinion**

*Consideration could be given to whether the definition of 'consumer' should be widened to include:*

- *the purchase of business goods or services for business purposes, other than where the goods are resupplied; and/or*
- *business consumers or corporations purchasing consumer goods for business purposes.*

Franchise Council of Australia response: **The definition should not be widened. Alternatively if the definition is widened there should be a specific exemption for a franchise agreement as defined in the Code.**

**Although the national consumer laws are clearly not intended to regulate franchising, the extension of the definition of "consumer" to business-to-business transactions will create substantial uncertainty that must be addressed.**

**The Franchise Council of Australia requires either:-**

- (1) **confirmation that the definition of "consumer" will not be extended to capture business-to-business transactions; or**
- (2) **the creation of a specific exemption from the application of the legislation for a franchise agreement as defined in the Franchising Code of Conduct.**

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#### **4. Further input**

The Franchise Council of Australia would welcome any further consultation or dialogue on this issue, and would be pleased to expand upon any aspect of this submission.