HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Reference: Fair trading

SYDNEY

Wednesday, 4 September 1996

OFFICIAL HANSARD REPORT

CANBERRA

HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Members:

Mr Bruce Reid (Chair)

Mrs Bailey	Ms Gambaro
Mr Baldwin	Mr Jenkins
Mr Beddall	Mr Allan Morris
Mr Broadbent	Mr Nugent
Mr Martyn Evans	Mr O'Connor
Mr Richard Evans	Mr Zammit
Mr Forrest	

The committee will inquire into business conduct issues arising out of commercial dealings between firms, including claims by small business organisations that some firms are vulnerable to and are not adequately protected against 'harsh or oppressive' conduct in their dealings with larger firms.

1. The committee is asked to investigate and report on:

the major business conduct issues arising out of commercial dealings between firms including, but not limited to, franchising and retail tenancy;

the economic and social implications of the major business conduct issues particularly whether certain commercial practices might lead to sub-optimal economic outcomes.

2. The committee is asked to examine whether the impact of the business conduct issues it identifies is sufficient to justify Government action taking into account, but not limited to :

existing State and Commonwealth legislative protections;

existing common law protections;

overseas developments in the regulation of business conduct.

3. The committee is asked to examine options and make recommendations on strategies to address business conduct issues arising out of dealings between firms in commercial relationships, taking into account, but not limited to:

the potential application of voluntary codes of conduct, industry self-regulation and dispute

resolution mechanisms, including alternatives to legislation and court-based remedies, and mechanisms to support these measures;

legislative remedies.

4. In developing options, the committee will seek to ensure certainty in the market place, contract dealings and other commercial transactions, minimise the regulatory burden on business, and keep litigation and costs to a minimum.

WITNESSES

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STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

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SYDNEY

Wednesday, 4 September 1996

Present

Mr Reid (Chair)

Mr Beddall	Mr Richard Evans
Mr Broadbent	Ms Gambaro
Mr Martyn Evans	Mr Jenkins

The committee met at 2.03 p.m.

Mr Reid took the chair.

CHAIR—I declare open the first public hearing of the inquiry into fair trading. It is timely that we are commencing taking formal evidence today, having had the opportunity to participate in the Franchise Association of Australia and New Zealand's conference this week. Representatives of FAANZ will be giving evidence this afternoon and I welcome them. Congratulations on an exciting and successful conference which has brought together both franchisors and franchisees to explore many aspects of franchising.

Whilst issues concerning franchising are clearly of importance to this inquiry into fair trading, our terms of reference are much broader than this, requiring us to look at business conduct issues arising out of commercial dealings between firms across all sectors. In particular, we have been asked to examine claims by small business organisations that some firms are vulnerable to and not adequately protected against harsh and oppressive conduct in the dealings with larger firms.

During the course of this inquiry, the committee will therefore be considering existing legislative protection, as well as the potential application of voluntary codes of conduct, industry self-regulation and dispute resolution mechanisms. Today we will be focusing on the franchising sector and I welcome the witnesses.

[2.05 p.m.]

PENFOLD, Mr Stephen Edwin, Chairman, Franchise Association of Australia and New Zealand, Suite 9, 2-6 Hunter Street, Parramatta, New South Wales 2150

PETERSON, Mr Robert Duncan, Director, Franchise Association of Australia and New Zealand, Suite 9, 2-6 Hunter Street, Parramatta, New South Wales 2150

ATCHISON, Mr David Alan, Joint Managing Director, Ice Creameries of Australia, Ice Creamery House, 271 Bong Bong Street, Bowral, New South Wales 2576

AHRENS, Mr Michael, Senior Partner, Baker and McKenzie, 50 Bridge Street, Sydney, New South Wales

CHAIR—Committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or make an affirmation. However, you are reminded that false evidence given to a parliamentary committee may be regarded as a contempt of parliament.

The committee prefers that all evidence be given in public but should you, at any stage, wish to give any evidence in private, you may ask to do so and the committee will give consideration to your request. Would you like to make an opening statement before we commence the questioning?

Mr Penfold—If we may, yes. I start by apologising for Mr Alan Lambert, who is the current chairman of the association. Alan is finalising the activities of our last three days of conference. I am the immediate past chairman of the association—I left that position last Sunday. I am also the chairman and owner of Kwik Kopy Australia which is part of an international chain of franchise operations. I have rights over Australia and most of South-East Asia.

I have been in franchising for 13 years. I have 100 franchisees in my franchise system doing roughly $60 million in sales. My system, developed over the last 12 years, employees about 600 Australians with 22 of those in our franchisor's office, just to give you some background.By definition, I am a small business operator.

I and the association were delighted to see, in the committee's terms of reference, clause 4 seeking that your outcome ensures, certainly in the marketplace and contract deadlines, minimising regulation, while keeping litigation minimised. Today, we seek to bring the business conduct issues of the franchising sector to life and to background the sector so that you are better equipped to make your judgments on the issues under the terms of reference. Our remarks, therefore, are predominantly aimed at section 1. We will comment on two, the legislative environment, but really leave that comment to the lawyers—we are businessmen, not lawyers.

We represent Australia's peak industry body of franchising, the Franchise Association of Australia and

New Zealand. That association recently adopted franchisees into its midst. We have two franchisees who have been on our board for the last two years and we are busily going through the process of bringing franchisees onto the board as hard as we can.

I have a couple of background facts before I will pass over to these gentlemen who are going to talk about the sector. The Australian franchising community, as of the last ABS statistics, had 26,000 franchisees in 550 franchise systems. That was at the end of Australia's wonderful three years of recession, where growth had been at a compound 14 per cent per annum, where we had gone backwards in the economy but the franchise community had been growing. Employment in the sector during that period went up by roughly 130,000 people to nearly 300,000 people. Those 130,000 people represented more than our fair share of the proportion of the 550,000 jobs created throughout the recession by small business. So 830,000 small businesses created 550,000 jobs. Our 26,000 small businesses—about four per cent—created 23 per cent of the jobs.

I would like to introduce Alan Atchison, past chairman of the association and joint managing director of Ice Creameries of Australia. He is also chairman of Ice Creameries of China where he has franchises. He has operated for 25 years in the Australian franchising world, has great experience and has been before these committees before. He operates over 100 franchise outlets in Australia with more than 500 employees and, again, Alan comes to this hearing as a small business operator.

The other person who will be talking is Bob Peterson, also a past chairman of the Franchise Association. Bob is director and/or chairman of Capt'n Snooze and Bumpa t' Bumpa, two franchise systems in Australia. Bob has 14 years in franchising. In those two systems there are 140 franchisees employing 850 people. Again, the two franchisor businesses are small businesses. With that, if I may, I will pass over to Alan.

Mr Atchison—Thank you. I think Stephen has given most of the introduction. He has given me a few more years in franchising than I deserve. I have been 20 years in ice-cream and 14 in franchising. In fact, we have 87 outlets in Australia, and one lonely outlet in Beijing, which we are hoping to add to soon. The reason I am here, and why I was perhaps invited, is to give my perspective of 14 years in franchising in Australia and my involvement over those 14 years in a number of government inquiries. During my term as chairman of the association, I had the pleasure, if I could use that word, of overseeing the hearing which David Beddall started, which resulted in the franchise code eventually coming into existence.

I would like to pose a question to the chairman, as an Australian American who grew up with franchising. I went to my first one for an ice-cream when I was eight. Would it be useful to the committee if I gave a capsule history of how modern franchising has grown? Or does everyone feel they are pretty much up to date?

CHAIR—From an Australian perspective, or from your international perspective?

Mr Atchison—You would have to speak about it from an American perspective and then growing into Australia, because it really is an American phenomenon.

CHAIR—Thank you. We would be happy if you would give us a brief resume.

Mr Atchison—I would like to do that, because a lot of people do not appreciate just how this most amazing business tool started. At the end of World War II, in the United States they had millions of returning soldiers and they also had a wartime economy which had to be converted to peacetime consumables. The soldiers who were coming back were ready for a change. They were ready to live lives in locations other than where their parents had raised them. They were ready to go into jobs other than the sorts of jobs their parents had given them.

In their moving and causing mass migrations in America, what is today known as the suburb was really born in America for the first time. At the same time, all of the wartime capacity was changed from building tanks to building cars, and Americans became exceptionally mobile. The result of all this was the invention of franchising, which had been around for a while. But truly modern franchising is a child of the suburbs. It is a child of the motor vehicle. It was, for the first time, business taking its services and its products to where people lived, rather than the reverse. Traditionally there was the high street, the village and the main business district, and people travelled to that for the services and products they wanted to buy. Franchising grew out of servicing these thousands of new suburbs which were coming into existence all over America. That is really how the early explosive growth occurred about 50 years ago, in 1947-48.

The first franchises, I am pleased to say, were ice-cream, but franchising is a new phenomenon. It grew out of World War II, and the explosive growth that franchising enjoyed in the States was because, after the war, society was changing so dramatically and people were changing. People were looking for new directions and new challenges. A lot of people who would never have gone into independent business suddenly felt free to do so. That is, in a capsule, how franchising was born. It grew incredibly rapidly in the United States. The US predictions are that franchising will exceed $US1 trillion by the year 2000, and there is an American franchise being opened, still, every six minutes.

When I started in franchising in Australia, the multinationals—or the global franchises—were basically the only franchises in this country. I am pleased to say that we were one of the first of the home-grown Australian franchises. I got into ice cream because I could not get a job, and then franchising evolved out of that and it continues to evolve. Over the past 14 years, I have been an observer. So that is a bit of my background.

I am here today for these reasons. The problem we had in the early years, and which stopped several early inquiries, was simply the definition of what franchising is. From our perspective, there is no definition and, if you cannot define it, you cannot legislate it—you cannot govern it.

Basically, we held off legislation and any action goal for five or six years. A definition was arrived at, finally. I would have to say that, after 14 years of looking at this, definition remains one of the difficulties in trying to regulate franchising—whether that is done legislatively, through a code of conduct, as self-governing or whatever.

From my perspective, the government is rightfully concerned about the very, very large companies. I will not single out the oil industry, but they do have a reputation for being so giant that they have a

disproportionate amount of power. So you have them. You have the global franchises. Companies like McDonald's, KFC and Pizza Hut are not really American franchises anymore; they are global franchises.

You then have the home-grown franchises, of which I am one. Australia has a number of home-grown franchises which are truly world class. In terms of world's best practice, a lot of Australian franchises do meet those standards. As always in business, you have the naive and the foolish. You have people who think they can start franchising but do not have a clue what they are doing. They take people's money—perhaps with good will; but they still take it—and lose it for them. The final of my five categories, as in any area, is the shonks—the crooks.

I guess, from my perspective, it is very difficult to come up with any code, organisation or anything which basically can cover that incredible range—from the giant oil companies, which are the largest companies in the world; to Australia's home-grown franchises, and a mature franchise system has roughly 100 outlets; and down to the crooks, and there are some of those out there and they need to be taken care of.

I certainly endorse the FAANZ's efforts, and I further endorse what the FCC has been trying to do over the past few years. But I still feel there are too many disparate interests and too many disparate sorts of organisations which are trying to be catered for. Before Chris Schacht left his position as the small business minister, I said, 'Chris, you are trying to catch the sharks, but you are going to net the dolphins.'

Specifically, from a franchisor's point of view—and I think I can speak on behalf of a lot of franchisors—certainty in the marketplace, which is in your fourth category here, is one of the things that concerns franchisors more than anything else. Australian franchising—and I understand it fairly well—is all about relationships. It is not about franchise agreements. Any franchisor who feels that he can use his franchise agreement as a weapon against his franchisees does not last long. If you do not have the trust and respect of your franchisees, and if you do not take care of them, then you as a franchisor have a very limited time.

Our franchise agreements are more of a tool for our franchisees than they are for us. Generally the lawyers, after charging us a great deal of money to write a franchise agreement for us, once they have taken their money, say, 'By the way, this is not worth the paper it is written on because the courts are always going to be looking after the little guy, and you are perceived as the big guy.'

Australian franchisors are not big guys. My four top franchisees earn more money than my wife and I do and we are quite happy with that. We think that that means our system is a success, but it takes roughly 50 shops to break even before we start showing a profit. I think I can speak for most Australian franchisors when I say that none of us are very wealthy. None of us are of a size where we can exploit our people and, even if we had a mind to, it would be impractical. I would simply like you to keep that in mind.

I have several other things to say: one is that I think we do need good statistics. I believe that the ABS report today goes further than we have but I believe that we need to go further. I think that the people in Canberra and the people who run bodies such as the FCC need to accept that, if you look at the statistics on failures of franchises, we are going to have 4,000 franchises fail within the next year to 18 months. Four thousand families are going to lose their businesses. They are possibly going to lose their life savings. They

are going to lose their homes—4,000 of them—and that is not good news.

CHAIR—Perhaps we might come back to that topic and pursue that with some questions.

Mr Atchison—I think that completes everything I have.

CHAIR—Thank you for that introduction and summary of how you see the situation and the development of it. Mr Peterson, do you wish to speak?

Mr Peterson—Yes. I have a couple of points that I would like to follow up on, Mr Chairman. Following on from one of Alan's comments, I have taken as a starting point my inclusion on the task force inquiring into the franchising sector with my colleague Michael Delaney on the back seat.

In those hearings one of the points that I made as a practising franchisor was that there is an argument that is continually trotted out concerning the concept of equalness. The concept of equalness between the franchisee and the franchisor is, as I claimed then, and I repeat again today, specious.

The argument fails to recognise that the essence of the success of the franchising relationship is not a meeting of equals. You are talking about not only scale of size but also attitudes and behaviours. It is actually a meeting and, in my opinion, its success is defined by its unequalness of attitude, size and a number of other things because it is the franchisor who is the entrepreneur, by definition, the creator of the system—the creator of the intellectual property, the knowledge and the know-how, trademarks and the refiner of the system.

By definition, a franchisee is not an entrepreneur. By definition, he is an informed follower and he can opt into that relationship at will or not as the case may be. He can go and set up his own hamburger shop called Bob's hamburger shop. He, by definition, is a follower. If, however, when he enters the relationship he has false expectations as to the equity and equalness, then the relationship is flawed from the outset.

Our induction processes, as a practising franchisor, attempt to address that. We say to franchisees before they become franchisees, 'Do you understand that there will be relationship issues between us?' We map it. It is called the double E factor, for those of you who are interested in the psychology of the relationship. We tell them fairly accurately the stages that the relationship will go through. It is called glee, fee, free and then we, where the franchisee and the franchisor come to an understanding of the mutual independence, but it is not of equals.

I have argued that in terms of the unequalness you can still maintain fairness betwixt the parties. It is a meeting of unequals; that is the essence of its success. I liken it to a controlled independence. My point to you, ladies and gentlemen, is that when tampering with that issue of equalness you take away the essence of its success because, without the relevance of unequalness and the ability of we franchisors to fairly control the independence of the franchisee, they would be but like the rest of small business.

The second point that I want to raise—I did raise it again at the task force—follows on from the fairness and equalness argument; it is to do with diplomacy and discipline. Diplomacy basically is the art of

negotiation without going to war, and that typifies the relationship on an ongoing basis between franchisees and franchisors. We tend statistically not to go to war. We tend statistically to work out our relationship issues between us. We are but human beings, but when it comes to a dispute the reality is that the discipline of the maintenance of the system rests with the franchisor. It is how it is applied, I guess, that we would talk about for many hours, but without that need for discipline the franchisee would feel uninhibited and would do pretty much what he wants. I liken it to painting the store pink because he likes the colour pink. The franchisor says, 'Our corporate colour is blue, whatever it may be, and that corporate colour is devised by experts and the input from franchisees is sought.' But, without the ultimate sanction, we would not have uniformity and consistency, which is what the consumer requires of us. We would have pink and blue stores, range diminishing and so forth. It is the essence of the conformity and standardisation that is being consumer driven that we are reflecting.

The third point that I wish to raise is to do with free society and intervention costs. During the task force days we spoke a lot about the level of litigation and we talked about the cost to society of government intervention. Currently, our sector operates under the world's first and the only—therefore, it is unique—self-regulatory voluntary code of administration. We were told today by the chairman of FCC at our conference that we have coverage of 65 per cent of the sector today. In my world—commerce—if I had 65 per cent of the market I would be doing exceptionally well. I commend the activities of its market penetration. Of course it can do better and we, as the FAANZ, have continually claimed ownership of that code of practice and continue to talk about it in very positive terms all over the world. The proponents, however, of government intervention, either by codes of practice or by legislative means, have continually argued—I argue—that they need to prove the case that free market forces have fallen materially short of producing socially acceptable behaviour to the society at large, not sectors within the society.

In the days of the task force, 1990-91, Alan Atchison and myself caused our honorary solicitors, Baker McKenzie, to investigate the level of litigation going back over 14½ years. To that period—which was to 30 April 1991—over a 14-year period backwards there were 71 cases related to franchising, both oil industry and Australian franchises home-grown, as Alan refers to them, and the multinationals or globals.

What we attempted to point out at that level was that, by contrast to one franchise year which was the other side of the issue, without recourse to external forces the fact that a franchisee and a franchisor may disagree about a plethora of issues to do with uniforms, length of hair, colour of glasses, length of hair in the nose and other issues is not a material breakdown of the relationship. It is the cut and thrust of the relationship between franchisee and franchisor in a commercial context. And 71 cases to the middle of 1991, which is what it was then, was not a material indication of a breakdown.

The last point that I wanted to make was that this issue of internalisation of disputes, complaints and gripes is at the heart of the relationship. As a practising franchisor I know that, every day, about 10 per cent of the network will in some way, shape or form not be comfortable with what we collectively—and I am talking about franchisees collectively with franchisors—are mandating, for example, the advertising issue or the extension of this product to the range or the deletion of that product from the range. In a network of hundreds an element will always say, 'I disagree.' If the collective will says that this pen is in or out, or that the stores are blue—whatever it might be—an element will not be comfortable with that decision. It is up to us as franchisors and franchisees to manage that expectation and that relationship problem. But unless it is

externalised, it is not of moment to society at large; it is but the cut and thrust of humans endeavouring to actualise their returns.

So Alan and I in those days said that that represented less than a quarter of one per cent of the franchisee year. I think the proposition still stands because today, at our national conference, Mr Bob Gardini of the Franchising Code Council reported on the inquiry by the FCC into disputes. An independent research company spoke to me and a number of our colleagues and came back with the figures—which was the first time I saw them, a little over an hour or so ago—that one per cent of Australia's franchisees are in litigation or are in courts and that 13 per cent of Australia's franchisors are in litigation or in courts.

The other side is that 99 per cent of Australia's franchisors are aware of the code and 92 per cent of Australia's franchisors are positive about it. Sixty-four per cent of Australia's franchisees look to the franchise code, 89 per cent of Australia's franchisees have good relationships with their franchisor, 69 per cent would buy their franchise again and 66 per cent had a good ROI. It is a fairly subjective issue as to what a good ROI is. But my point is that if these types of disputes, complaints and gripes are internalised, it is not a proper externalisation. Costs to societies do not exist and, literally, there ought not to be extensions to regulations.

CHAIR—Thank you. Before we proceed to questions, could I introduce three colleagues who have arrived: Mr Richard Evans, MP, Mr Russell Broadbent, MP, and Mr Harry Jenkins, MP. On that final note, you started to move into the relationship between the organisations. I wonder if you could outline the relationships between your association and the Franchising Code Council Ltd, the *Australian Franchising* magazine, the ACCC and any other key players in the franchising area? What is the current relationship with those organisations?

Mr Peterson—I might pass to Stephen.

Mr Penfold—I suppose that one could best say that the FAANZ was very instrumental in the creation of the Franchising Code Council. It was the creation of that original code that is very involved in your inquiry. The FAANZ has been totally supportive of that code and the council's activities right throughout. The FAANZ has, in the last year, changed our entry requirements to make it a mandatory requirement that people are registered under the code before they can join our association.

There is no direct link. The council was fairly carefully set up in its original days so that there was not a direct link. It is a requirement of the council that it represents itself, not an association, although in real terms there are positions on that council that seem to me to be clearly defined for association roles such as our own, the NTAA, and the Oil Industry Council.

I was one of the first councillors on that council and stayed on the council for two years by invitation from yourself, sir. The relationship at the moment with the council is that we are very supportive of the code and of the council's activities. I wish that I could say that we have a good working relationship with it. We are somewhat remote, as those who were at the meeting this morning might have seen.

CHAIR—Is there a difference in your position from what it was 12 months ago?

Mr Penfold—I do not think so. I think that the relationship has always been supportive of the council and the code. We have had a little difficulty in the exchange of ideas. I think that it is because of the council's desire to stay independent of influencing outside bodies. As for our relationship with the ACCC as an association, we have not worked hard at creating a relationship.

CHAIR—Do they run independently? The franchising magazine has no—

Mr Peterson—The franchising magazine has no connection with FAANZ other than as a sponsor and as a contributor of funds to FAANZ.

Mr Penfold—It is a commercial transaction.

Mr Peterson—It is a commercial transaction. We jointly sponsor the franchisee and the franchisor of the year awards, and we look to the franchising magazine, which is a separate commercial organisation, for part payment of those types of activities. Apart from that, it is a commercial organisation. We have a contract, a strategic alliance, with the proprietor of *Australian Franchising* magazine which has three or four years to run. He is thus allowed to use our masthead or brand endorsed by the Franchise Association of Australia and New Zealand. But that is it.

Mr Penfold—We have a similar relationship with the provider of exhibitions. There is an exhibition delivery system around Australia, whereby franchisors take their franchise systems to offer to potential franchisees. The two commercial providers of exhibition services have negotiated contractual arrangements with the association so that they can use our masthead.

Mr Peterson—We also have similar strategic arrangements with educational facilities and private deliverers of education around Australia, whereby we allow in a limited way certain people to put on certain educational events. We allow them to use our brand endorsed by the Franchise Association and we ask them for a royalty for the use of that brand.

Mr MARTYN EVANS—Mr Peterson, referring to the number of people who are in dispute in court, you said one per cent were in court, then you said 13 per cent were in litigation. Can you clarify that as I do not quite understand that point?

Mr Peterson—It was the words that I wrote down a little over an hour ago. For clarification, 13 per cent of franchisors and one per cent of franchisees—of their respective universes—are in litigation or in court, and 10 per cent of franchisees—that is the result at the bottom—are in major disagreement or are in court. So you would start with the 10 per cent of franchisees—the universe is 26,000- to 30,000-odd—who say that they are in major disagreement and/or in court. Of that 10 per cent, one per cent are in court or in litigation. My proposition was that it only becomes a society issue when it is externalised. A major disagreement is my example of the pen in the range or not in the range—the painting of the blue. That is my proposition.

Mr MARTYN EVANS—Thank you, Mr Peterson.

Mr Penfold—I would like to add a bit on that. At the ABS survey that was conducted in August 1994, the statistics at that point were that 19 per cent of franchisors—or 97 franchisors—were in litigation with a franchisee, and that 235—the extrapolated figure from the 65 per cent of people that responded—of the 26,500, or less than one per cent of the then franchisees in the community, were in litigation with their franchisor.

Let me put a personal perspective on it. My system has been in business for 12 years. I have 100 franchisees. Let us say that is half of 50 by 12 of some 600 years of franchisee/franchisor relationships. I have had a dispute that was in litigation. If I had been asked that question in all of the 12 years, for three years I would have said I was in dispute, because it would have been true. I would have had a piece of disputation that was in litigation, and that period was a quarter of the lifetime of my franchise system. I have, in fact, had one dispute with one of 100 franchisees over 500 franchisee years of activity.

The press that is given to franchise disputes is always spectacular because, when there are failures, they are awful failures. Therefore, it often gets blown out of perspective. As I said this morning on the stand, as a community the franchising community should be very proud of the fact that we only have 235 franchisees in dispute. If the law courts that cover marriage had 235 disputes out of 26,500, what a great society we would have.

CHAIR—Has that dispute been resolved? How long did it take, and did it go to litigation?

Mr Peterson—It did not go to litigation. It was resolved on the steps of the court. I will tell you the reality of that dispute. I bought this business from a company that brought the franchise from America. They ran it for three years. As Alan said, it takes an initial momentum to create a break-even point. At the end of three years, the Kwik Kopy system in Australia had 32 franchisees doing $6.8 million in sales, had accumulated $400,000 worth of losses in the franchisor company getting to that point, and its previous owners were disillusioned, to say the least.

I bought it from them at that point. At that point my wife and I went into a mortgage and bought the business. One of the franchisees that was in that system at the time of our purchase was a square peg in a round hole. From day one he did not like us; we did not like him. It was a mistake and everybody recognised it was a mistake, including him. The first thing I did when I bought the business was try and resolve it. He went to his lawyers. We finished up in disputation. We could not reach a mediated solution. It took three years to get to the point where we finally reached a settlement.

CHAIR—Thank you very much for being so frank with us.

Mr Penfold—Every franchisor who has been in business for more than five years can tell you such a story. It is part of our daily life.

Mr Atchison—I would be happy to add the same thing. In 14 years of franchising we have had two cases which have resulted in litigation. I am one of the 13 per cent which currently have litigation going. You could say I am one of the bad 13 per cent or you could say, to use Stephen's example, I have 800 years of total trading in my shops and I have had one case every 400 years. It depends on how you look at the

statistics.

Mr BEDDALL—Mr Peterson, just to go back to some of those statistics—and I think they are the ABS statistics so you may not have the full data on them—one of the things that I have a little concern about, because we did not get the full figure, is that only 69 per cent of people said they would repurchase the franchise. Is another 20 per cent saying they are not sure? You would not want 31 per cent being unhappy. Maybe that figure is not—

Mr Peterson—Mr Beddall, if I can just correct that. These are not ABS figures. I have stolen the thunder of Mr Gardini, the Chairman of the FCC. These are his figures from the FCC inquiry in the last several months and I simply wrote them down off the overheads on a screen this morning. So I would claim not to be an accurate scribe. But 69 per cent would buy again was what I read on the screen today. Therefore, the inverse, one would presume, would not buy again, and is that a high figure or not—

Mr BEDDALL—We could extrapolate that one from Mr Gardini, I suppose.

Mr Peterson—Yes.

CHAIR—Mr Gardini will be appearing before us and I am sure he will provide us with that information.

Mr Penfold—In my franchise system, again like most other franchise systems, we have our top 20 per cent of performers and our bottom 20 per cent of performers. Our top 20 per cent of performers, characteristically, have all the attributes that make this the perfect business for them. Our bottom 20 per cent of performers have less of the attributes. I would think that most of our bottom 20 per cent of performers would give the answer that no, they would not buy again.

I think that is a sector problem but I do not think it is a regulatory problem. I think it is an educational problem—for the sector to do a better job of qualifying and editing and presenting and making sure that the people who finally make a buying decision are not just making a buying decision based on facts and figures and stuff, but they are making a buying decision based on their temperamental and emotional fit with the job that they are buying.

Mr Atchison—I believe that these statistics are meaningful but, again, I want to try to put things in perspective. I am in the ice-cream business and if you ask my franchisees during the month of January if they would buy the same franchise over again, 90 per cent would say yes. If you ask them in the middle of July, 75 per cent would say no. I think the current economy is a bit like the winter and I think perhaps that high figure of people who would not is based on the current state of the economy. If we had an economy which was a summer economy, I think the figure would be much higher.

Mr BROADBENT—It is in that area. It sounded like the dairy industry you were talking about—the top 20 per cent of performers and the bottom 20 per cent of performers. However, what vetting is there by your organisations or by yourselves as franchisors of the people who present themselves as participants in the organisation?

Mr Penfold—In my organisation there is, on average, about a four-month lead time from first application. The first application is generally in response to a recommendation from an existing franchisee or from a newspaper advertisement. We run about 14 newspaper advertisements a year and we get, on average, 300 to 350 applicants to those newspaper advertisements.

Mr RICHARD EVANS—Per advertisement.

Mr Penfold—No, in the year. We qualify in the advertisement the capital entry requirements. Then we go through a structured interview process that takes about two months. It is deliberately elongated to make sure they do not make a quick decision and that they are forced to go out and seek advice. In the process of that, we do all the things that the code requires, which is to give them copies of the code and to give them copies of all our existing franchisees' addresses and telephone numbers. We tell them to go out and make their own inquiries. We then structure a program of them going out and meeting our existing franchisees to make sure that we put them in front of good and bad franchisees. We deliberately try to wheel them up in front of franchisees who we know are in the bottom 20 per cent as well as medium and high performers.

If they get through all that process and they are still happy and they want to continue on, and we are getting comfortable that we have a mix and match, then we take them through some psychological testing. They are sent out to a psychologist who runs a series of tests which look at their personal characteristics and try to put a match. We send them off for medical testing—we are quick printers; you would not think of it as stressful, but it is a very stressful business. We have had a couple of failures in past years because of medical reasons, so we send them off for medical testing.

If we go through all that, then they get to sign a contract and go through the requirements of the code and after they have signed the contract we give them 14 days. We insist that they go to their lawyers and get their lawyers to sign off that they have explained the contract to them. We insist that they go to their financial advisers/accountants. We do not make them sign off on it but we are about to do that. So that is our induction process. I reckon we get 10 per cent wrong'uns. That is neither their mistake nor our mistake. Many times a franchisee makes up his mind that he wants to buy your system and he very quickly learns what the questions are that you want which answers to and will make sure that he provides them. We get deliberately misled.

Mr Peterson—Could I add that we do all of that, and one of the other things I wanted to mention is that we take a poll of all of the executives in the organisation that this person, the applicant, has spoken to over the period of induction which, in some instances, in my businesses, can be as long as two years. It is never any less than two months or slightly more than two months. We straw poll all of the executives and the chief executive officer has to take the aggregate—it is a formula we have worked out—and I would agree that we still get it wrong even after all of these things: psychology tests and the aggregation of our executives' attitude to this person and so forth. We still get an element of disputation within about the pen, about the pink building or whatever it might be. A level of angst, I guess, is the way I am describing it.

Mr Penfold—There is a suggestion, or more than a suggestion—it is often quoted in the press and by the critics of franchising—that franchisors churn and deliberately get wrong franchisees in who go broke so

that they can sell the same site two, three or four times. I am sure those people exist in the community—I am sure they do. I do not know how we are ever going to get rid of them. As far as the bulk of franchisors are concerned, again some facts out of our franchise system—and I do not think we differ from many others. We charge $50,000 for a franchise fee. We put $38,000 worth of goods and services that we have to procure outside into the $50,000 franchise fee component. So we are left with a little margin.

A typical franchisee in our system in the first year pays us a further royalty component of $24,000, so for the first two years of participation in our system we have a gross profit to work on to find this person, to train him, to site him, to deliver our services on an ongoing basis to help him set up his financial system, to help him understand the technicalities of the industry he is in, of about $30,000. I think we break even on a franchise in the fourth year. Every time I hear these accusations of churning, I feel like beating the person who makes them around the head. If I churned I would go bankrupt. If I want to make more money next year, I stop selling franchises. Every time I sell a franchise it costs me money.

Mr BROADBENT—Do you believe the current system that is in place plus the common law is enough control over the current franchise system in Australia?

Mr Penfold—Yes, I do. As an association and as an individual—no, let me say it from an individual's point of view. I think from an individual's point of view, if a federal government were to find a way to legislate to control franchising, it would make a damn of difference to me. It would cost me an extra $5,000 probably to comply in legal costs and form filling, et cetera, with the bureaucratic process of any registration system. But I have a respectable up and going—we diligently manage it; we still have our problems but we diligently manage it. I do not think it would influence me one iota. I would hate to see it happen because I think it would slow down the growth of this sector dramatically. It would stop the new ones coming in. Last night at our awards contest, our franchising awards, I was fascinated at the young couple from—

CHAIR—Mildura.

Mr Penfold—The Pooch people. Can you imagine. There is a business called Mobile Pooch Cleaning. It is in Brisbane and they have—I sat next to the girl yesterday afternoon. She started this business about three or four years ago. She has got 53 franchises. She and her husband are wonderful people, busy, busy, busy people. One of their franchisees was one of the award winners. I do not think they actually got an award, but they were finalists, and my concern is that if we legislate we are going to stop those people coming on to the market. It will be too hard. You will never get them to the starting post. Franchising delivers such revenue, such wealth to this nation, that we must not slow down the input of those entrepreneurs.

Mr BROADBENT—Can I add to the question before you go on. Are your franchisees protected appropriately under common law?

Mr Penfold—I believe, yes.

Mr Peterson—I believe so.

Mr RICHARD EVANS—I was interested in the comments made by Mr Lambert about the 4,000-odd people going to the wall over the next period and I was interested to hear your comments about your induction program of, I think, four months—in your case two years. I do not know whether that is an unusual program for franchisors to implement or it is an average or—

Mr Peterson—The two years in my instance was from the time of inquiry to the time of execution of the contract. We have specifically a twelve week training course. That is three months on the job with no pay. He has to have gone through a process of induction to get to that position and the elapsed time—it is not unusual in our industry for that to be over two years.

Mr BEDDALL—Is that for both Capt'n Snooze and Bumpa T' Bumpa?

Mr Peterson—It has averaged it out. It would be close enough to it.

Mr RICHARD EVANS—I would suspect that with the 31 per cent we are talking about, if the question was would they buy the franchise again, it is probably the wrong question. The question probably is: would you go through start-up again? Whether you actually ever get out of start-up, it is a horrendous period to be in, having been through it as a franchisee. What I am getting to is that when I started looking at moving into a business, I found very little help from government enterprise, like the Small Business Advisory Board or whatever it might be. What I am saying to you is: who should be responsible for the education of these people? I know you have got your own responsibility, but there is a lot of preparatory work in start-up, understanding the expectations, and I guess that is probably your role as well, but is there a government role involved in that in helping people with their business planing, helping people get educated in these areas, or should it be the sole responsibility of the franchisor? Could it, in fact, fall back on the association?

Mr Penfold—I think it falls back on the association to some extent and we would like to see that develop. I personally do not believe that there is a role for government to supply that sort of preparatory education for small business operators, other than in a very generic sense, like the development of business plans, et cetera, the need for financial accounting, the need for cash flow analysis and these sorts of things. Nearly all small businesses are very locally driven by their events. My franchise and the management needs of the franchisee in a Kwik Kopy franchise are entirely different to those of Capt'n Snooze; they are entirely different to those of Ice Creameries of Australia. The key ratios in my business are not the same as Alan's business or Bob's business and for a government agency to supply that sort of information—it is too generic.

Maybe there is a need for government agencies to highlight the fact that you need to find out what the key ratios are in a business beforehand. But, again, most of the franchisees that come into our system—and, I think, lots of systems—already have a business background. They have started. But I can but concur with you. The first two years of start-up is a mindbendingly difficult experience.

Mr RICHARD EVANS—And the 4,000 that Mr Atchison was talking about may, in fact, fall into that period of—

Mr Penfold—That was Lambert, I believe, originally, the current chairman.

Mr RICHARD EVANS—Yes, I beg your pardon.

Mr Penfold—It is really no wonder so many unfranchised small businesses fail. It is no wonder the failure rate in normal small business is so high, because at least a franchisee coming in, going through that terrible two years that you went through, Mr Evans, has got somebody there caring about them. The level of care differs from franchise to franchise and when you ask the question, 'Are we typical?' the answer is, no, you are sitting talking to three of the better franchisors in the country.

Mr RICHARD EVANS—Is there a case, then, that there should be some requirements on franchisors to apply that period of education and help in those initial periods?

Mr Penfold—I think there is success and it is in-built. To learn how to run a Kwik Kopy franchise, we send a husband and wife to America for a month as part of their franchise fee. They go through a month of training in the university of Kwik Kopy. Then they come back to Australia and spend another two weeks in our office. Then they have our staff living in their centre for three weeks. That is entirely different to the guy who bought a VIP mowing service. He gets about three weeks and then he is on his own.

Mr RICHARD EVANS—Is that all relative or should the VIP mowing service have more of an induction period?

Mr Penfold—No. If you try to put a benchmark and say, 'Everybody should have a minimum of this', you would not capture the people who needed the big ones and you would probably overstate the people who needed the little ones.

CHAIR—Could I have a response to the initial question about the 4,000 franchisees who you claim will go to the wall this year?

Mr Atchison—I would not like to leave that hanging, but I said that 4,000 failures is the good news. I am saying that if we have between 30,000 and 40,000 franchises in Australia and if we have a success rate between 80 and 85 per cent, the numbers simply say that 4,000 to 5,000 of those franchisees are not going to succeed. The good news is that if they were not franchised, that 4,000 would not be 4,000; it would be 15,000 or 20,000.

I am trying to address this from the point of view that, frequently, I believe that we as franchisors see a desire from our decision makers that there be no failures. We see an unrealistic thing that if there are failures in franchising, that is too much and somehow franchising should be a guarantee of success. Franchising is not about eliminating risk; it is about minimising risk. That is really the best that we can do.

We in Australia believe in the free enterprise system. Part of the free enterprise system is failure. It is what keeps the free enterprise system running. Failure keeps the customer being able to buy products at a good price. Failure keeps the customer being able to get good service. For the past three years I have had the pleasure of doing business in a country where failure is rewarded and sustained. I am talking about China. They are trying to learn the free enterprise system. They keep propping up businesses that have not worked for years; my partner has not worked for 2,000 years! They have 2,000 years history of losing money. They

simply cannot understand that you have to make money to be in business.

I think we have to value, as a society, that part of free enterprise is the right to fail. That is what gives it the efficiency. As Stephen was saying, it lets the young poodle people—the pooch washing people—into the market. They may succeed and they may fail, but that is part of what we are all about. The good systems will develop and prosper, but there will be failures. I do not believe that we can legislate against failures, I do not believe we can educate against failures and I do not believe that the FCC, with all of its best officers and hardest efforts, can eliminate failure. It is part of the free enterprise system.

Mr RICHARD EVANS—We were talking about litigation before. Do you see a case for an independent arbiter, instead of going to court, not over the blue or the pen, but over a contractual issue or a supply issue or something like this? Is there a position for an independent franchise arbiter?

Mr Penfold—Frankly, no. We believe that there are sufficient final methods of redress in the current law. We believe that the code needs to continue on. As an industry we need to take that self-regulatory code and make it work. If we need any support from government—we ask for it very carefully because we do not really know that we want it at all—it is that maybe you should address the Trade Practices Act in such a way that you force the participants in our industry into mediation before they can go on to court or to the Trade Practices Commission, but don't do it in such a way that it is fuzzy and blurry. Do it in such a way that it is very clean, very clear and very specific and takes into account existing contractual arrangements, because the franchise community is so diverse you cannot set a benchmark. The contract has to be integral to a dispute.

Mr Atchison—To add something to what Stephen was saying there, as a franchisor I thoroughly endorse all forms of problem solving and dispute solving which can possibly be used to avoid litigation, but part of the mentality that I see frequently is that arbitration and mediation both involve compromise. There are a number of areas where you can compromise, but if you have a franchise system that says the wall will be blue and the franchisee says that it should be pink, you end up with a compromise that says, 'All right, we'll have a purple wall.' In my case there are certain things in my system we simply cannot compromise on: the way we run our shops and the hours we trade. These are not areas where you can compromise. There are areas where, obviously, mediation is suitable, but franchising is about a stable set system and there are certain areas where you simply cannot say, 'Let's meet in the middle. You want to close at six and I say you close at 10. You close at eight.' It does not really work that way.

Ms GAMBARO—Mr Penfold, I would like to congratulate you on the progress that you have made with the code. It has certainly come a long way in two years. I would like to ask two questions; one leads on from Richard, but there is another question I would like to ask before I get to that one. I know this term of reference covers retail tenancy, but there is not a day when I do not have people coming to me regarding retail tenancy issues and most of the disputes relate to what was represented to them at the time of the contract. How many of your disputes between franchisors and franchisees would relate to issues that relate to the time of the contract as opposed to issues that relate later on? You mentioned colours of the store, the pen and all those sorts of things. Are most of them contractual ones that relate to the signing of the contract?

Mr Penfold—I think the difficulty is how do you define a dispute? I am going to be obtuse in answering the question. I think most of the disputes that reach litigation have a core problem. That can have

been compounded by misinformation, but generally the core problem is that you have got a square peg in a round hole. We are dealing with one of the 20 per cent—one of the bottom 20 per cent who should not have got there in the first place. We should have been wiser, so should they, and ultimately they lose too much money and they finish up in a law court. That is the cause of the dispute.

Ms GAMBARO—So you are saying to me that you can clarify it as simply as that?

Mr Penfold—No, I am not. It is much more complex than that. My own personal feeling is that that is where the core of most of the ultimate nasty disputes come from. I do not know that we have ever gathered enough information to be able to highlight them more. One of the things the association would love is for this committee to go back and force the ABS to take more surveys of our sector so that we have more real facts.

Ms GAMBARO—Is it a communication problem? Are we talking a different language when we speak about the franchisor-franchisee relationship? Do you think more could be done, as Mr Evans mentioned, in educating potential franchisees at that point as to their obligations?

Mr Penfold—Yes.

Mr Peterson—Absolutely. If I could just add to that as well, the trade association, FAANZ—the Franchise Association of Australia and New Zealand—has an extensive educational process going on around Australia and New Zealand. Every month there are 800 people who get together at 7 a.m. for breakfast, they network and then there are further break-outs. That is all done voluntarily around Australia. In addition to that, we run dozens of seminars and exhibitions, all over Australia, all about education of potential franchisees, who are, in the jargon, called 'pot franks'. We continually wish to have a better quality of potential franchisee, a better understanding of the relationship and a better understanding of the rights and obligations. I just wanted to make sure that we made the point that the educational process is done not only at the unit level by each franchisor but certainly by FAANZ nationally. For example, last evening there were 600 people in a room.

I think the point that Ms Gambaro is making concerns most of the disputation sheeted home to the pre-contractual period or the post-contractual period. I do not have the figures in front of me, but our learned adviser Mr Michael Ahrens, from Baker McKenzie, which is the trade association's honorary firm of solicitors, has just passed me a piece of paper. It says that the current remedies with respect to the pre-contractual period of section 52 of the Trade Practices Act—which has such impact upon us franchisors it is emblazoned on our foreheads—involve going to the extent of having all of the pre-contractual discussions videotaped in the future, which is in vogue in America.

I do not know of anywhere in Australia where they are doing that. But for the corporations I insist on an independent person being present with the potential franchisee at all formal meetings. Almost like *Hansard*, we take it in such a way that we are aware of our complete exposure to the claims of misrepresentation and misleading conduct. However, that is from my perspective as a franchisor.

From the franchisee's perspective, there are very adequate remedies in section 52 of the Trade

Practices Act in the event that a franchisee was wilfully misrepresented. He has absolute recourse to section 52, which is highly effective when used by appropriate franchisees against inappropriate franchisors. There is a tremendous body of case law in Australia where franchisees have successfully sued franchisors for misleading conduct.

Ms GAMBARO—I have one more question for you, Mr Penfold. Today at the conference you were talking about the role of the association and the role of the FCC. You mentioned that a number of your roles overlap. One of the areas I would like you to take us through, which Mr Evans mentioned, is mediation. If someone rings the association with a dispute, do you then forward it to the FCC, and what is the process of mediation that exists at the moment?

As well, I would like to ask whether it is working effectively. I know that you have made comments about an independent arbitrator and that that is not working. But a number of the problems that the FCC also faces relate to enforceability and defamation when it goes in there to bat for people. Can you run us through that?

Mr Penfold—The processes of a complaint coming to the franchise association?

Ms GAMBARO—Yes, thank you.

Mr Penfold—At the moment we refer it to the FCC. We ourselves do not try to take them to mediation. We do not try to offer a facilitation process. The FCC has its own process in place which tries to get the parties into mediation by persuasion. But I noticed in the last magazine it puts out to the franchisee community its statement that it had in the course of action some number of investigations.

As an association, we do not believe that either the FCC or the association should put us somewhere between mediation and the courts. If the parties cannot do it in mediation, then we have a very good court system and lots of remedies for use. It is not our role. We do not believe it is the FCC's role, nor should it be a future role for it, to become a pseudo ombudsman or a pseudo conciliator. These cases, when they do finally reach a court and are unable to be mediated, often run for weeks.

I think part of the problem of the current executive director—although these are my thoughts that I am putting forward—is that he is overwhelmed. He does not very often get happy little franchisees ringing up to tell him what a good world it is. He gets heaps of franchisees—in fact, the statistics I read said that there were, I think, six a week—ringing up with some sort of a problem.

Over the last six months, the FCC has sorted that down to—I do not have the figure—I think, 42 disputes, of which 20 are serious investigations. I can only read into that that the FCC believes that it has a role in trying to act as a court before the court or act as a mediator before the mediator. Frankly, this association thinks that is wrong.

We recommended to the Gardini inquiry that the Gardini inquiry should commission a psychologist to write a book or a pamphlet, a precis process, that could be distributed to anybody in disputation that would lead them to a plethora of mediators. There are mediators all over the place these days; it is a whole new

profession. We do not believe that we or the FCC should get involved in the process of putting an ombudsman or one of our staff as a pseudo ombudsman in place.

Ms GAMBARO—So are you saying to me that the FCC would be a referrer to other mediators?

Mr Penfold—Yes.

Ms GAMBARO—I know that there are some well established franchises that are still with the FAC. Some of the terminology has changed in the last two years, including the name of the association, which you pointed out to me the other day. So how do they work? Is that an effective system?

Mr Penfold—I cannot remember what the statistics are of FACs—

Mr Peterson—Eighty-seven per cent.

Mr Penfold—Eighty-seven per cent of franchise systems in the last ABS survey had a franchise advisory council. They have a level of effectiveness; that is, some low, some high. Some of them tackle disputation resolution. More often than not, it has been my experience that when you go to a franchise advisory council and say, 'Help us with the resolution of problems,' the franchisee council members say, 'You're the franchisor. We pay you a royalty to look after that sort of thing. Our business is to get on with making money.'

They want to participate in the shape of whether it is going to be blue on green and yellow in the future, and they want to participate in the marketing activities, and they want to participate in the development of new technologies, but they really do not want to get into the hard stuff. That is why they pay us, as franchisors, to look after the hard stuff. Interestingly, when the franchisee is not a good fit in the system, it starts making noises. It is the franchisees that are the first to tell us to get out there and solve the problem. That is what they pay us their royalties for.

Mr BEDDALL—Mr Peterson touched on the issue I wanted to raise and, more or less, I want to go back to it so that you can embellish it a bit for the committee. Sometimes there is a mistaken view that legislation protects the franchisee when, in fact, the reality is very different. From memory, I think in the United States now a franchisee is basically given documentation to read and very little information is given because of the fact that anything said could be misleading. I think that was one of the prime forces that convinced the government of the day not to put a compulsory code in a legislative code. Maybe you could embellish that a bit. Bob Peterson was talking about how we think we are still the only self-regulator in the franchising world and how that has worked to the advantage of the franchisee.

Mr Atchison—Could I remark on that for you? The situation in the United States is so bad that franchisors are not allowed by law to even make projections. I have friends in one of the largest ice-cream franchises in the States and at any one time they are handling 80 cases simultaneously. That is a system with 4,000, but at any one time they have 80 lawsuits.

They do not talk to prospective franchisees. If people are interested in their franchise system, they

bring them into a room, they play a one-hour video, they say, 'Do you have any questions?' and if the franchisee says, 'Yes, I have questions,' they say, 'Good, we'll play the video again.' And that is it. They will not respond to questions, they will simply play the video again. That is what all the legislation in the States has led to.

Mr BEDDALL—Because of the fear of litigation?

Mr Atchison—Yes.

Mr Peterson—Mr Chair, I am aware of the time limits and that we may, in fact, be running into it. It is literally 10 minutes from the published time for our departure. If I could perhaps go back to one of your queries at the outset which was about the role relationship between the Franchise Association of Australia and New Zealand Ltd and the Franchising Code Council—the FCC.

CHAIR—You may well include the Franchising Advisory Council in that, too.

Mr Peterson—The franchise advisory councils are within each system. FAC is the acronym given to the mechanism internally within each of the systems. A FAC is a grouping of franchisees in each system selected by some mechanism to help in the role relationship.

CHAIR—Thank you.

Mr Peterson—If I could come up a level in order and ask Stephen to talk about the FAANZ—I am sorry about all the acronyms—the trade association's view and a proposition that we would like to discuss regarding our role relationship with the Franchising Code Council.

Mr Penfold—We had sought the opportunity to come back at a later date because we wanted to take this proposition to the Franchising Code Council before we made it public, so that if we were not running on parallel lines we could knock some of the edges off those. As you heard this morning, that agenda has been overtaken. As an association, we are concerned because as a community, franchising pays to the association something like $400,000 for the services that the association provides.

Mr Peterson—That is per annum?

Mr Penfold—Per annum, collectively. The community pays a further $400,000 roughly per annum to the Franchising Code Council for the services that the council provides. The Franchising Code Council, as per its last published available funds from the last government, was getting a further $2.3 million over the next three years, or roughly $800,000 a year.

So we have an association earning $400,000 a year from its membership, and a council taking $400,000 from the membership plus another $800,000 from the taxpayer. Given the present government's desire not to use taxpayers' funds for those sorts of purposes where possible—and certainly the minister has made it clear to me in conversation that he would choose to have the industry look after its own problems rather than expect the taxpayer to fund them—the association has sought some way that we could try to make

this more effective and maintain the code because, as an industry sector, we do not want to lose our code of practice. We consider it to be our code of practice.

When we went looking at the details of this, we believe that there are many, many areas where duplication occurs and that if we are ultimately going to produce for the sector, paid for by the sector, the same sort of services, we are not going to have $1.6 million available. We will probably only have $800,000 at the most, and when we do our sums we wonder why we need $800,000 to produce the same things.

It is our proposition, and we would like to leave it with you and come back at a later date to talk it over in more detail, that there is a long-term need for the Franchising Code Council, an independent council that can on an annual basis address the minimum benchmark entry standards for the community and change those entry standards as the community changes. There is a long-term need for an independent council that will do that.

Beyond that role we really do not see too much for the council to do. We do not really understand why the council needs its own office, its own employees, to do most of the other things. Most of the other tasks that the council provides can be provided by our association or an amalgam of associations using largely existing membership monies. We do not believe that we need to draw the current level of $400,000 that the FCC is drawing down for the association to be able to do it.

That is the summary of what we would like to say. We have it in a proposition and we would like to give you that proposition, although not right now because the current one is under my signature when it was developed by the board and I was still chairman. I am no longer chairman so we would like to readdress it and get it to you tomorrow if we can.

CHAIR—Can I just ask you about the disputes process under what you are proposing and where you would see that going?

Mr Penfold—It is very much as I just described. We do not see that the process should require the Franchising Code Council or the association to participate as a solver of disputes. As a participant it should be a teacher of how to solve disputes. As a participant it should be a reference point for mediators who are out there in their growing numbers. The association certainly has a role and it is one of the reasons why we believe the association should get involved in this.

We have a chapter network that Bob described that brings 800 people around the country together on a monthly basis. They are volunteers who want to be or who are already franchisors. We have franchisees involved in that now. And given the right materials we believe that we should be taking that, via the chapters, on a voluntary basis to every franchise advisory council in this country, that is, the internal advisory councils of franchise bodies.

Concerning the dispute mechanism in doing the sell job, we believe that we have the perfect mechanism to do it. We have a chapter network of volunteers. A chapter network comprises franchisors and franchisees who are willing to give their time and believe in it. We can very easily put an education process together in a package for them to take to franchise advisory councils and then set off over the next year

doing that around the country, taking it to 40,000 existing franchisees.

Mr BEDDALL—The ultimate regulation for a code though is the penalty imposed. It was always the dilemma we had with a voluntary code. Is it envisaged that a member of the franchisors association who is in clear breach of the code of practice—now that the adoption of the code is compulsory for membership—would lose membership of the franchisors association? It is a very big selling point for a franchisor that it has membership of your association.

Mr Penfold—We are suggesting that the requirements of entry are that you have met the requirements of the code in disclosure documentation and process. And the audit process that is currently being conducted by the council, we are suggesting, should be a compulsory annual requirement of every member of the association or every member that wants to register under the code and not join the association. We are suggesting that that is the mechanism. No, we are not suggesting that we should then put in place a policing mechanism that goes out and somebody looks over my shoulder to see whether I am behaving ethically. If it gets to the point of whether I am behaving ethically then, frankly, the association believes that the courts are going to decide that.

Mr BEDDALL—Mr Atchison was saying that somehow we have to find a way to weed out the shonks. The shonks are still running with your banner.

Mr Atchison—I would say, Mr Beddall, that the penalties are there in the marketplace. This is the trouble, and I am back to the beginning of definition: the large corporations have entire floors full of lawyers who can fight off anyone. If, as a home-grown Australian franchise, we fight our penalties in court and we lose one case, we have lost our professional indemnity insurance. If we lose a second case, the penalty is death; we are no longer there. So from where I sit, I would say that there are very draconian penalties if I do not play the game fairly.

CHAIR—I will have to draw this particular segment to a close. But before I do, I accept your offer to return again. I understand that you have one final comment to make.

Mr Penfold—May I introduce Mr Michael Ahrens from our voluntary legal advisers—

CHAIR—Honorary.

Mr Penfold—And I ask whether Michael can make a point about the defamation protection for either the FCC or the directors of the FAANZ. May I, sir?

CHAIR—Would you prefer to give us a written thing, or are you quite happy to do it verbally?

Mr Ahrens—I am happy. I was on the franchise council for three years and this point was quite high on the agenda on the submissions and in the Gardini report. The point of defamation was raised earlier. I think that it is very important because, whether it is the franchise council—and being on the council, we are very sensitive to this issue—expelling people from the code, or if the association takes on expelling people from the association, the risk of being sued for defamation is quite sensitive.

This point was raised, and the previous government looked at the point and said, 'Sorry, we cannot help you.' It realised that there was a problem. Senator Schacht took it to the point of saying, 'We will talk to the states about it.' Under various state laws, the stock exchange has obtained qualified privileged protection from defamation. I have always felt that if you have anything other than a government department moving against people to affect their incomes, such as expelling them for breach of a voluntary code, you are going to have to deal with the defamation point. I would be very happy to put in a further written submission. But it has been dealt with in the past, and examined, at least at the federal level. I have failed in my attempts to raise it at the local and state levels.

CHAIR—We accept the proposition that you have put forward that you will put in a written submission. That would be helpful to us to consider that aspect of it, so thank you for the offer. I thank you for your attendance and your frank answers to the questions today. We look forward to receiving further evidence and information from you.

[3.39 p.m.]

CONAGHAN, Mr Anthony, C/- Phillips Fox, 1 Eagle Street, Brisbane, Queensland 4075

CHAIR—Welcome. The committee's proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives demand. The witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded however that false evidence given to a parliamentary committee may be regarded as contempt of parliament.

The committee prefers that all evidence be given in public but should you, at any stage, wish to give any evidence in private, you may ask to do so and the committee will give consideration to your request. Do you wish to make a short statement before questions?

Mr Conaghan—Mr Chair, I propose to make a short opening statement of some five minutes or so and then try to assist the committee with responses to your questions.

I do not pretend to have full knowledge about the issues that are the subject of this inquiry nor to have all the answers. So that the committee can see the areas where I have some knowledge and might assist you, I propose to tell you how I came to be here, then establish some credentials, describe my relevant experience and then summarise the main points of my submission.

How I came to be here is: I was asked to present a paper at the recent annual trade practices conference organised by the Law Council of Australia and the business law section trade practices committee of which I am a member. That was attended by Professor Allan Fels and other representatives of the ACCC. During that conference, Mr Allan Asher, the Deputy Chairman, suggested to the conference that the paper would be useful to your committee. I really had not presumed it would be so, but I hope it is.

I have been a solicitor in private practice since 1978. I head the intellectual property group at Phillips Fox in Brisbane. I have been involved in franchising for over 10 years. I have acted and act for both franchisors and franchisees. I am currently conducting litigation for both sides of the fence. My submission reflects my own views and is not being canvassed or considered by clients. I hope I bring a balanced view to the inquiry.

Having been at the FAANZ national conference for the past two days, I am conscious that the jokes about lawyers got lots of laughs. It is indicative that the image of lawyers has become tarnished in recent years. On a personal note and feeling a little vulnerable, and in an attempt to at least—

CHAIR—Be a politician and then you feel vulnerable.

Mr Conaghan—To try to get some degree of credibility, I have managed to be actively involved in the community in some ways. It may assist you to know that I have been an officer in the RAAF Specialist Reserve (Legal) for over 15 years and received the Reserve Force Decoration for that. I also do pro bono work for charitable and other nonprofit institutions, the local P&C and all of those things, as well as try to

look after three sons and my wife.

I am a qualified mediator of the Queensland Law Society and I have been actively practising alternative dispute resolution techniques and, in particular, mediation, for several years. My relevant experience comes from being at the coalface and giving advice, conducting court cases, and resolving disputes for both franchisors and franchisees. My experience tells me that more legislation, by its very nature, inevitably has a number of consequences. These include increasing costs of compliance to the business community, increasing litigation and, in some areas, increasing uncertainty in the commercial marketplace.

The committee will undoubtedly hear a diversity of views which will suggest that more legislation, in one form or another, is warranted and will have an overall beneficial effect. I am not so sure. My experience tells me to approach this a little cautiously. The position I put to you this afternoon is, in fact, against my self-interest. My current view is that no further legislation should be enacted at this time. It will only produce more work for lawyers, increased costs, increased litigation and further uncertainty in the commercial marketplace; and that is relevant to your reference (4).

To summarise my submission, the current legislative environment has demonstrated an ability to protect most consumers and, indeed, business people; and I particularly think of the Trade Practices Act as a ready and fine example of that. This is not to say there are not areas of application of current law that are not finalised. Some of these areas, such as the unconscionable conduct provisions of the Trade Practices Act, are still evolving; and their effect is going to continue to evolve. Also, I am aware that there are franchisees who have suffered at the hands of unlawful and, indeed, predatory conduct. Indeed, I am acting for some of those in proceedings in the Federal Court.

There is a perception that there are a lot of problems. Recent research will produce statistics about that and you will hear more about that. Undoubtedly, you all know of instances yourselves where complaints have been made to you personally. Given the reality, or at least the perception, of problems, the concept of enacting new legislation is undeniably attractive, as in the case of ‘harsh and oppressive’. This is a deceptively simple phrase which is much harder for me, as a practitioner, to interpret for franchisors and franchisees. In this day and age a quick fix might be superficially attractive, but any new legislation comes at a substantial cost.

I am not so sure that access to justice issues, rather than the adequacy of actual remedies, is not an issue in itself. For example, the most recent budget and the increase of fees in the Federal Court has a hearing fee per day of $1,100. I am wondering how, for instance, in my current franchisee litigation—where, inevitably, what we would say was unlawful conduct has left them in a less than pecunious position—they are going to pay $1,100 per day for a hearing that might take a week or two weeks.

As well as this, in some instances there is a lack of resources of the court—with the current Federal Court budget, I understand, being cut from some 10 to 15 per cent, with no prospect of new judges. In Brisbane at least, we have a substantial delay of a year or two years in getting things on. There are other issues besides simply whether there are adequate remedies under current law. There are real issues, from my point of view, in trying to get things on: issues of practical access to justice.

The use of mediation needs to be encouraged. In fact, it is interesting to note that, at the 1993 congressional hearings, Mrs Myers, the member for Kansas, in the hearings which had the International Franchise Association present—which, in the inevitable American way, is the American franchise association—referred firstly to the Australian franchising task force report and made some comments about that. She then said:

I congratulate the International Franchise Association for instituting an alternative dispute resolution process based upon the Australian model to work out problems between franchisees and franchisors, if possible, without costly litigation and attorneys' fees.

Perhaps that is one of the reasons that, from time to time, people say that self-regulation in Australia in franchising is leading the world, and we have some reasons to say that. However, it is undeniable that there needs to be a far greater use of mediation. That is one of the things that this inquiry is going to explore. Commonsense dictates that it is a much more practical, cost-effective way to go.

You may ask: why do so many cases settle at the door of the court? Mr Penfold referred to this—although he seemed to be talking about a different circumstance. In my experience, they do so because often that is the first time the parties have really come together. We should bring them together as soon as we possibly can. It is my experience that the formal process of having an independent mediator to take positions away, to get to the concerns and try to laterally resolve those, is a much better process over time.

I think more time is needed to explore the self-regulation process and to enhance that with both the FCC and FAANZ. The existing legislation, particularly the unconscionable conduct provisions, needs another year or two in operation for us to see how that is evolving. The basis for that is seeing, in more recent times, ACCC intervention in the Hamilton Island case and the Ultra-Tune case. It is not so much the entry into the franchise being a problem, which was Ms Gambaro's point, but the relational issues during the franchise. The other aspect of concern is the conduct during the relationship, and the ACCC has been effective in dealing with that in recent times.

I understand, from the conference I referred to previously, that there have been a number of cases where the ACCC has successfully intervened into the relationship base. The ACCC has for the first time, as representative for a former franchisee who was then without funds, been able to secure a settlement on a good basis—as the press report said—for the franchisee. So these things are evolving. I would hesitate to go to the US model where we have seen a gambit of litigation occur, and I would advocate otherwise.

CHAIR—Thank you. I was very interested to hear your comments about self-regulation and best practice. I want to refer to a particular issue on page 17 of your submission. You state:

Therefore, careful thought has to be given to . . . defining a 'franchise' before any charges such as those contemplated in the Gardini Report to make the Code compulsory are implemented. Otherwise, the consequences may be quite disproportionate, in terms of compliance, to the 'problem' sought to be addressed.

Would you elaborate a bit further on that aspect?

Mr Conaghan—The consequences I refer to go back to the first paragraph at the top of page 17. In

the USA, in a number of states, there is various legislation relating specifically to franchising, as well business opportunity laws, public money raising for new businesses and those sorts of things. Often each state has a similar definition of franchising but, in some cases, there are different definitions of franchising. What you now have in the United States is a body of case law as to what is a franchise. Some of the states have very involved regulatory requirements for disclosure. There is also the issue of the filing of documents. The prospectus provisions state that you have to file the franchise agreement and the disclosure document beforehand. So, if you then get into a situation where there is a distributorship agreement—for instance, there is a software agreement, an agency agreement, a trademark licence agreement—is that going to fall within the definition of a franchise, because if it does there may be substantial compliance requirements, filing fee requirements, registration requirements of the document. And that is where I saw that there was an issue, that it would have to be carefully thought through.

I bore in mind the attempts in 1986 and 1987 of the Attorney-General to come up with a definition of franchising which was satisfactory overall, and the Attorney-General's final view was that it was very difficult to come up with such a definition. Mr Beddall, I am conscious of the reference in your report to that issue. Indeed, what you have said is quite right. At first glance in looking at this I thought, 'Well, the definition of a franchise—that is going to be a relatively easy thing to achieve because franchising is just a method of distribution of goods or services in its base form.' When you look at the definitions of how you try and do that, it becomes very much harder.

To get some guidance from the United States experience, there have been things like a software distribution agreement found in Minnesota to fall within that, and the consequences of that are that the document itself does not comply with legislation, and there are criminal and civil sanctions and fines which follow from that. So the consequences may be disproportionate in that you are then going to have this new body of law for lawyers saying, 'Is it a franchise? If it is not, we will have to—' and the shonks that we talked about are going to adopt the view and call it different things. I have seen documents called franchise agreements, for instance, that the definition says are not franchise agreements, they are agency agreements. People start playing those sorts of silly games. It is difficult to hit upon a definition which might cover the area which is of concern but not capture other areas which are not necessarily of concern at the moment.

CHAIR—Thank you for that. Earlier in our hearings today we heard some comment from the Franchise Association of Australia and New Zealand about the franchise advisory councils. I wonder if you might make some comments about them—you no doubt know of their existence—and the role that they play in mediation and, when parties might be in dispute, what role they play in that, and how the whole mediation process occurs.

Mr Conaghan—Yes. For my clients who adopted the franchise advisory councils, what we have seen is that they have acted as a very good conduit of communication in a formal and in an informal way between them. Differentiating the model of the franchisor from a dictatorial approach to the franchisor who adopts a win-win scenario and is prepared to listen to feedback at least. So they have acted in that way. I think from experience what that has done is that it has been able to nip some of the problems in the bud as they emerge, rather than allow situations to have occurred where, for example, the first time a franchisor knew it had a problem was when the Federal Court application was served at the office. For one reason or another, the franchisor could probably have better monitored it. But on the other hand a franchisee probably did not feel

that they had an avenue of communication to say, 'We have a problem and it is not being properly addressed.'

Perhaps even at a lesser level, the field hand or the field consultant that franchisors have goes around and visits, as opposed to the director's understanding that, hey, there really is a problem here. In the franchise advisory council it is communication to the top, where perhaps in bigger organisations other people try to solve the problem themselves and it is not getting solved, and it needs to get resolved. It has been quite useful as far as another conduit of communication is concerned. As far as real mediation is concerned, it has not been my experience that they have really had a role in that mediation and that, where there really is a one on one problem of a franchisee or a franchisor, that has tended to have been dealt with outside the FAC scenario.

CHAIR—They prepare the franchisee for meeting with the mediator? Is that right?

Mr Conaghan—Yes, that is right. It has been through the conduit of the FAC that a problem is seen to emerge and the franchisee says, 'We've got to address this, but rather address it in concert with other franchisees there.' It is taken out of that, and we say, 'We've got a problem. We have to address it.'

Mr BEDDALL—Do you see a benefit in the fact that, say, when the agreements are being written up for signature by the franchisor and the franchisee, there is a mandatory clause in there that says any dispute should first go to a mediator?

Mr Conaghan—Yes, I would recommend that—

Mr BEDDALL—So the court would then say, 'Have you done that'?

Mr Conaghan—That is right.

Mr BEDDALL—At least the question is asked before it gets to the court.

Mr Conaghan—Exactly so. There is a decision of Mr Justice Drummond, I think, on that point about referring it off to mediation in the old arbitration type of provision. Yes, or it has to go to mediation first. While I think of it, Mr Evans, you had a question earlier which touches on the point that the franchisor really wants a franchisee who is going to be a good business person at the end of the day, because success for him is success for the franchise system. Under the code of practice at the moment, the only requirement is for the franchisee to go off and have a solicitor explain the terms of the agreement and sign a certificate saying that the franchisee understands that. I have recommended to my clients that, in addition to that—it touches upon what Mr Penfold said, as well—we will not allow a potential franchisee into the system unless the franchisee has seen an accountant or a financial adviser or otherwise and has gone through the whole process of preparation of what is just normal good business practice—a business plan, a marketing plan and a sales plan—and that they have looked at the financials and understand exactly by looking at the disclosures and the projections or the figures that are there and by looking at their model of the business. Then the accountant signs a certificate that he has done that and that the people understand.

At least in some instances we have, if nothing else, introduced the franchisee to an accountant or a financial adviser where there can be an ongoing relationship and a basis to make it work and to address those issues up front, because it is better to have the right franchisee come in rather than there being a problem in the system. That is going to more mechanisms to try to address that issue. Of course you have, unfortunately, situations where you have some of those franchisors who are not genuine in their endeavours about building the business and indulge in churning, for instance. That is the very issue of one of my cases at the moment, which is against a franchisor who, it might be alleged, could be said to be indulging in that sort of behaviour. We have got sufficient legal remedy and we have issues about access to justice, but otherwise I do not see that we need new law for me to get a proper remedy for that client.

Mr BROADBENT—Going on from what you just said, why is it that you argue at one point that we do not need new law and that common law actually covers the ground that needs to be covered, but that you then say you would like the government to enact a new law that puts in place a mediation process? In fact, are we inhibiting your rights there?

Mr Conaghan—The question was: if there was in the voluntary code. I did not understand it to be—

Mr BEDDALL—No, not law. In the voluntary code.

Mr BROADBENT—Just in the voluntary code.

Mr Conaghan—So that in the agreement there is going to be a compulsory provision? I would certainly agree with that.

Mr BROADBENT—Wasn't there another part of your submission where it suggested that, under the Trade Practices Act, we could be doing something about changing that legislation to allow for a mediator process?

Mr Conaghan—No, I think that was from Mr Penfold.

Mr BROADBENT—A previous witness, was it?

Mr Conaghan—Yes.

Mr BEDDALL—Under section 51AA there already has been successful intervention, hasn't there?

Mr Conaghan—As far as I know, there have been no decided cases as yet. The information for the ACCC cases I referred to came from the published press releases of their successful intervention and a description about what had been involved.

Mr BEDDALL—So it was settled before?

Mr Conaghan—Yes. So there has not been a reported decided case and undoubtedly there will be other lawyers who have different views about the adequacy of that. Indeed, my view is that it still needs

some more time to least explore what has become new legislation to see how that goes over the next year or two and, if it is proven not to be adequate and the problem is still there, perhaps we will have to come back to it. To hasten slowly, I think might be the—

Mr BROADBENT—Where a person is financially disadvantaged or in a difficult situation as is the case with a client of yours that you have described, would not $1,500 for mediation be a further impediment on their activity? Would they not be better off to be into the court as quickly as possible?

Mr Conaghan—My experience is that it is a lot faster to get to mediation than it is to get to court. The reality is that there could be months and years difference. The other aspect which touches upon the access to justice situation is, where we have had clients in that situation, we have used the court appointed mediator. In the Federal Court in Brisbane, the registrar is qualified as a mediator and so we have had some mediations before the registrar which uses the facilities of the court without my clients having to pay for that. I understand, though, with the new budgetary restraints, that consideration now has to be given whether that is a service which the court is going to be able to offer.

Currently, we have a situation where a court has ordered a mediation—again, perhaps a franchisee in impecunious circumstances. In the first directions hearing, we have had some directions and we put the claim. The first thing we have done is to ask the court for a court appointed mediator so we can try to get a resolution of it. I do not know what is going to happen now with the new budget restraints: whether my clients will then have to find some money to find a mediator because I am just doing it on a speculative basis. Otherwise, they would not be able to get any rights.

CHAIR—As there are no further questions, I thank you, Mr Conaghan, for your attendance and for responding so freely to the questions put to you by the committee.

Mr Conaghan—Thank you, Mr Chair.

[4.06 p.m.]

BUCK, Mr Neill, Executive Director, Franchising Code Council Ltd, PO Box R1346, Royal Exchange, Sydney, New South Wales 2000

GARDINI, Mr Robert, Chairman, Franchising Code Council Ltd, PO Box R1346, Royal Exchange, Sydney, New South Wales 2000

SHEDDEN, Mr Warwick, Board Member, Franchising Code Council, and Managing Director-Shareholder, OZ Design Furniture, 401 Darling Street, Balmain, Sydney, New South Wales 2041

CHAIR—The committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as a contempt of parliament.

The committee prefers that all evidence be given in public but should you at any stage wish to give any evidence in private, you may ask to do so and the committee will give consideration to your request. Do you wish to make an opening statement?

Mr Gardini—I wish to make an opening statement. Thank you for the opportunity to give evidence before the committee today. I am the Chairman of the Franchising Code Council, which is the body created by the franchising sector with the support of the Commonwealth and state and territory governments to provide a self-regulatory framework for the franchising sector in Australia.

Franchising is a major part of the Australian economy. It creates the conditions for the generation of wealth by individuals and encourages the type of entrepreneurial behaviour essential in a dynamic and forward looking country like Australia. In 1994 the Australian Bureau of Statistics survey of Australian franchising made the following findings about the nature of franchising in Australia. The survey found that there were approximately 555 franchise systems with approximately 26,000 franchisees. The total turnover of the franchising sector for the 1993-94 financial year was $42.7 billion. It employs something in the order of 279,000 Australians, and a 67 per cent growth in numbers of business outlets operated by franchisees since 1991 demonstrates an annual growth rate of approximately 14 per cent. And 18 per cent of home-grown franchise systems export their goods.

A recent major independent survey commissioned by the Franchising Code Council has found that there are many good things to be said about the sector. The survey involved interviews of half an hour duration and covered 100 franchisors and 700 franchisees from all industries in the sector, both registered and not registered with the council. It was a survey at random. I can now advise that I expect the report to be available by 30 September and it will set out the full findings of that independent survey.

For the purposes of today, we have had some preliminary findings provided by a consultant. They demonstrate that 66 per cent of franchisees said the franchise provided a good return on investment and 28

per cent said it did not; 69 per cent of franchisees would buy their franchise again; 76 per cent would recommend the system to prospective franchisees; 89 per cent of franchisees said that they had a good relationship with their franchisor; and 20 per cent of franchisees were attempting to sell their franchises.

To turn to the background to the present situation, the franchising code is the sector and government's response to 20 years of attempts at legislation in the franchising sector, following various reviews and deliberations. The Australian Trade Practices Act 1974 provides a key starting point in examining the sector for it introduced a regulatory framework for business-to-business trading relationships. In addition to the anti-trust aspects of the act dealing with price fixing and the like, the act codified the concept of prohibiting misleading and deceptive conduct in trade or commerce under section 52.

Following the Swanson inquiry in 1976 and the report of the Blunt committee, the government introduced the Petroleum Retail Marketing Franchise Act in 1980. This act only addressed franchising in the petroleum industry and did not deal with the remainder of the sector. During the 1980s several unsuccessful attempts at specific franchise legislation led to the Beddall report of 1990. This report called for specific franchise legislation relating to prior disclosure, cooling-off periods, conditions for the alteration of franchise agreements and conditions for termination, renewal or transfer of franchises. In 1990 the Franchising Task Force recommended a self-regulatory code of practice to deal with franchising problems.

The franchising code, as administered by the then Franchising Code Administration Council, was introduced on 1 February 1993, and some 14 months later I was appointed to conduct a review of the code. The review found the code had two major weaknesses. The first was a lack of coverage across the franchising sector, and the second was the inability of the code to deal with standards of conduct, particularly problems associated with exploitative conduct.

Following the review, the council developed a strategic plan to implement those recommendations of the review that were within the province of the council. The government, partly in response to my review, developed the better business conduct bill, announced it would fund a small business unit within the Australian Competition and Consumer Commission, and entered into an agreement with the Franchising Code Council to provide $2.37 million over four years to assist the council to move to self-sufficiency and to implement its strategic plan.

The council's strategic plan contains four main elements to meet these requirements. The first is a compliance system for the code, including the conduct of random audits and the development and implementation of effective complaint handling systems. The second is cost-effective and efficient dispute resolution systems and the promotion of alternative dispute systems in franchising as an alternative to litigation. The third is an education and awareness program to promote best practice in franchising and to encourage wide registration and compliance with the code.

The final element is a policy and operation system for the council, including the establishment of a number of policy subcommittees to implement the plan and the development of effective administration systems. Briefly, those subcommittees are a code review committee, a dispute resolution committee, an implementation committee and a standards and compliance committee, the latter committee meeting monthly.

The council is eight months into the implementation of the strategic plan and we believe the council has made significant progress in education awareness in the sector and also with compliance arrangements and in the development and implementation of dispute resolution arrangements.

The levels of registration have increased to 450 franchisors out of a possible 650 to 700 in Australia. The council has directly facilitated the resolution of a number of disputes and referred many more back into the franchise systems for resolution between the parties. The council has set out a plan that will provide a framework for best practice and successful self-regulation. This plan provides for a minimalist approach to government regulation and the ownership of the code by the sector.

Over the next 12 months the council will undertake the following new activities or development of existing activities: the development of a comprehensive advertising and awareness program over the period on a state-by-state basis; marketing of the code to non-registrants; building or improving the relationship with key stakeholders in the sector; widening surveillance under the code of practice; further education in mediation and the availability of dispute resolution procedures that the council provides; revenue raising and moving to self-sufficiency; and evaluation of our own performance.

The council now finds itself only one year into the implementation of the strategic plan underpinned by a four-year contract with the government, and there is now some reduced level of funding for the council. That is an issue I would like to refer to in camera at the conclusion of the public part of this evidence.

CHAIR—Right, thank you.

Mr Gardini—I mentioned some very positive results from the council's inquiry into disputes in this sector at the commencement of my presentation. There are also some results which point to the challenges for the sector and the government. Some 50 per cent of franchises surveyed did not have a formal process for dispute handling and resolution. A total of 25 per cent of franchisors say they have a major disagreement or dispute or are in actual litigation with their franchisees. A total of 10 per cent of franchisees that say they have a major disagreement or dispute are in court. That 10 per cent of the 25,000 or so represents 2,500 franchisees and 13 per cent of franchisors say they are currently in litigation or in the courts.

In regard to the code itself, the survey found 99 per cent of franchisors surveyed are aware of the franchising code. Ninety-two per cent of those franchisors who were aware of the code were positive about it. Sixty-four per cent of franchisees would attempt to involve the FCC in resolving a serious dispute if mutual negotiation between the parties was not working. This new evidence provided from the council's inquiry into disputes and the information contained in its submission indicates a need for action, we believe, in the following areas.

There needs to be provision of general underpinning of the code through the Trade Practices Act, particularly in relation to standards of conduct, which we believe are not adequately covered. There is a need to ensure that processes exist to inform the market of the names of those parties removed by the council from the code. The council should be provided with some protection from defamation and litigation which may arise in the normal course of investigation and compliance activities.

Further, it should be ensured that the council has sufficient resources to move to self-sufficiency over the four years of its current strategic plan. The Australian Competition and Consumer Commission should be adequately resourced to take action in the area of franchising to create a framework for deterring illegal behaviour and encouraging compliance with the franchising code.

On behalf of the council I request the committee to consider the position of the council and the sector it serves and to make recommendations to ensure that the code is able to be effectively implemented for the benefit of the sector, the public and the Australian economy.

CHAIR—Thank you. Do either of your colleagues wish to make any further statements at this time?

Mr Gardini—No.

CHAIR—Can I ask you about the figures you quoted. Was it 26,500 franchisees?

Mr Gardini—That is correct.

CHAIR—Of them, about 8,000 are not registered members of the association. Is that what you were referring to?

Mr Gardini—There are no franchisees registered under the code but if you take the number of systems which are registered—approximately 450—we say that we would represent something like 17,000 franchisees.

Mr Buck—Just commenting on the process, franchisors sign to join the code and at that time they pay a registration fee on their own behalf and they pay a registration fee on behalf of each of their franchisees. For example, they pay $15 per franchisee and an amount for the whole of the franchisor. The person who signs the certificate is the franchisor but they capture the franchisee.

CHAIR—Is it the same figure for any franchisor and franchisee?

Mr Buck—There is a sliding scale, depending on the size of the system, but the $15 is fixed. The maximum that a franchisor can pay is $2,000 and the minimum is $250 which is the base fee. If they have one franchisee it is $250 plus $15.

CHAIR—Who set that figure?

Mr Buck—That is the original figure that was set at the inception of the council.

CHAIR—With the 35 per cent who are not registered members, you have no contact with them, no influence over them. They are not registered with the code council so how do they receive information about the activities of the Franchising Code Council?

Mr Gardini—The council is active in the marketplace. We place advertisements in national

newspapers, the 'Don't Sign' campaign in the business opportunities columns. We attend franchising exhibitions on a state by state basis. We have a stand and we provide information about the code. We use that opportunity to speak to franchise systems that are both registered under the code and not registered under the code to find out the reasons why certain franchise systems are not registered and to encourage them to register.

We conduct presentations to the law societies and accounting bodies. We provide a newsletter and we are circulating our newsletter—and there are two editions of that so far this year—very widely throughout the franchising sector to those who are registered and, more generally, to others who wish to have access to it. We are trying to build up a wider database to explain the benefits of the code.

CHAIR—Could I move on to another topic and that is the nature of your organisation's relationship with the Franchise Association of Australia and New Zealand and the ACCC.

Mr Gardini—In terms of the ACCC, we are currently negotiating a memorandum of understanding with the ACCC which would set out the relationship that we have with that organisation in relation to the ACCC receiving complaints concerning a franchise system that is registered under the code. The council would seek that that original complaint be referred to the council to see whether or not we can assist in dispute resolution as a much more cost effective mechanism without the ACCC investigating the matter and possibly taking court action. We are exploring that opportunity.

The council is clear as to the nature of our strategic plan. We have offered to provide training to their small business unit on an Australia-wide basis to give them insight into franchising issues. In terms of the enforcement role of the ACCC, we recognise that they are a statutory body with their own priorities in relation to enforcement. However, they should recognise that the code, to the extent that it can resolve disputes more cheaply, should be given that opportunity. If we cannot then resolve those disputes, we would refer the parties back to the ACCC, with a view to the ACCC seeing whether or not they can take further action.

That relationship is developing between the council and the ACCC. We see it as a very important role. You can see from the Hamilton Island case, which was a case of misleading deceptive conduct and a case of unconscionability, that Mrs Evans and Jalpalm did not succeed in the Federal Court. It was the subsequent action by the ACCC which resulted in a court settlement. The one approach is to have a legal remedy and the second is to have effective access when you may have lost the financial means to take action.

We would see that effective underpinning of the code and the relationship with the ACCC would provide a basis for an effective self regulatory mechanism.

In relation to the Franchise Association of Australia and New Zealand, the council, has, in developing its strategic plan in the middle of last year, provided a draft of its strategic plan for that organisation to comment on before the board took a decision to approve it. We meet from time to time with the representatives of the FAANZ to discuss our individual activities and programs. We provide, in the development of all our brochures and documentation, certainly in relation to dispute resolution, our general code brochure. We provide them in draft form for the FAANZ to provide their comments before we actually

finalise the document. We have consulted with the FAANZ in relation to the recent review of the code. The code is valid for a 12-month period and once we have registrations from about the middle of the year, or from March of each year, the council consults with the sector, because the sector owns the code. We consult with FAANZ, with the legal profession, with the accounting professions and as widely as possible to see whether or not the sector has a particular desire to make changes to the code. Those comments come back to the council. At the last meeting in August, the council considered a number of proposed changes. Those changes will now go for a final examination to the FAANZ before the council takes a final decision at its AGM in November.

CHAIR—Would you say that your relationship is in good shape at the moment between yourselves and FAANZ?

Mr Gardini—I think you were present at today's franchising conference. I was an invited speaker to be involved in a discussion concerning the code of practice. I attended the conference at lunchtime yesterday and it was brought to my attention that there were certain concerns within the FAANZ that were going to be expressed today. I attended a briefing yesterday afternoon with a view to discussing with the panel of speakers what issues were going to be discussed and how we might run the session. The immediate past chairman of the FAANZ was not present at that briefing. I spoke to him at the dinner last night and was somewhat surprised to see that he was proposing, or there was going to be a public initiative, to announce that their organisations could, in fact, effectively administer the code of practice.

CHAIR—What is your view of the proposal?

Mr Gardini—As I indicated at the conference, I see a difficulty with that. In terms of self-regulation, and there are a number of models to look at, there is a danger that an industry association which serves the interests of its members finds it very difficult to also be a referee or policeman—however you describe it—in the sector.

Essentially, if you are looking after the interests of members, you are putting on a number of events and serving their interests because you also wish to retain their membership; you have got a financial interest in actually doing that. If you combine the two functions, I think, inevitably, one function suffers.

My own experience as a lawyer indicates that, in the role of law societies, the predominate role that seems to be captured is one of the regulator. I think most of the members of my profession would say that law societies do not actually do much in the way of advancing the interests of the profession in the form of a business association or trade union type of role.

In terms of other self-regulatory mechanisms, you look at the banking ombudsman scheme, which is a self-regulatory mechanism. The Australian Bankers Association does not administer that scheme. A separate ombudsman was established to keep it at arm's length so that the council, which is broadly representative of the sector at the moment, with five franchisors and franchisees, two service providers and one lawyer, has no other brief than to achieve and try to assist the self-regulatory regime that the code provides. We do that without any fear or favour. We do not have any concerns about significant loss of membership because of certain actions we may take. I think that there is a real concern that a body charged with both responsibilities

would find that it runs into conflicts.

The second point is, in terms of resourcing, how does such a body ensure that adequate resources go to the regulatory role, or the policeman-type role, rather than the role that runs the excellent type of conference that we have seen on display over the last few days? That is a concern.

Our council also has the compliance and standards committee which ensures compliance with the code. If there is not compliance and there is an unwillingness for parties to change their disclosure documents and to comply with the code, ultimately, that committee has to consider the removal of such systems from the code. There are conflicts of interest situations that can arise.

If there is a major event going on where one of the franchisors may be a sponsor and, in the following week, there is a consideration of an allegation of non-compliance, everyone is going to be really wondering—if not saying it openly—whether or not someone ought to be tapping someone on the shoulder or whether they should be taking action that should be taken. I think there are some real dangers in mixing those two roles in the one body.

CHAIR—Does the FCC have some form of registration of your members' interests? I know it represents franchisors and franchisees.

Mr Gardini—Yes.

CHAIR—But in terms of representation and interest in any other activities which might be an apparent or perceived conflict of interest?

Mr Gardini—In terms of their involvement on our council directly, there is a provision in our memorandum, our articles of association, which requires all members to declare any conflicts of interest. I, as chairman, have declared potential conflicts in relation to my involvement with lawyers engaged in alternative dispute resolution—the organisation known as LEADR. Upon becoming chairman, I provided all directors with a copy of the company directors' manual on their obligations under the corporations law and I have reinforced their duties and obligations to the council on a number of occasions. It is a matter that I take very seriously, that conflicts ought to be registered.

In terms of the operations of the Standards and Compliance Committee, which I chair, we have developed a procedures manual, which offers natural justice and procedural fairness to everyone whom we deal with. We ensure that parties with a conflict leave the room for the consideration of particular matters where they have a conflict. I believe that we have adequately addressed those issues. I am very confident in the work of the council in that we do not run the risk of being either perceived or in any way alleged that we do have any conflict.

CHAIR—I think Mr Shedden had something to add, too.

Mr BEDDALL—Perhaps I could just follow up on your point. Could we get a copy of who is the current composition of the council and what organisations they represent?

Mr Gardini—Certainly, in fact, I faxed that through to the—

CHAIR—I think that might have been provided to the secretary. The secretary has not had time to distribute it to members, but we certainly will distribute that. Are you happy with that?

Mr BEDDALL—Yes.

CHAIR—Mr Shedden, I believe you had a point to make.

Mr Shedden—Yes. I will make a couple of general comments. First of all, as a practising franchisor for a number of years and as a director on the FAANZ for a number of years—although I am not now—and as chair of the Standards and Compliance Committee and as a growing franchisor, I would like to firstly endorse the fact that I believe the code should be underpinned because it is part of our growth. I certainly believe that a co-regulatory type of situation is desirable because you have sector people involved in developing that code, and I believe it is part of our growth. I support the defamation and litigation protection, particularly as I am a council director and member and as I sit on the Standards and Compliance Committee, which is very involved with the procedures manual.

Putting on my franchisor hat, as a FAANZ member, I certainly support Mr Gardini's comments. However, as a franchisor, thinking of my pocket, which we all do, it is of concern for the future of this sector that we could possibly be asked to put our hand in our pocket for two organisations that are self-funding. That may be a problem in the future, particularly for the younger franchisors in this country. They are the ones that need the education and certainly the acknowledgment of a code of conduct.

Mr BEDDALL—In terms of the four-year funding that was provided, is that a decreasing amount per annum so that you are weaned off or does it just cut out in four years?

Mr Gardini—The position I can announce from the budget is that funding was provided for the first year in the sum of $375,000. In this most recent budget, the funding will be provided for this financial year in the sum of $648,000, which is either the same or slightly more than it was under the four-year agreement. However, there will be no further additional funding for the subsequent years. So the challenge is for the council to achieve self-sufficiency in the next 12 months.

Just to explain the position in relation to our funding, the council earns about $300,000 from registration fees each year. If you took the $2.4 million over, say, four years, that is an additional $600,000. But that was only ever to be to raise the education and awareness amongst the sector and the community, to spend a lot of money on education and advertising. Once that had been achieved, the council accepted we had to move to self-sufficiency.

So the position really in the longer term would revert back, despite Mr Shedden's comments, to the original position that took place in 1993 when the code was established. That was that the franchising community could join the FAANZ. That was a matter of trade association that would further their interests, and there is always a separate charge in relation to administration of the code. The sector said at the time, following the franchising task force report, that it really wanted a code of practice. It really had to accept the

obligations that went with that to find the funding.

So I do not think the sector can really have it both ways. It also needs to fund it to really have the ownership of the problems because, if it really does take that ownership, it pays for it, then it really has an interest in each aspect of the code and the benefits that the code provides.

So, in overall terms, I do not see the funding issue as necessarily absolutely critical, but it is very important. There are other issues. I mentioned today at the conference and in our submission that there are only so many things the council can do. Essentially, we are looking also to government for a policy response and to address the issues of defamation. We need to ensure also that the code is authorised by the ACCC, and we are awaiting a decision on that.

We need to have a relationship with the ACCC so that we are efficient in the delivery of our services and they are too. Essentially, in terms of underpinning, the council supports the need for that, and it is opposed to specific franchise legislation. The council believes that we are very close to achieving an effective code of practice, if we can have a combination of government policy responses and an adequate performance by the code council. Until we deliver that, we will never be able to really judge whether or not self-regulation can be successful.

Ms GAMBARO—Mr Gardini, in the time that the council has been operating, have you deregistered any franchisors, and what are the penalties? I would like for you to run us through that. Do you feel that in the past you were not taken seriously enough because you were not seen as having any great power? What would it take to empower the council?

Mr Gardini—That is a very good question in terms of the criticism that is levelled at the council. The common saying in the media is 'the toothless tiger'. Let me deal with that. Let us first look at compliance with the code. The obligation under the code for the franchisors is to produce a disclosure document. In the past, the council just accepted the cheque and issued a number. The code, following my review, was amended to include a requirement that the council could request the disclosure documents from a franchisor.

At the beginning of last year, the council commenced a pilot program of a random audit of 50 franchisors. The result of that audit was that 14 per cent were removed from the code, because either they would not comply with the request from the council to produce a disclosure document or they said that they were no longer enfranchising. That was the result of that.

We are currently conducting a random audit of 150 franchisors. We are still going through that process. It is rather time consuming. When we receive the document, it goes off to our independent auditor, who has a check list to go through to see whether or not the document is compliant as to form only. In other words: does it contain a positive statement about all the requirements contained in the disclosure document? If it does, we immediately write back and say that in a limited way we have looked at that document as to form only and it complies.

In relation to documents that our auditor believes have some deficiency, we write back to the

franchisor and say, 'You have 30 days to amend your document in relation to the following parts. Would you then resubmit the document?' We have carried through that process. Some of the documents have come back. Sometimes we need to go back one more time and say, 'Look, you have fixed that up but we still have a little difficulty with this.' So the council encourages compliance for those who are willing to comply with the code and tries to assist in achieving compliance. However, I do expect that there will be a number who are likely to be removed from the code as a result of the audit of 150 this year.

In addition, this year we sought renewals of registration from those who were registered last year. We sent out a number of letters. We noticed that about 80 did not renew, mainly for reasons that they were no longer in franchising or they were struggling to get their systems under way. So, as a matter of automatic policy if there is a non-renewal, the council must under the code remove those from the register, because the register is an ongoing dynamic document.

Ms GAMBARO—You may remove them from the register but how do you—I hate to use the word 'police'—how do you ensure that they are not trying to solicit franchisees in that interim process? Do you have a tracking system?

Mr Gardini—At the moment firstly we write to them advising them that they are now being deregistered, and under the code they must now advise their franchisees that they are no longer registered under the code. That immediately provides a checking mechanism for those franchisees to say, 'Why aren't we now registered under the code?', particularly those who say they are no longer in franchising or whatever. So we impose that obligation on them.

In terms of the enforcing of that and vigilance by the council of that activity, that is something that is being currently considered by the standards and compliance committee with a view to doing some surveillance of those systems to ensure that they are not making representations, for example, that they are still registered under the code. If they were making such representations, either the council itself would have to consider a threatening letter of misleading and deceptive conduct action or refer the matter to the ACCC in relation to that issue.

In terms of your broader question of compliance—is the code a toothless tiger—we would say that after a period of developing our strategic plan and creating a presence in the marketplace prospective franchisees will say, 'Look, we are not going up with a franchise system that is not registered with the code.' We think if we can get to that level then market forces will put pressure on franchisors that there is a financial penalty of losing registration, so they will take that loss of registration fairly seriously. However, in the past I think there has not been that concern because competitors have known in a particular industry, say, one franchise system is registered—and I think this would apply to Mr Shedden's system, he knew a particular competitor who was registered under the code but did not have a disclosure document, so that did not really do much for the credibility and integrity of the code. But that has changed now, so I think we are having an impact in the marketplace where we are being taken more seriously.

In terms of complaints, I think we have given you a list of matters we are now receiving and in the last six months we have had something like 435 inquiries. We are resolving a lot of matters just quickly over the telephone. It is very time consuming but it is very cost-effective also. If you put in that time initially you

can achieve results.

CHAIR—Do you try and resolve the problem or do you then try and go to an independent mediator? One of the criticisms that you get from the franchise association is that you are trying to be the person who solves all the problems rather than go to mediation where an independent person can therefore resolve it.

Mr Gardini—That is a comment that in our code review process they have made in their submission to the council. We find it rather curious because we have met with the FAANZ. We do not have that role. We have a role to investigate complaints to see whether there has been non-compliance with the code. That means we either make telephone inquiries or, if necessary, the executive director conducts, in very serious allegations, field investigations. They are to see whether or not there is a breach of the code. If it turns out that it is a standards of conduct matter, the council does not have any role to discipline or take any further action in that area except to one stage, and that is to ensure that the possibility of mediation is considered.

Provision 13 of the code requires that, once the parties have tried to resolve their difficulties together but they cannot make progress, either party can approach the council to appoint a facilitator. So we do not actually offer mediation services directly. All we do is reach a stage in the investigation process where we form a view—and we have had some of our staff trained in mediation—and we then refer the matter to our facilitators, the Accord Group, which has 35 mediators appointed around Australia to provide the service. So we do not provide that service. The provisions of the code require that a party requests the council to appoint a facilitator, and we act upon that.

I think that there is some confusion about this. The council has discussed this matter and we will go back to the FAANZ in terms of some misunderstanding of that role. I would like to receive some specifics from them as to where they think we have conducted ourselves with a view to mediating. I do not believe that to be the case.

Ms GAMBARO—Mr Gardini, how are these facilitators appointed? Is it a subjective decision?

Mr Gardini—With regard to the process for the appointment of the facilitators of the Accord Group, last year the council, through its Dispute Resolution Committee, decided to ask a number of dispute resolution organisations in Australia to provide proposals to the council. We had a meeting in Sydney where we sat down and said, 'We want groups to provide these services. We also want some assistance and advice in running some seminars. We need to produce a dispute resolution brochure. We want some things from you. We are prepared to pay you a small amount of money for an ongoing relationship.'

Various proposals came in. The Accord Group was ultimately appointed by the council and the requirements by the council were that it should establish a panel of mediators on an Australia-wide basis. It did not have the ability to do that, but it said to the council that, through its connections with the law societies and Leader, it would establish that panel, and it provided a list of those mediators.

The requirements that the council had were that those mediators should have commercial experience, and that the Accord Group, through its association with that panel, would provide during the course of the appointment some training to those mediators in the characteristics of franchising. Once those presentations

have been scheduled, both Mr Buck and myself would make a direct presentation to those mediators. So that is the current position. We are not in the business of duplicating the large number of mediators that exist right around Australia. Essentially, there is not enough work for them. As a mediator myself, I know exactly that position.

Mr BEDDALL—Let me just go back a bit in time: is there a requirement for each franchisor to advise the council of the names and addresses of franchisees and, if not, do you think that it should? My concern is that, whilst there is a very high recognition of the role of the council amongst franchisors, there is not so much amongst franchisees. If a franchisor were taken off the list because he or she did not comply, and you write to the franchisor saying, 'Please advise your franchisees,' there is no guarantee that that franchisor will do that. Would that not be more a role for the council? That would happen if you had a list of franchisees.

Mr Gardini—Yes. I think at the moment the answer to the question is that there is no requirement in the code other than the application form that states the number of franchisees that the franchisor has. But there is no requirement to provide the names and addresses. However, at the moment the council believes that there is a need to communicate with the broader franchisee community; particularly, to provide them with the newsletter; to advise them on dispute resolution, and to do it directly.

At the moment we are doing it through the franchisors. We say to them, 'We know how many franchisees they have and we are providing them with a suitable number of documents.' We have also said to the franchisors, 'If you do not want to do that, the council is very happy to do that directly.' We have had some mixed reaction to that. Some systems are giving us access; others are saying, 'No. You give it all to us.' Whether it goes in the bin or goes out to them, we do not know.

In addition to that, now that we have established our computer system, our next step is to establish a database of franchisees. That is going to be a difficult task but, by sitting down with the telephone directories on a state-by-state basis and asking people in our newsletter on our back page if they want to receive the newsletter to register with the council, we will provide it to them. Over the next 12 months, we will establish a franchisee database to provide the information direct. The point you make is very valid and is something that really needs to be addressed.

Mr Shedden—Can I just add to that. On the basis that the Franchise Advisory Council, at minimum, should be advised. At least that could be a conduit of information to go out to the franchisees in the fraternity. I think that is a very valid point because the Franchise Advisory Councils play a very important role in most franchisor situations.

ACTING CHAIR—Are there any further questions?

Ms GAMBARO—That was a good question. I was interested in the mediation side of things as well but I do not have any other questions.

ACTING CHAIR—We will go in camera on the overall financial thing. One of the points I would like to put to you is on financing, and it is probably one of the reasons you may have some disputes with

other franchisors. It is that, in a sense, they are paying for the franchisors association and they are also paying for the council. If you have such a database and a person signs up to be a franchisee, the council is more for the interest of the franchisee than the franchisor. Perhaps a registration fee and an annual fee from all franchisees would help solve some of the funding problems. Has that been considered?

Mr Gardini—Certainly, it was my understanding that it was considered at the development of the code. There is quite rightly the view by franchisors now, that if you are also going to give franchisees some ownership of the code, if they are not prepared to pay $15, essentially you do not really have their interest. Some franchisors have not paid that amount for them and said, 'You must pay that because you must take an interest in this.'

The council itself finds that small business franchisees essentially work very, very long hours. They are trying also to maintain family relationships and it is difficult for us to get their attention as to the importance of dispute resolution when they do not have a problem. They essentially want to know about the council when there is a problem, but it is very difficult to catch their attention with all the other commitments and responsibilities they have. That is a challenge that we really need to address. I am not sure of the answer to that.

ACTING CHAIR—Perhaps I could do a consultancy for you.

Mr Shedden—Perhaps we need a franchise advisory council. In our system, we have openly stated—and we got their approval when this first came in—that it was taken out of what we call the supply rebate fund. Therefore it gives them some ownership to this code.

ACTING CHAIR—When people are signing up for a franchise, as a whole, there is a series of documents they sign. One of the things they could sign is an agreement to pay a fee and then sign a bank authority which would automatically take it out of the bank and it would be there forever. Small business never cancel bank authorities.

Mr Gardini—No, they are too busy trying to earn a living. It is a very important issue. Council is exploring it at the moment because, despite the change in funding arrangements, there is a need to move to self-sufficiency. We are looking at a number of options and that is one of them. It always comes back to the issue of really capturing their interest.

Essentially, our recent survey demonstrated that when we have asked the franchisors, 'Did you offer a cooling off period?' the answer to that has been extremely high. When we have asked the franchisees—and we know it is being offered—the response to that has been extremely low. I am not too sure of the answer, but I suspect that when you are entering into a franchise agreement, all you are interested in is the excitement of going into the new business and, essentially, you lose sight of all the documentation that was offered at the time.

So I think that demonstrates that, whilst they might go off and get legal and accounting advice, really their hearts and minds are on the nature of the activity rather than on what was actually provided to them. So the question will be what the appropriate time is to get their interest. To take Warwick's point, if we can

establish a relationship with the franchise advisory councils, say one in each system, someone who takes responsibility for getting the material at the next meeting will say, 'Look, we've got this and the council should be aware of it. Do you want more information?' Then, I think, instead of having the database of 26,000, which is very volatile too and the cost of maintaining it would be very significant, if we could get a smaller number, where there is an established network to communicate that information through, then we would have a much better chance of success.

In that regard, we have entered into a relationship with the Western Australian Small Business Development Corporation to jointly advertise in Western Australia with that corporation on a dollar for dollar basis of the 'Don't sign campaign' in the newspapers in Western Australia. They also have a segment on radio to promote the code. Instead of them also providing mediation facilities, we have said, 'Look, we have this relationship with the accord group, so you can contact the accord group if you wish to avail yourself of those services.'

At the moment, we have a draft memorandum of understanding with Small Business Victoria in relation to the provision of our publicity and information about the code. We would once again offer mediation services through the accord group to Small Business Victoria. So we see the delivery of the small business corporations as very fundamental at the first point of contact of people in the states looking to buy franchise systems. Through creating this network on a state-by-state basis, we believe that we can actually be very effective, without creating something new.

We do not want to grow into any large organisation. We believe that the infrastructure already exists around Australia to deliver that service and it is only a matter of the council tapping into that. The response that we have had to date has been very positive. Neill and I attended the meeting of the Small Business Development Corporation in Hobart earlier this year—

ACTING CHAIR—Who represented Queensland, by the way?

Mr Gardini—Michael Jackson is still there.

ACTING CHAIR—The bureaucrats won that one. They got it abolished with the new government.

Mr Gardini—Right. So that is that network that we think is very important. It exists and it is there to be used.

Mr JENKINS—Mr Gardini, I have questions to do with the health of franchise as a sector. Early this afternoon, Mr Peterson paraphrased some figures that you gave the conference this morning. One of them that we queried was the fact that I think you told them this morning that 69 per cent of franchisees when asked said that they would probably take out franchises again, which raises the question: does it mean that the other 31 per cent have had bad experiences and do not want to do it? What would be your analysis of those sorts of issues?

Mr Gardini—I think, broadly speaking, the sector is growing pretty strongly in difficult economic times. I think you must accept that. In terms of 69 per cent of franchisees who would buy it again, I think

financially they are doing pretty well. Twenty per cent said they would not. That would be a mixture of commercial reasons. Retailing is just very difficult at the moment and I think people would make judgments about the number of hours they are working, the investment that they have put in. Essentially, the cash flow might be quite good, but the returns on the investment might not be all that good.

We will have a much more detailed report by the end of this month for your consideration, but from the figures in terms of 10 per cent of franchisees saying they are either in litigation or in serious disputation, that is of serious concern because that represents a figure of approximately 2,500 franchisees who are saying their financial investment is somewhat at risk. With their analysis, we will try and tie that back to whether or not—

ACTING CHAIR—How big was your sample?

Mr Gardini—The sample was 700 franchisees.

ACTING CHAIR—Is that out of 26,000?

Mr Gardini—Yes. Our advisers estimate that that has an accuracy rate of plus or minus three per cent. It would have been much more expensive to reduce that a percentage. But that is still a reasonable figure and is fairly consistent with the ABS survey in 1994.

Mr JENKINS—I might just clarify that. That ten per cent represents actual disputes with a franchisor, not a third party.

Mr Gardini—Yes. They are either in litigation or in serious dispute, and have had questions asked in relation to the level of disputation. So they were given that choice then further questions were asked about the nature of the problems. Once we start to break down that data we will have an understanding of whether or not it relates to standards of conduct issues.

ACTING CHAIR—The franchisors are quite open when they say that ten per cent slip through the net. No matter how good the system is, there are those people who will always want to buy a franchise. It is the same reason people sign retail tenancy agreements—they are scared somebody else will.

Mr Gardini—Yes.

ACTING CHAIR—So they sign it without reading it.

Mr Shedden—It relates to their expectations, too.

ACTING CHAIR—Their expectations are high.

Mr Shedden—Particularly in the last few years, in franchising in general we have probably done ourselves an injustice in the sector, because we have a passion for entrepreneurialism and for growing our businesses and people can see that. In fact, in tough economic times we have shot ourselves in the foot,

because for part of those ten per cent it could be that their expectations just have not just been met for whatever reason. But seventy per cent or thereabouts is a pretty reasonable number.

ACTING CHAIR—The other thing we always were concerned about was the person who was buying a job. I do not know whether any data has been looked at among those ten per cent. Were any of them public servants who got payouts and rushed off and bought franchises because they wanted to buy jobs?

Mr Gardini—I know that in 1994, when I conducted the review, there was a great deal of that element in terms of prospective franchisees. There were a large number.

ACTING CHAIR—There are a lot more now.

Mr Gardini—It has continued. It is a concern, but essentially all that we can do as a council is say 'Look, the code provides for minimum standards.'

ACTING CHAIR—Some of my former colleagues are probably looking for franchise opportunities, too.

Mr Gardini—We cannot protect people from poor commercial decisions. Essentially, if there is a downturn in the economy or people make poor commercial decisions, that is in the nature of commerce. We are concerned if the ten per cent relates to exploitative conduct. There is a financial interest, in a franchise system, in saying, 'If, as a franchisor, I am losing money and my franchisees are not doing well, I can actually remove some franchisees and get another franchise payment, because there are a large number of people queuing up to buy franchises.' There is actually a financial incentive, particularly if there is an inadequate legal remedy against that sort of conduct to actually prevent that continuing.

We are not talking about small investments. The range of investments in franchising would be from a service delivery lawn mowing system for $20,000 to $25,000 up to $1 million for a motor vehicle franchise or a McDonald's. That is a very significant investment. At the end of the day, the public policy issue is whether or not there is a level of disputation which involves exploitative conduct compared to normal commercial risk. I mean, we are not in the business of protecting people from themselves. I do not think government is in that business either. That is just one of the realities.

Mr JENKINS—Do the different lines of business activity or the different scales that you have just mentioned affect the number of disputes?

Mr Gardini—I might ask our executive director to answer that. We are keeping a register of the complaints that are coming in and we would like to think that those who were struggling to establish franchise systems might be cutting a few corners and having a few more disputes. But, in general terms, we are getting a serious level of complaint from often quite well-established systems which are engaged in conduct which essentially cannot be contained or on which there is no action the council can take.

Mr Buck—There is no pattern. We did some analysis on the complaints. At the point that I did the last analysis we had about 75 complaints that had translated into something other than simply a telephone call

and they were spread across the range of size of franchise. We took the view that there may well be a pattern associated with the nature of the size or length of time of operation and that does not appear to be the case. The complaints we receive are spread across the board.

Mr Shedden—Could I make a comment, Mr Jenkins? The 10 per cent number in speaking to franchisors is a number which is discussed. Obviously, if you have a system with 100 then you have 10 or thereabouts disgruntled franchise owners who are going to cause more of a problem than we have at 25. We have one or two bubbling for whatever the reasons might be. The bigger the system, the more people there are who are going to be disgruntled. That would be a fair comment because if the 10 per cent theory runs through, which it seems to, and this is a generic comment—

Mr BROADBENT—In the last 10 years in Australia you have had both public and private restructure of the economy which allowed many people to come out on packages or with proposals to go into the franchising area. Concerning the phenomenal growth in franchising, has that had an effect on that? There will not be as many packages available over the next five years. Will that have an effect on the growth in franchises?

Mr Shedden—That is a difficult question. The current inquiry rate about franchising is down because of the economy, because of the statistics, because of the uncertainty, and because of the change of government, et cetera. The inquiry rate is down and many of the larger franchisors in this country are getting together to lift their marketing profile. To answer your question, I do not believe it will have a significant impact because the people who want to be in their own business and have that burning desire go that way anyway.

Mr JENKINS—Have you got data or have you got a feel for the performance of small business within a franchise environment as against small business outside of a franchise environment?

Mr Gardini—The council has not conducted that research, although there is some research available. Mr Beddall, that was put to your committee's inquiry.

Mr BEDDALL—From memory, franchising value adds about 10 per cent and small business is about 70. That is where somebody just goes out and decides to open a business with absolutely no experience. You would expect the failure rate to be—

CHAIR—We had better not get too far into that. If you have not done the research then it would be difficult for you to continue along those lines.

Mr Gardini—That is right.

CHAIR—We might draw this segment to a close and I will ask that the next stage of our hearing be held in camera.

Resolved (on motion by Mr Beddall):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Evidence was then taken in camera—

Committee adjourned at 5.33 p.m.