HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Reference: Fair trading

SYDNEY

Thursday, 5 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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Present

Mr Reid (Chair)

Mr Beddall	Ms Gambaro
Mr Broadbent	Mr Jenkins
Mr Richard Evans	

The committee met at 8.59 a.m.

Mr Reid took the chair.

LONIE, Mr Michael James, Manager—Tenancy, Australian Retailers Association, 20 York Street, Sydney, New South Wales 2000

SHETLIFFE, Mr David Reginald, Director, Tenancy and Retail Business, Australian Retailers Association, 20 York Street, Sydney, New South Wales 2000

CHAIR—Welcome. I declare open this committee meeting. The committee proceedings are recognised as proceedings of the parliament and warrant the same respect as the proceedings in the House of Representatives itself 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. Would you care to make an opening statement?

Mr Shetliffe—Thank you. I want to make a couple of quite short observations. With regard to this inquiry, we have taken, in one sense, a fairly narrow view of the terms of reference and we focused our attention very specifically on one of the issues nominated in the terms, namely, retail leasing. We have done that with the view that, from our perspective, the general provisions of the Trade Practices Act governing the regulation of trade between commercial enterprises are appropriate and satisfactory, and we are not asking for any particular changes, other than in the areas that relate specifically to the matters we have put in our submission. We have taken the view that this inquiry is about trading relations between two commercial parties and that it should not be confused with general issues of competition and competition policy.

We have, as an association, for a number of years been pursuing retail leasing legislation within various state jurisdictions, and a number of those jurisdictions have introduced leasing legislation in recent years. Our view is that they do prescribe the basis for good leasing practice and good shopping centre management practice and are not just about dealing with particular matters of fair trade or unconscionable conduct or things of that nature.

We do, however, as we have identified in our submission, have a view that there still remain problems, in virtually all of the state legislation, that appear to be very difficult to resolve. That really relates to the circumstances that exist at the expiration of an existing lease. Most of the provisions of the legislation deal with what has to happen at the start of a lease and what has to happen during the currency of the lease; but, at the expiration of a lease, there are difficulties that still emerge. They fundamentally relate to the proposition that a retail shop's location has a very specific relationship to the general asset, goodwill and prosperity of the business.

For the independent retail operator—that is, somebody who owns only one shop and operates out of that shop—the problems are twofold. One problem is that there is the capacity for the landlord to just fail to enter into any negotiations to renew the lease. That means, essentially, that that business and the built-up assets of that business are put significantly at risk. The opposite side of that argument is that neither we nor landowners want to get into a situation of perpetual leases. Nevertheless, there is a mechanism of fairness and equity that needs to be addressed in that issue.

The second thing that can happen is that a premium can be asked for and obtained from tenants. Whether they are individual tenants or chain store tenants, a premium on rents can be extracted on the basis that the costs to the business of relocating to another centre would be very substantial. Therefore, at the end of the day, there is a real opportunity for a landlord to extract a premium in rents on the basis that it is cheaper to pay a higher rent than it is, in fact, to close your shop and move somewhere else. We believe those issues are ones that are difficult to resolve. We believe that this inquiry should perhaps put its mind to a resolution of those things, along the lines that we have suggested in our submission.

I think we should bear in mind that, notwithstanding the concerns that people have about perpetual leases, there is no doubt that, in property valuations and the general aspect of being able to sell retail properties, there are assumptions made about the continuation of the lease revenue that is going to come through. There are some assumptions made by people, when they want to sell a shopping centre, that there is continuity of lease coming through. Yet, when it comes to the crunch, there is very much a change in the power relationships between the tenant and the landlord that does cause problems.

For some time, in regard to some of the proposals that have been canvassed, particularly in regard to section 51AA, we have had some real concerns about a general strengthening of those kinds of provisions. They will lead to business uncertainty in a whole range of general business and commercial transactions where there is much more freedom for parties to enter into commercial arrangements and adopt alternatives than there is in the very proscribed situation that I have been talking about.

It seems to us that the characteristic difference that exists between, say, the franchising area and the retail leasing area is that you have a situation where there is essentially a possibility, as a result of the structures of those particular types of arrangements rather than the choices of the individual enterprises, for there to be a monopoly of supply to a particular business or part of a business. If you are in a shopping centre there is only one person that is supplying you with space: that is, the owner of that particular shopping centre. If you are in a franchising arrangement for motor vehicles, petroleum products or anything like that, you are in a situation where there is, as a result of those arrangements, only one supplier of a significant part of your business input.

Therefore, we have put forward the proposition in our submission that it is in those circumstances where there is such a monopoly of supply of a significant business input that there may need to be some special consideration given within the Trade Practices Act to ensuring that, given the extra power that is granted to one of the parties as a consequence of withdrawing the supply of that significant business input, there is some mechanism that enables us to modify that and reduce that power, or a mechanism of appeal or some other way of ensuring that there is fair and reasonable practice.

I guess we are arguing that there is an onus upon businesses that are involved in that very special kind of arrangement to make special provisions. We are also arguing for there to be some protections put into legislation to protect the less powerful of those parties—which does not necessarily mean, I might say, a very small business. We find that many of our larger members suffer the same problem. It is not necessarily a big business versus small business debate. It is, in fact, a function of the structural arrangements that exist in the industry sector.

Therefore, we believe that whilst we would not be recommending any general changes to 51AA for normal commercial transactions, it may be appropriate, in those special circumstances we have outlined, for there to be some special consideration. We have also suggested in our submission that, in order to try to remove business uncertainty about what some of that means, provisions can be put into the legislation to provide that, if you are operating within an agreed code of practice which defines what is reasonable practice in terms of dealing with that power imbalance, that can be a defence against a charge of any harsh or unreasonable conduct. That may well force the parties to sit down and work out how they can deal with the difficulty but you then have the legislative underpinning for that. That is basically the view we have taken.

We think the Trade Practices Act should not become a basic extension of state based legislation in the retail leasing area. We believe that a strengthening in this area may well help underpin some of the state based legislation and help us in the continuing debates to try to resolve this particular focus of monopoly of supply of major business input. That completes my submission.

CHAIR—Thank you very much. It has opened a number of areas. I would like to come back to your comments about the leases. There are a number of examples of extreme hardship where small retailers have been particularly affected and experienced losses which, in some cases, have led to them losing all their worldly assets

I would like to pursue some of the factors involved. One of them would be the relationship of franchisees in large shopping centres vis-a-vis other retailers in strip shopping areas and whether there is a predominance of franchisees being placed under difficulty in large shopping centres. Is that your experience?

Mr Shetliffe—I think a bit of a double whammy can occur when you have franchisees—Mr Lonie may comment further. What tends to happen is that a franchisor, very often, is the head lessor of the particular space within the centre. Then there is a franchising agreement between the franchisor and the franchisee. Most interpretations of state legislation would indicate that that subtenant arrangement, if I can describe it as that, is covered and protected by the arrangements which exist in various state pieces of legislation.

Franchising within the retail sector is a growing form of doing business. It is a mechanism by which many smaller traders see their ability to compete with larger traders enhanced as a result of cooperative buying arrangements, marketing arrangements and things of that nature, with general support infrastructure and product support to the business. There is a growing trend there. I think there are double lots of complications that occur with franchisees in regard to the leasing situation because you tend to have the franchisor which basically agrees the rules under which the business will operate and the franchisee is often put in a position of take it or leave it. Mr Lonie may wish to add to my comments.

Mr Lonie—Yes. I think your comment, Mr Chairman, is valid. I will talk about retail franchising as opposed to other matters. I think many of the franchisors clearly see centres, and especially the larger regional centres, as being the area in which they would wish to locate their business as opposed to locating them within the strip shop area. Where the problem arises in the relationship between the franchisor and the franchisee is that in negotiating the rents, the franchisor normally negotiates a rent which would be the current market rent applicable to that shop, irrespective of whether it was operated by a franchisor or another

retailer. When you add the franchise fee, which can be between five and eight per cent, on top of the occupancy costs with no substantial increase in sales due to it being a franchise, that is where you start to get your problems and clearly it is a difficulty, yes.

CHAIR—So, under those circumstances, the franchisee—because of the location—is in a slightly vulnerable position in terms of relocating.

Mr Lonie—He virtually cannot relocate his business because the lease is held basically by the franchisor and it is locked into a particular centre and then within the franchise agreement, from my understanding, the obligation on the franchisee is to operate out of that particular store. He cannot pack up his bag and go, because there are some geographical aspects that do come into it.

CHAIR—With your association, do you receive complaints from your membership and are some of the franchisees members of your Retailers Association as well as other retailers?

Mr Shetliffe—In answer to the second question, the answer is yes. And, yes, we do get concerns expressed and we often find that we are asked to sit down and help individual franchisees in their negotiations with franchisors. One of the difficulties can be that very often a franchise agreement will specify that the rent to be paid for a particular site will be entirely determined by the franchisor.

With regard to when the business is in a bit of difficulty, I had a case just recently of a franchisee whose business was not trading as well as everybody would have liked and another retailer who was not caught up in the franchising agreement would have been able to sit down with the landlord and hopefully negotiate an outcome that enabled the business to continue and get a rental adjustment or something like that. What happened in the franchisor arrangement was that the franchisor basically had the power to do that and he could be determining, 'That's the best I can do for you and you are stuck by your franchising agreement and have to continue to pay that rent.' That leaves the franchisee in an exposed position, there is no question about that.

CHAIR—Within your association, do you have a mediation unit? Who does that part of it?

Mr Shetliffe—People like Michael Lonie and other people around our states would certainly provide advisory services and support to people to help them try to negotiate, and we very often find ourselves acting as mediators in trying to resolve a situation. We have substantial databases on what rents are being paid and what is fair and reasonable. We are increasingly starting to gather data on benchmarks for particular types of business that give us an opportunity to, if you like, equalise the balance between the knowledge base that the landlord often has and the lack of knowledge that the tenant often has as to what is a fair and reasonable thing in terms of other comparable circumstances around the country in similar centres. That kind of information that we can make available often is very helpful in being able to redress some of that power imbalance that can occur.

Mr Lonie—In those states and territories where we do have legislation or regulations, many of these matters are referred through to the mediation processes that exist within that legislation. I am only aware of a number that have ultimately gone through to the tribunal. Some of those matters clearly in a formal mediation

sense under those acts or regulations or codes do get resolved. In a number of instances, it is largely bringing obstinate parties together and basically giving them a process. The mediation aspect is clearly the critical one, but I would like to also say that in a number of cases of hardship both the franchisor and the franchisee are in agreement.

It is often the case of the landlord being intransigent in terms of having set rents that were way beyond levels in the initial feasibility study to enable them to generate the sales to afford that rent level. There are a number of centres throughout especially the east coast of Australia in recent times where clearly that is the case. It has taken a long while to bring the adjustments in. They were possibly built three or four years ahead of their time or, in some cases, the demographic studies that were done were clearly based on incorrect information.

Mr BEDDALL—Going back a bit in time, there was a movement to try and get all of the states to agree to uniform retail tenancy laws. The general view of the state ministers I dealt with was that every minister thought he had the perfect one and everyone should adopt that. How close are we now getting to all states having retail tenancy laws and how much uniformity is there amongst those laws?

Mr Shetliffe—In Queensland, New South Wales and South Australia within the last few years we have seen the introduction of what we would regard as improved retail leasing legislation. Within each of those pieces of legislation, there are significant common elements. It would also be true to say that significant parts of that legislation have been built around agreements as to good practice between tenants associations such as ours and landlord associations such as BOMA.

In Victoria there is some movement going on at the moment in terms of improved leasing legislation and there is a committee beavering away to try to work something up. Tasmania has just reactivated a process to get some regulations in place. There is an inquiry going on at the moment in the ACT. I understand that the Western Australian government is about to hand down some initial drafts of proposed legislation there. Our view is that we ought to have uniform legislation. I think the New South Wales, Queensland and South Australian legislation are not common in all areas, but there is a lot of commonality about them.

As an association, we have just undertaken an exercise to try and define, if you like, what we believe would be our view of what common legislation ought to be and what it ought to contain, and that is picking some of the best provisions out of each of the legislation. Landlord associations may well have a different view about what ought to be common and what level it is. Our view is that we ought to have common legislation but it ought to be based on good legislation rather than lowest common denominator legislation. So we are working hard to try and move toward common legislation. There are still a number of states that we need to see further action in.

Mr BEDDALL—It seems to me—and this is a follow-up question—that there is a tendency now, and you have identified the fact that franchising is a much faster growing business system, if you go to the big business centres, to try and have the popular franchises in those tenancies. The franchisor, of course, is national, and even the franchisee can be disadvantaged if there are not those uniform tenancies because the franchise dealing out of New South Wales, probably as a head franchisor, is aware of the laws here but not

aware of the laws elsewhere. Is that trend right—the fact that the major shopping centres are encouraging more and more the large franchising operations to move in when they construct or redevelop?

Mr Shetliffe—I think that large shopping centres have always tried to encourage the well-known, popular retail stores into their centres. When the national chains came into existence through the 1970s, for example, and started to become very prominent, they took their own decision that they wanted to be in just about every centre that was around the place, and the centre owners wanted them to be there.

My judgment is that some of those major chains are starting to rethink some of their policies at the moment. That is what is, in fact, going to cause some interesting redressing of some of the inequities that have existed in the system in recent times. The same thing applies with the major franchisors. If you are going to open a shopping centre, it seems sensible that you would want to put in there well-known brands and well-known store types. With the rapid growth of franchising, your observations are correct.

Mr Lonie—Franchising largely is a way of bringing on what I call the 'incubators': the new within the retail environment, who have started off somewhere with a successful model. Many of them, who are somewhat restricted in capital, clearly see franchising as being the way to go. They often are in a niche. Clearly, some of the landlords say, 'There is something that I don't have that is new to this,' and away they go. I think the point that Mr Shetliffe made, combined with the fact that there is a growing perception that many of the public are becoming bored with what I call the 'clones' or with the sameness of these particular centres, may—in the longer term, not the short to medium term—bring about some change in that respect.

CHAIR—I might just follow up that point. I think you touched on this. They are undercapitalised and perhaps do not have experience. Is that perhaps one of the major difficulties?

Mr Lonie—Yes, in respect of the franchisee. He may not be undercapitalised, because he may have taken a fairly significant redundancy package, but he is inexperienced in operating a business and inexperienced in even interpreting a business plan.

Ms GAMBARO—Mr Shetliffe, outgoings are an area of great concern in this particular retail tenancy area. I recently had someone visit me. This particular tenant had a shop in a shopping centre and a relative had a similar store in a comparable shopping centre. They each had the same number of stores and they were comparable in size. The outgoings from one centre were considerably more than the outgoings from the other centre. Could you explain to the committee how that can occur? How are outgoings calculated?

Mr Shetliffe—Most pieces of state legislation deal with the issue of outgoings. One of the things that we have insisted on in regard to outgoings, all the way through, is that they be based on gross lettable area—and only gross lettable area—so the outgoings that a particular store pays are in proportion to the area of the centre that it occupies, not in proportion to any other factor. That was an issue that, given some of our larger members, we had to do some selling of, to get that particular view adopted as a policy position. But that has been accepted across the industry as the basis on which they are allocated.

The challenge comes in determining what level the outgoings will be at. There are provisions in all of the state legislation that we have just been talking about for requiring estimates of outgoings to be given to

tenants at the start of the financial year and for a full audit of those outgoings to be made at the end of the financial year, so there is accountability on landlords regarding outgoings.

The challenge comes if a centre, for example, decides to clean the centre five times a day, as opposed to some other centre that may only do it two times a day. Then the cleaning costs at one centre would be higher than the cleaning costs at the other. The control of how often a centre is cleaned and, therefore, what the level of that outgoing, in dollar terms, will be, is really up to the centre manager to determine. That is where you can get those kinds of variations. It is often about different levels of service or different cost structures that exist within the centres. We have grave concerns about some of the high variations that do exist.

Ms GAMBARO—I could understand that in areas like cleaning, but what about fixed charges, such as electricity?

Mr Lonie—I would suggest, if I may, that the statutory charges normally are very much lineball and many of the fixed charges are very much lineball. But there is one charge and one fee where clearly there is an enormous variation across the industry, and that relates to management fees. We looked at five or six centres yesterday, basically in New South Wales, with one major landlord, where the outgoings had increased by $2.7 million, across those five or six, in management fees alone. When you looked at some of the increases, some of them were up to 100 per cent.

I did an analysis of what that was as a percentage of the outgoings. It was interesting, because it was came out at an average of 24 per cent or 25 per cent. When I looked at one of their major competitors, another landlord of similar size and scale of centres, they were also at 25 per cent. So, they had almost doubled their management fees, to bring them in line with the other major landlord. That is a significant variation, and that is one of the areas where you can get it.

I would suggest that—with the exception of Queensland, perhaps, where there has been the ability to buy bulk electricity and the landlord can charge it out—most of the other charges in terms of electricity are fairly standard. When you look at an across-the-board analysis of a range of centres, there is not a lot of variation in cleaning. You may get the odd one in security, which could be related to variations, but the others generally are within, I would suggest, plus or minus two or three per cent of each other, on a per square metre basis. We try and bring it back to a per square metre rate, to try and get some commonality.

This management fee, clearly, is an issue. The big difference, I would suggest, if you were to look at the management fees charged by a managing agent as opposed to someone who is associated with the property trust directly, would be that the fees charged by the managing agent could be half of those charged by someone who has a direct relationship with the property trust.

Mr RICHARD EVANS—I am interested in the smaller centres, really. It is always nice to think of the big centres, with four storeys full of retailers and a lot of people moving through; but, in the smaller centres, ultimately the shopping centre manager is the agent of the owner and therefore has a requirement under the owner's terms to maximise as much as possible the tenancy and the rent. Therefore, in some tenancies in some shopping centres, they in fact encourage tenants that may not be suitable for that particular

shopping centre. They may ring in professionals, for instance, and therefore decrease the flow of traffic into the shopping centre. There does not seem to be any requirement under retail leases to in fact cover this area of tenancy mix and downgrading of the shopping centre into a non-active centre. I wonder whether there is a need to cover that area within leases, to protect the smaller retailer who might have the local pet store but no-one comes to see him.

Mr Shetliffe—There are a number of issues that that raises. The flip-side of that particular concern is what we are seeing, for example, at the moment with a number of banks that are significantly closing branches around Australia. There is a lot of concern, with the number of banks moving out, from members of ours that are in those smaller neighbourhood centres that you describe, about losing one of their anchor tenants, to use the jargon of the industry, that are designed to bring traffic to a centre so that other retailers can benefit from them. So there are constant structural changes.

The question of what is an appropriate tenancy mix is a very vexed question, I guess. At the end of the day, if you are a property owner, why should you not be able to maximise the returns you are getting from your investment? That is one side of that argument. On the other side of the argument is that an integral part of what that centre is, is the relevant mix of tenants that are sitting there. How can we regulate to say that there must be a particular type of tenant mix within a centre? I understand the problem you are raising, but I really have difficulty in seeing how we can provide a mechanism that protects that.

There are disclosure statements normally given as part of the requirements under legislation that specify that owners must spell out what the rules are. There are permitted uses and contractual arrangements that often specify the type of store that can go there. The only possible mechanism is that if somebody goes into a centre and the tenant mix is given as part of the disclosure statement, and that is the basis on which you make your investment—that a bank is going to be there and that that is going to be the mix—then through the life of your lease, whether it is five years or whatever, that tenancy mix would be maintained, or the landlord at least has to disclose that he has no plans to change that tenancy mix. But, at the end of the day, if the bank suddenly decides that it wishes to close its branch, and that changes the structure of the centre, I am not sure that I can see a way that we can stop that happening. Michael may wish to comment.

Mr Lonie—I think the main problem is that normally, in going into a centre, you will base all of your feasibilities on what exists at that point in time, and you will take into account that particular mix. The problem stems from the time that mix changes. There is no adjustment to change the commercial relationship that you have with your landlord to reflect the change in the tenancy mix and the impact of that upon your business. It is clearly an issue that does need to be addressed because it can occur, not only within the smaller areas, but also within the major areas. You may go in expecting a dry goods supermarket to be there, if you are a fruit and vegetable operator, and then you turn around and you find that you have not only got a dry goods supermarket, but you have also got a brand new, fully-fledged supermarket with all the fresh produce. This has an absolutely devastating effect on your business. You could be there with three years to run and no mechanism either for compensation for what you have got in your investment, or even the ability to pack up and go.

Mr RICHARD EVANS—You would be looking to address this particular issue?

Mr Lonie—It is an issue that does need to be addressed.

Mr RICHARD EVANS—The last question I want to ask concerns goodwill. I guess goodwill relates to a lot of issues but, in particular, when an owner decides to redevelop his shopping centre—and he has got every right to do that—a tenant may have been there for 10 years, five plus five, coming up to the end of his 10-year term, and has got a lot of goodwill. The owner and, therefore, the managing agent, do not see that they want this tenancy in the new centre. Therefore, they say, 'Sorry. End of lease. Goodbye.' I have always thought that that is not really equitable. Perhaps, the landlord who is forcing a tenant out—one who is a successful tenant who has complied with the lease—should, in fact, be liable to pay some sort of goodwill measure. I am unaware that that is available to tenancies. Is it an area that your association would like to see addressed, as well?

Mr Shetliffe—That goes to the heart of what I raised in my opening remarks and in our submission which is the challenge that arises at the expiration of a lease. What you have highlighted is the classic problem that is created: somebody has built a business up, and is sitting there with all of his assets linked to that location. That is the important thing about retail leasing: there is not a free market that enables that business to move across the road.

Compare that, for example, with an office location. If I run the Australian Retailers Association in a particular office location, I come to the end of my lease and the landlord says, 'We really want to use this for something else now,' then we move across the road or there are other places we can go to that do very little damage to our business. We may incur a bit of cost in relocating, and so on, but the new landlord is probably going to help us with some of that. So we can move. There is a much, much freer market in terms of office location than there is in retail.

But if I have built the retail business up in that centre, my customers know where it is and my catchment area for that business is linked to that location. If I am stopped from being able to carry on my business because of some particular objective of the landlord which may be a perfectly legitimate commercial one to do something else with his property, then as the tenant I am in a very vulnerable position. It really does run the risk of undermining the whole principle of why people invest in small retail businesses—which is to build up some goodwill and be able to sell on a good business. That is the driver behind people investing in small businesses.

The counter argument that always comes up is: 'This is a commercial arrangement. You knew you had a five-by-five lease and, at the end of that, there was no obligation on us. You knew that right up front and you therefore have to make sure that you have amortised all your costs, your capital investment of the business.' That is the argument that is put against what you are putting. We tend to take the view that a mechanism has to be found that at least makes sure that the tenant who has done all the right things has some access to some compensation or something.

Mr Lonie—In our submission to the ACT working party, which is currently reviewing its code of practice, we have suggested the English model which basically does compensate for fixtures, fittings, and so forth, and also gives some additional cash compensation usually related to about 12 months rent, and that is paid upon termination under those circumstances.

Mr RICHARD EVANS—By the landlord?

Mr Lonie—Yes.

Mr RICHARD EVANS—Is that subsidised through the rental over 10 years?

Mr Lonie—No, it is not—not that I am aware of—in the English model.

Mr Shetliffe—Certainly when we raise that issue with our friends at BOMA, for example, they would argue that, yes, it is; that the consequence of that kind of mechanism is that rents do go up to ensure that the total cake is sufficient to provide for that compensation in the commercial development services.

Mr RICHARD EVANS—Would you see it going into variable outgoings? I would not imagine, say, Coles New World in a small centre wanting their rental subsidising some small retailer. So would you see some sort of subsidy being worked into the variable outgoings?

Mr Lonie—I cannot see where it could be worked into it. I think you have to look at it in a global sense. Whether it is rent outgoings or whether it is just an occupancy cost, it would largely be into the rent component.

Mr BEDDALL—Can I go back to the differential between the centre owned by the property trust and the centre owned and operated by the owner. It seemed to me some years ago there was a great rush of buying and selling of large centres. Every time there was a buying and selling of a large centre from one trust to another—which was very good for the property trust in terms of saying how well it had done in investments—there was a commensurate rise in the rents charged to the tenants. We have got a lower inflationary environment. Has that had any impact on the turnover of centres or is that still happening on a fairly regular basis?

Mr Lonie—There has been little turnover in the better centres, although there may have been some moving of the deck chairs as to the structure within the property trust. The rents have continued to climb, even though sales have been static. That has largely been due to the fact that there is the ratchet clause, or the automatic increase of X per cent or dollars over the term. Clearly, in what I would call the secondary and tertiary market, the market has softened significantly in the last six to nine months.

Many of those who bought properties two or three years ago are now looking at a significant downgrading in their valuations. For example, the State Superannuation Board of South Australia bought the Imperial Centre in Gosford for $80 million from Stocklands about 18 months ago and it is now being valued at about $40 million. It has between 14 and 18 vacancies. The occupancy costs are high and the sales are low. Within those areas, the impact is starting to come and it is slowing down. There is likely to be some realignment of the rents because clearly they are just not getting the sales to support the tenancies and the tenants are moving out. Of course, when you have a vacancy, they sort of grow. In that secondary market, they are selling them or offering them for sale. There was an auction here the other day with Knight Frank, nationally, of seven properties. Two out of the seven sold and, with the others, one did not even get a bid and I suggest that the others were well and truly under what the reserve was.

Mr BEDDALL—A lot of these are now five and 10-year leases so that people in their seventh or eighth year would have signed lease agreements that had an inflation or up to 10 per cent ratchet clause. How much of a problem is that becoming now? A lot of people out there are paying two and up to three times the inflation rate in rent rises.

Mr Lonie—It is still a significant problem. Let us look at some of the occupancy costs of 20, 25 and 30 per cent in these instances. These people are operating on a gross profit of 38 per cent. When you put wages and that together they are out of business. That is the biggest problem. Many of the landlords have bought them—especially in the secondary and tertiary areas—on a funding package. They have put perhaps 30 per cent equity in and they have been totally dependent upon that income stream coming in. They are point-blank refusing to adjust the rents back to a level to enable the tenant to survive.

Mr Shetliffe—Having said that, I think it would also be true to say that in other centres there is a recognition of some of those problems and there are some signs of a winding down of rents and a preparedness by some landlords to make the sorts of adjustments that you have been referring to. I agree with Michael that there are others where it is very difficult for them to do it and they are not.

Mr Lonie—Those adjustments are usually made on a lease renewal and not during the term of the lease.

CHAIR—You mentioned the English model. Do you have any particular information that you could provide to the committee in writing so that we can have a look at that?

Mr Lonie—Yes, I will get something to you.

Mr RICHARD EVANS—If you are a commercial owner of property, I guess one way to maximise your potential borrowings is to maximise the property you have so you have to increase the rents. Therefore, you are able to borrow against that paper asset and not bother collecting the rents. If people cannot pay the rent, they give them a rent-free period for 12 months or whatever it might be but they are getting their access to cash elsewhere. It is overvaluing the property and therefore a lot of these rents are exorbitant.

Mr Lonie—Are false, in a market value.

Mr RICHARD EVANS—Yes, that is right. I am not aware—you might be able to help me out here—of any control over maximising property like that.

Mr Lonie—It is a difficulty that we are having with the valuation profession and with the disclosures from the landlords to valuers, either valuing leases for current market rents or even in terms of truly valuing what the actual property is worth in the disclosure of those particular arrangements. Many of them have got confidentiality clauses, even though I think the courts have ruled some of those to be illegal. But, if it is not declared, it is often extremely difficult for the valuer to pick up. It is a concern from our side of the industry. Let us say you give 12 months rent-free. If you look at what the real rent is over the term of the lease, you will see that it is significantly lower, especially when you are ratcheting in the second and third year. That five, eight or 10 per cent increase that you are talking about is on a false base.

Mr RICHARD EVANS—And the property down the road compares their rent with the property up the road, so it is giving an inflationary rental increase.

Mr Lonie—Yes, right across the board.

Mr RICHARD EVANS—Are you suggesting that there should be some look at that particular issue?

Mr Lonie—Yes, I think there clearly should be. What the forum is, I am not sure.

CHAIR—Thank you very much for your evidence this morning and for appearing before the committee. Thank you for your offer to provide additional information.

Mr Lonie—I will endeavour to get that to you next week.

Mr Shetliffe—If there is any other information, following considerations of the committee, that you wish to get from us, we would always be happy to respond.

CHAIR—Thank you very much for that offer.

[9.47 a.m.]

KEVIN, Mr Mark, National Retail Manager, Australian Petroleum Pty Ltd, GPO Box 3916, Sydney, New South Wales 2001

TOPHAM, Mr Frank, Government Affairs Manager, Ampol, GPO Box 3916, Sydney, New South Wales 2001

CHAIR—Good morning. Committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself 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. I now invite you to make an opening statement.

Mr Kevin—I would like to make a few opening remarks and briefly summarise our submission. Before I do that, I would like to talk specifically about the oil industry and to paint the picture for our industry. We operate in a mature industry, which means very little growth. Growth for us for petrol sales is about one per cent nationally. In some states it is less than that and in some states it is a little higher.

We also operate in an industry which is basically overcapitalised. There is general agreement within the industry from service station associations, MTAAs and so on, that there are about 30 per cent too many service stations in the industry. In a mature industry you usually end up having a lot of emphasis on price competition, and that is what we have on petrol. That drives low profitability and therefore pretty poor returns on everyone's investment, whether it be the oil company or the franchisees. We also have a market that keeps changing. Recently, you would have seen Woolworths announcing their move into retailing petrol at their supermarket outlets. I am not painting a very healthy picture of the industry but we need to be aware of what sort of industry we work in.

As a result of that, over the last 10 years we have had nine oil companies reduced down to four. Australian Petroleum is the result of the merger of Caltex and Ampol, which is a further sign that things are not all that profitable and to get economies we actually have to get a little bigger and get the synergies of working together.

If I could talk specifically about Ampol, we have over 2,000 branded outlets, so that is 2,000 sites with either an Ampol or Caltex badge. Of those, we have about 1,000 which are franchised where we own the property and we have a franchise with an operator in there operating his own business. We understand the overcapitalisation and as a result since the merger in May 1995 we have been in the process of closing sites. We have closed about 150 sites in the last 18 months. The majority of those have gone out of the industry.

With this climate of low margins and pretty tight profitability, there is obviously pressure on everyone involved, including franchisees. With sites closing, new entrants coming in and pressure on margins, there is

obviously going to be quite a number of complaints that come out of the industry. Some people are obviously upset with this change. For some people that change means being pushed out of business by these market pressures. I suppose it is very easy for those claims to be caught under the harsh and oppressive conduct umbrella. We argue very strongly that these cases are not a result of that; there are other factors in the industry. We ask the committee to take each claim on its merits and not put everything into 'the harsh and oppressive conduct by oil company' basket.

We also believe very strongly that deregulation, not further regulation, is one of the answers for this industry. That is very much the thrust of the recent ACCC report into the industry. We in the oil industry have industry specific legislation. For example, the franchise act was brought in in about 1980 to cover the tenancy arrangements between the oil companies and the franchisees. Whilst it might have been necessary in 1980, we certainly believe it is not necessary now. We believe it is actually impeding the economic efficiency in this industry by, for example, inhibiting the ability of the landlord—us—to divest sites. Therefore this never-ending circle of overcapitalisation and low margins is being continued and perpetuated in a way by the franchise act.

The oil industry itself has set up a self-regulatory body—I think we would call it—known as Oilcode. It is a process whereby disputes that may occur between franchisees and the oil companies can go through a process of conciliation involving an independent conciliator. That came into being in 1989. Since then we have had 20 cases that have reached the conciliation stage and all of them have been settled with no further legal action or whatever. Whilst we have 20 cases that have reached the conciliation stage, there is a whole other bunch of cases that never got there because they were resolved before reaching that end point of the conciliation.

We believe very strongly that this sort of mechanism which was developed by all parties in the industry, the service station associations and the oil companies, is really the model that should operate in our industry in particular. We believe that those sorts of mechanisms, with the Trade Practices Act, are really sufficient to stop any behaviour that might not be appropriate.

We could probably go a bit further if we talk specifically about Ampol. We believe strongly in consulting with our franchisees. Recently we have been negotiating about a new franchise that will cover the majority of our franchisees. We have gone through a process of negotiating with a representative body of franchisees and negotiated each and every clause of the new franchise agreement. It got to the point where that body which is representing the franchisees is actually endorsing the new franchise. We use that as an example of the way that we are trying to conduct our business with our franchisees.

In summary, Mr Chairman, I would just like to reiterate that we believe that further deregulation of some of the industry specific legislation is the way to go, not any further regulation. We believe that we have got mechanisms in place and we believe that they are appropriate for our industry.

CHAIR—Thank you very much. Would Mr Topham like to make any comment at this stage?

Mr Topham—No.

CHAIR—You mentioned the Oilcode; can you tell us who the representatives are on that conciliation body? You claim that it has been successful but you say there were a whole bunch of cases—and I am not sure how many a bunch is—but perhaps you could tell us a bit more about the number of cases that did not get to conciliation. But firstly, who are the people represented on that Oilcode conciliation process?

Mr Kevin—Oilcode was put together by, obviously, the oil companies, under the auspices of the AIP, the Australian Institute of Petroleum, in association with APADA which is the Australian Petroleum Agents and Distributors Association which represents obviously the distributors, and also the MTAA which represents all the service station bodies in the various states.

Those parties agreed to set up the Oilcode mechanism and, as such, it has a constitution, I think we call it, and rules for operating and so on. Those parties that I mentioned meet on a committee to oversee the operation of Oilcode.

CHAIR—In that process, who do you see as being the representative of the franchisees?

Mr Kevin—The service station associations.

CHAIR—Are all of your franchisees members of those associations?

Mr Kevin—A vast majority. Something like 90 per cent are members of the relevant state body. The Oilcode body that is represented by all those people appointed a conciliator, who does all of the cases that come up to Oilcode.

CHAIR—How many is a bunch?

Mr Kevin—I said a bunch, and it is a lot. The process of Oilcode is that, if there is a dispute between the local manager and the franchisee, the Oilcode process says that has to go to the next level, which may well be me as the national manager. So there is an overseeing of the case before it would go to the next step, which is a meeting of the relevant service station association and myself as representing the company. If we cannot solve it there, then you go into the Oilcode process where you bring the conciliator in. So that process which is in place has led to a lot of these cases never getting past step 1 or step 2. That is why I say that it is pretty hard to put a number on that.

CHAIR—Would you have any information about the basis of those disputes—what the content of them was? Do they relate to rentals? Do they relate to restrictions on what they might sell out of a service station? Or what are they?

Mr Kevin—It will relate to anything that has to do with the agreement that we would have with the franchisee. So there might be a dispute about rentals; there might be a dispute about the level of profitability. Any issue like that will—

CHAIR—Do you have a breakdown of those figures at all?

Mr Kevin—We could certainly do that—of the 20 cases, what areas they were involved with.

CHAIR—I am not seeking names or anything, I just wanted an idea of a cross-section of what those disputes were.

Mr Kevin—The nature of the cases.

Mr BROADBENT—Mr Kevin, rather than talking about disputes that you have been through, the new entity of your merged companies would have put together a future program for where you are headed by the year 2000 and then on to the year 2010. In that process you would have also worked out just how many outlets you will need to have by the year 2000. What have you put in place for your current franchisees to let them know where your company is headed, what their role is in the plans for the company, and how they will be affected by the year 2000 if they happen to be on a site that your company is not interested in? Secondly, have you put any incentives in place for those people to encourage them out of the industry?

Mr Kevin—The answer to just about all those questions is yes. Since the merger, we have had a look at every one of the service stations that we own or lease. We have identified the ones which are not going to be with us at whatever time frame it is—the year 2000 or beyond.

As soon as we made that decision we spoke to the franchisee concerned so that he does not get any surprises. Even if they have got four or five years left of their franchise, we are getting to them and saying, 'Your site won't be part of our future plans.' We do have a package that helps the franchisee exit the site. That involves counselling the franchisee—sort of an out-placement service that will help him direct his energies into future roles.

It also has a financial side to it, in that we are helping the chap get out of the site and start up somewhere else. We are trying to do that in an honest and open way, rather than coming along one month before his franchise is up and telling him we are not going to renew. That has led to quite a bit of heartache because, whilst we are taking that open and honest approach, not everyone likes it. We have taken that approach to get to the franchisees and to give them as much warning as we can as to what their futures and the futures of their sites will be.

Mr BROADBENT—What about the changes that have come about since the process began, in regard to the Woolworths company you mentioned wanting to sell fuel from the grocery store window? You will now have the smokes stand next to the petrol stand, I dare say, and that will have an impact on all those people you have discussed. That is different from your first discussions with them, because in some areas your sites will be directly affected by Woolworths or any other company going into those things. Other sites very quickly will become unviable for you or unviable for Woolworths—I am not sure who is the best operator, you might like to tell me that. Further deregulation, as you mentioned, may impact on many families right across Australia with regard to their franchise positions. How do you intend to address that? Will it be in exactly the same manner as you have done? Will it have an impact?

Mr Kevin—We do not want to punch at shadows of what might or might not happen with Woolworths. But we do want to understand what the impact will be on ourselves and our franchisees. We are

in the process right now of trying to work out the worst possible and best possible scenarios and how they would affect our franchisees. When we have finished that, we will be making sure we do speak to the franchisees about what we think might happen.

Mr BROADBENT—Do you think there is any place for the federal government to be involved in the proper business dealings between two parties, especially when a franchisee has five years warning of what may be the appropriate outcome on their site?

Mr Kevin—Do we think there is a role for a third party in the relationship? No.

Mr BROADBENT—I will put it another way. Do you think the current common law we work under is adequate for the delivery of outcomes for both parties?

Mr Kevin—I certainly think the Trade Practices Act covers all the issues that need to be covered. Industry specific legislation, as I have said, may have been relevant 16 years ago; we do not believe it is relevant now. We evidence that by the fact that the Oilcode and so on, and a different attitude to our franchisees, are in place.

Mr BEDDALL—I might comment on that. This is the only part of the franchising industry that is legislated. Yet it tends to have more disputes than those which are not legislated. Perhaps there will be a lesson in that, down the track, as well. What is the Motor Traders Association's view? There were some discussions about the franchising code covering the oil industry overlaying the top of the legislation and then eventually moving out of the legislative role. Has that discussion taken place between the users and the industry itself?

Mr Kevin—Yes, that was in play late last year. All the bodies in the industry were trying to come up with a franchising code which would suit the legislation. We are trying to start that up again because, since the election, that has been put to one side.

Mr BEDDALL—The other point you made was that you had closed 150 service stations. How many have you opened in the same time? Having an electorate on the outer suburban fringe, I think I have, in one street, seen at least three of your outlets opened in the last five years. There seems to be a continual growth in outlets where the population moves and over-servicing by all the oil companies.

Mr Kevin—The 150 which we have taken out of the industry lines up with about three that we have put in. It is a constantly moving thing. If you looked at the 150 sites you would find they were in the inner metropolitan areas. With road changes and so on, the population does move out, so you need to be out there where it happens. We have taken that sort of number out with very few being put in.

Mr RICHARD EVANS—You mentioned the deregulation of the industry and said you were probably about 30 per cent overcapitalised at the moment. I think that you mentioned one per cent growth. You also mentioned that yours was a mature industry.

I guess being a 'mature industry' means that you are almost a public service: although yours is a

commercial operation you are providing a public service. I think the perception in the marketplace would be, 'That petrol station is not open anymore. Where the hell is it? Where do I have to go?' I just wonder what the quid pro quo would be if there were deregulation. Who would then, as Mr Beddall was asking, determine where the sites would be and whether they were, in fact, providing a public service by being placed in those particular locations?

I know that the mix between commerciality and public service is a fine one, and I know which side of the ledger you would probably fall under. But as a legislator and community service complaint receiver, speaking as an MP, I am concerned about the over-commercialisation of retail outlets that, in fact, provide public services. What I am asking is: should there be a partnership in determining where the best sites might be as you are moving out into the community, or should it be left solely with the industry?

Mr Kevin—I suppose that partnership does come into play with local planning regulations, in that they are determining what sort of usage may happen on what sort of land. I do not know whether you could call that a de facto partnership in determining where they go.

Mr Topham—I might add a comment there, to say that this industry is just retailing. We are selling petrol and a whole range of other goods. More and more, we are selling other goods rather than petrol. Now we are finding that traditional retailers of items such as those that Woolies sell are moving into petrol retailing. So, rather than looking at petrol as being some strange, isolated sector of the retail industry, it is really part of a continuum. Unless there is constant change and adaptation, we are going to find that it is not serving people's needs. Corner stores are disappearing and convenience stores are growing up. The big retailers are starting to put in petrol pumps. We need to maintain the flexibility to, in fact, make sure we are serving consumer demands. So I think the notion of any kind of explicit planning of that process is probably going to be inimical to actually providing consumers with what they want.

Mr RICHARD EVANS—Would that cover operating hours, as well?

Mr Topham—Absolutely. In various states we find there are restrictions put in place, ostensibly to provide protection to certain sectors—typically, the small business sector. But I think that is misplaced, because our franchisees are small business people and are obviously investing in the business to provide a service that they think is demanded. Otherwise, they are not going to make a go of it. So this notion of partnership, in any kind of directed planning sense, is probably the wrong route to take. It is a partnership in the sense of government providing the means for industry to be as flexible as possible in order to meet consumer needs.

Mr JENKINS—How do you protect your market share through the selection of sites? I take it that planning processes will dictate where the actual sites are. But at a time when you envisage that you are going to reduce the number of sites, in a competitive world, you will be trying to maximise the protection of your market share. How do you go about that at the same time as downsizing the number of sites?

Mr Kevin—There is certainly a balance required in trying to get out of the sites that are dying, take those funds and put them into areas that are growing. Something that we are constantly doing is trying to get that balance right. As a reflection on this overcapitalisation that we talk about, with 150 sites coming out of

our portfolio of sites the market share impact has been really minimal. That is a reflection of the fact that we do have enough other sites to service that sort of business.

Mr BEDDALL—By the nature of those sites, you have got long term franchisees. Do you make a conscious effort to try and ensure those franchisees have the opportunity to at least become involved in the new sites or other sites?

Mr Kevin—Yes; with better franchisees you encourage them, if they can financially, to have maybe one or more sites. We certainly are not moving to the extent that some of our competitors have where, with this master franchise notion, one chap may have 20 or 30 sites. That is not what we want to do. But if we do have good operators who have the management and financial ability to manage more than one site we try and encourage that.

Mr RICHARD EVANS—In relation to what Mr Broadbent was saying before about Woolworths trying to get into petrol, is it a natural extension that the petrol companies would like to develop their sites into greater retail outlets? I do not know if there is any regulation on petrol sites and whether there is a restriction on what can be sold on those sites. Would you like to see more of an opening up of the market on your particular sites?

Mr Kevin—We see ourselves as being in the retailing game. You may have noticed that service stations have gone from having a regulation two-bay workshop and a small shop to something that probably does not have a work bay but will have a larger shop where you can buy anything from pizzas and muffins to baked beans, chocolate and so on. Certainly we are going down that route to provide that service to the public, because they are demanding that sort of convenience retailing. As far as restrictions are concerned, there are some local restrictions around the place, but in most states they are not too onerous.

Mr BROADBENT—If I can just clarify the statement by Mr Richard Evans, I was not talking about Woolworths trying to get into the industry. Woolworths have announced that they will be investigating sites where they will be selling petroleum products from some sites where they currently have retail stores.

Mr BEDDALL—If I can follow that up with a question on retailing, you have a situation now where some of the major oil companies are going into what you could basically call multi-franchising—that is, running a fast food outlet such as a McDonald's, Burger King or Hungry Jack's that is attracting people to that site and, at the same time, they will buy their petrol. Are you looking at any of those strategic alliances yourselves?

Mr Kevin—Yes, that is definitely the trend, that you have some sort of branded fast food. That certainly is the experience in the USA. You trade off each other if you have both got strong brands, whether it be Ampol, Hungry Jack's or McDonald's, and that seems to bring a better outcome for both parties.

CHAIR—I want to go back a few steps and talk about your processes with your franchisees and what sort of program you have for advising the intending franchisees of what the terms and conditions of the agreement will be prior to signing it, and whether your company has a program of education that gets into that area before they get in as a franchisee.

Mr Kevin—We have a very extensive disclosure process which culminates in a disclosure document which sets out everything we know about the site. Obviously, the agreement that the chaps are going to enter into is attached to that. But it goes a bit broader and tries to give all our knowledge about what will happen to that site now and in the future. That covers things such as whether we have plans to develop another site up the road and whether we know of any other companies that have plans to develop sites. All that sort of information we do disclose to new incoming franchisees.

CHAIR—Based on hard facts or on projections of what might occur?

Mr Kevin—No, based on the facts as we know them—to the best of our knowledge at that time. We also disclose things such as termination of franchises—for example, how many we have terminated in the last 12 months, or whatever. We try to give the full picture to the franchisee. We also strongly encourage them to go and talk to other franchisees, in an informal sense, and find out what we are like as a company—

CHAIR—Within your operations?

Mr Kevin—Yes.

Mr BEDDALL—In terms of going to the franchisees: when you get to those multi-franchise sites, is it that the one franchisee owns the McDonald's and the Ampol service station, for example, or do you tend to have separate franchisees? Are you working in concert with the other franchisees, or do you find a common franchisee?

Mr Kevin—It varies. For example, if there is a Hungry Jack's on the site, then there may be one franchisee for the two franchises—be it Shell or Hungry Jack's, or whatever. On other sites, they will be quite separate; there will be two franchises on the one site. It is a bit of a mix and match. It also depends a lot on the criteria, say, of the Hungry Jack's or the McDonald's. They may not match up with what our criteria of a franchisee is.

Mr JENKINS—Your company is a wholesaler, as well. Do you sell to no-name brand service stations, as well?

Mr Kevin—Yes, we do. We sell to unbranded sites, as well.

Mr JENKINS—Have any of the complaints of your franchisees been in relation to the perception of deals that have been done on unbadged sites?

Mr Kevin—Yes. There have been quite a number of complaints about that. If we sell to a no-name outlet down the road and that person chooses to take no margin, or a very low margin, then the franchisees do get upset about that. We have got to be very clear that it is a different class of business. With a franchise site, we do have investment in there—anything from $800,000 to a couple of million dollars, whereas, if we are supplying a no-brand person, our involvement is purely the supply. There is no money invested in that. There are different categories of the trade throughout the industry.

Mr Topham—Part of the reason for sales to those other independent sites is, in fact, regulation. The regulation is the undertaking which the company gave to the ACCC on the merger between Caltex and Ampol last year which required the company to sell 50 sites over a period of two years to independent operators. I am making no comment whether that is a good deal or otherwise for us—I mean that is not pertinent to the point I am making. But certainly, regulation has come into the picture to force the sale of fuel to those independent operators. Whether we would make the sales on a commercial basis is another question. But certainly, it is another case of regulation actually distorting the marketplace.

Mr JENKINS—Yes. I suppose I am looking at the relationship between your wholesale arm and the retail arm in looking after the franchisees and how you endeavour to make sure that everything that is happening can satisfy the franchisees that it is fair and above board in the way that the wholesaling is going on.

Mr BEDDALL—And to follow that up: I am sure that your franchisees would actually say that you should recuperate your capital cost of building the franchise out of the franchise fee, rather than out of the sale of petrol. If you are selling fuel, then the infrastructure that you have built is being paid for by the service fees that are paid on the sale of petrol, not on the cost of production, I would have thought.

Mr Kevin—To build a site—as I say, a couple of million dollars—you actually do need to get a return on that.

Mr BEDDALL—Yes, but that should be coming from the retailing side, rather than from the wholesaling side.

Mr Kevin—We are not party to a retail margin with the franchisee. We actually wholesale to a franchisee and the retail margin that he makes on the fuel, or anything else, is his. We are restricted by legislation, again, to the number of sites that we can operate ourselves and participate in that retail margin. That is the sites act, another bit of legislation which is industry specific and which the ACCC recommends should go, as well.

Ms GAMBARO—You said you encourage the owners of petrol stations to take on other sites, but not to the extent of some large franchises that have master franchise arrangements. How many other sites would owners of petrol stations own, on average? Do you have figures on that?

Mr Kevin—The number of our franchisees having more than one site would be two or three per cent. It is very small.

Ms GAMBARO—Is it the high cost factor in the industry of purchasing another site? What are the factors that keep that at such a low rate?

Mr Kevin—There are a lot of factors. There is certainly the financial one: to finance yourself into another franchise is expensive, and a lot of people do not have access to those funds. The big one is the management ability of the franchisee. Running a 24-hour service station is a very difficult thing; and to run two or three of those is obviously more difficult. That is a big factor, as well.

CHAIR—As there are no further questions, I thank you for appearing before the committee this morning and answering our questions. We look forward to receiving additional information from you. Thank you very much.

Short adjournment

[10.30 a.m.]

TERRY, Associate Professor Andrew Llewellyn, Director, Centre for Franchise Studies, and Head, School of Business Law and Taxation, University of New South Wales, Kensington, New South Wales

CHAIR—Welcome. Committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself 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. Would you like to make an opening statement before we commence any questions?

Prof. Terry—I do not think so.

CHAIR—In spite of a number of problems which have arisen from disclosure in relationship issues, franchising, as you know, is clearly gaining popularity as a way of doing business and has grown to a major extent. To what extent do you see the problem associated with disclosure and relationships between franchisors and franchisees impeding the further development of this style of trading? You might commence by responding to that.

Prof. Terry—I think there is a very real danger that the benefits that franchising can offer to the small business community and to the community generally have a potential to be impeded by the activities of a minority of franchisors who probably do not have as much awareness of their responsibilities as reputable franchisors do.

CHAIR—In terms of educating the likely franchisees or in relation to disclosure?

Prof. Terry—The two general issues in franchising obviously relate to the prior disclosure issues but also to the relationship issues. I think that the prior disclosure issues are relatively uncontroversial and I would not have thought there is much argument with the proposition that prospective franchisees are entitled to full prior disclosure, possibly even to a greater level than is available to them at the moment under the code. While the prior disclosure issues obviously have a very significant role in trying to prevent problems before they have arisen, there is also the need, I think, for the relationship issues, the issues relating to the substance of the relationship between the parties, to be somehow addressed. Both of those, I think, are important considerations.

CHAIR—You have indicated in your submission that the code of practice, in your view, is not sufficiently comprehensive. Where are the flaws and what would you propose to include in that code of practice?

Prof. Terry—I find it hard to divorce the issue of the regulation of the sector with the question of how that regulation should be imposed. I do not think it is too hard to identify what the issues are. It is

obviously much harder to determine whether those issues should be resolved through a code of practice which is made mandatory, or through a more general type of harsh or oppressive provision. In relation to the code of practice itself, the main problem is the coverage of it. In relation to the actual content of the code, the most glaring problem relates to the standards of conduct, which are there as advisory standards for franchisors and are beyond the scope of the very limited disciplinary powers of the Franchising Code Council.

CHAIR—Is it any different from any other normal commercial arrangement between somebody else in business and their suppliers?

Prof. Terry—Yes. I think there is a world of difference between a franchising relationship and an ordinary business relationship.

CHAIR—Could you tell us a bit more about that.

Prof. Terry—The differences can be identified at a number of stages. Let us start with the franchising contract. Most commercial contracts are virtually complete in themselves. Franchising relationships may have a term of up to 20 years, although a lesser period is probably more common. But obviously franchise agreements have to have built into them the adaptability and the flexibility so that the franchisor can respond to changed market situations. But what that means is you have a franchise agreement which is virtually, by definition, an incomplete agreement. So much of the dynamics and the mechanics and everything is off the contract. Even on that reason alone, I think franchising is very different from other relationships. In other relationships, an independent businessman will succeed or fail on his or her own efforts. At the end of the day, they have a business, the destiny of which they control. In franchising, ultimately, all the franchisee has acquired is a right to operate somebody else's business for a particular time.

CHAIR—Is a major factor in the relationship that the franchisor is the principal and only supplier to that franchisee? Is that the major impediment as you see it?

Prof. Terry—That is a difficult one to answer because in a lot of cases the franchisor is not the major supplier to the franchise system. Certainly, the franchisor provides the actual system and the trademarks on the intellectual property and all that sort of thing but the franchisor may or may not supply the products and other materials or goods required in the context of the agreement.

Mr JENKINS—There must be something more to the relationship than running somebody else's business. You would have another model where somebody would set up their business and then put in managers or something like that. It is a different relationship. The franchisees would see the franchise that they were in charge of as their small business. You said that the relationship was different because you have someone—I do not know whether I am paraphrasing your words wrongly—running somebody else's business?

Prof. Terry—But I think that, at the end of the day, is essentially what a franchise is: a franchisee has simply acquired the rights under contract to operate their own business, but under the intellectual property and the format of somebody else. What that means is that, when the agreement comes to an end, the

franchisee's right to use that intellectual property—probably in most cases the right to use that site, even the right to operate in that business, because of restraint of trade covenants and confidentiality covenants—may effectively mean that that person is disenfranchised in every meaning of the term.

Mr JENKINS—Mr Chairman, I just want to wind back a little bit and ask about the reason for setting up the Centre for Franchise Studies within the university.

Prof. Terry—The comment was made in the Franchising Task Force in 1991—which was very valid—that franchising is a form of business organisation which is just so important, so significant and which is increasing so much, it was remarkable that there was so little in the way of educational programs provided for it. That was a very valid criticism of the tertiary sector generally.

I think the main thing that drove the establishment of the Centre for Franchise Studies at the University of New South Wales was a recognition that franchising was a legitimate area of business; it was a legitimate area of research; it was an activity, the orderly and structured growth and development of which depended on education and training for the sector generally and also research to support the centre.

We have the situation that the ABS survey says there are 555 franchise systems. But some people would say there are 2,000 franchise systems. When the level of knowledge about franchising is such that we do not even know how many franchise systems there are, it is obviously very difficult for franchisors and for franchisees and for governments, difficult for everybody to make the right decisions. They were the considerations that drove it.

Mr JENKINS—How much of the centre's research and training is self-initiated and how much of it is initiated by others or on a contract basis by others?

Prof. Terry—Virtually all of it has come from the centre itself. We were set up with small seed funding from the Faculty of Commerce which sponsors us. But, unfortunately, it is the nature of franchising or the nature of people in the sector, I think, that we have not had a generous benefactor come from anywhere and endow us with the level of funding that we really need to fulfil a lot of our mission statements.

The centre has been very active in all sorts of ways—in submissions to this inquiry, into the Franchising Code Council inquiry, and to the ATO in respect of their goodwill submissions and things like that. Our main flagship at the moment is our certificate in franchise studies, which is the only course of its type where we have five subjects offered by distance education and a three-day residential at the end of it. At the moment that is our main form of funding.

CHAIR—Who goes to those courses? Who enrols for them? Is it open to franchisees as well as potential franchisors? What form do they take? Do you just have a seminar or do you have a weekend in? How does it operate?

Prof. Terry—Firstly, they are open to anybody who wants to come to them. From the start, we thought that our main constituency would be management within franchise systems, and I guess most of the people come are from that constituency. We do get prospective franchisors, and we get franchisees and

consultants. This year, we had 25 doing the course. We had someone from India, from New Zealand, from Malaysia, and from Indonesia. We have made a contribution in that way, too.

There are five subjects. The course is predicated on the basis that education in franchising requires a broad general education. Whether you are a franchise solicitor, a franchise consultant or a franchise adviser, franchising, more than any activity, is a multidisciplinary activity. Specialist skills, I am convinced, have to be built on the base of a broad general education. There are regulatory issue subjects, the commercial overview issues, and a subject on franchise system operation development and management. There is a course on financial accounting and one on management accounting. They are comprehensive courses with a couple of hundred pages of material that has been written, plus textbooks and exercises. It comes together with a three-day residential weekend where there are case studies, break-up groups, invited speakers and that sort of thing.

Mr RICHARD EVANS—I have two questions for you. The first one deals with some of the comments made by the Franchise Association yesterday when they were talking about the fine line between dealership and franchise and the confusion that may, in fact, be there between dealers and franchise holders. There is a different relationship, but there is some confusion in the marketplace as to what is a dealership and what is a franchise. Yesterday, one of the gentlemen commented that some crooks have actually got into the industry of franchising and they want to try to get rid of them. Do you have a view on this particular matter? Because of the rapid growth of franchising, the whole image is changing a bit, as well; but there were a number of unscrupulous people involved in it in the early days, back in the mid-1980s or thereabouts. Do you have a view on regulation or perhaps making sure the franchisors are not profit takers?

Prof. Terry—The theme of the state of the nation address I gave to the plenary session of the franchising conference that has just finished was to the effect that franchising has achieved much. Franchising has made a magnificent contribution to the Australian economy; it has empowered small business; it has given people the chance to benefit economically and socially from proprietorship; it has encouraged international expansion and created jobs: all the benefits you are all aware of. The theme I wanted to leave with the delegates to that conference was that, in my opinion, the wonderful achievements for the franchising sector have been diminished, or have the potential to be diminished, by the activities of fringe players and by inappropriate practices that are, unfortunately, not as uncommon as we would like to think they are.

The message I wanted to give those people is that, as a sector, they have to work hard to lift the reputation and profile of the sector so that their achievements are not diminished by those who do not make the same level of commitment to the code, to best practice and to all those sorts of things. I must admit that that was possibly a bit of a brave thing to say to a group of franchisors, because I think franchisors regard regulation as something which their sector can do without. I was trying to make the point that, if regulation gets rid of the bad players and lifts the profile of the good players, it is something that should be encouraged.

Mr RICHARD EVANS—Who should regulate it?

Prof. Terry—I think self-regulation in the present form just has not worked. The comments of Mr Gardini are unanswerable. Seventy per cent coverage of franchisors is a magnificent achievement. For a voluntary self-regulatory code where you put up your hand and say, 'I will pay the money. I will abide by

this code of practice,' that is a wonderful achievement. But even if it was 90 per cent coverage, at the end of the day you are still left with 10 per cent of the sector which is not prepared to assume the obligations of the code. Very clearly, the challenge for the inquiry is to make the practice of franchising fit the promise of franchising. And that really requires all people who want to trade off the name franchising, who want to participate in it, being subjected to the same standards.

Mr RICHARD EVANS—The last question I wanted to ask you was about these people who may come out with a massive cash payout from a company or a public service and who move into franchising with limited practical small business experience. I know from my own experience that there is difficulty in finding information. I do not know whether it has changed in the last few years. But what sort of education would you, as an educator, be recommending to people moving into a franchise? Where would they be sourcing information from and what should they be doing in a preliminary sense? We cannot go and say, 'If you want to move into a franchise, you have to do this first.' We have to have an open market, but surely there should be an education process where these people can go and get the knowledge.

Prof. Terry—If it was possible to say, 'You cannot go into franchising without doing an education program'—which it is not—I agree with you that that would be very helpful. Just to take that one step further, even though there is a need to educate franchisors and everybody in the sector, it is franchisees who most need that education. Because educated franchisees are more sophisticated and more knowledgeable and can differentiate between good and bad franchise systems, they are really going to drive good franchising because they are going to force franchisors to lift their game. Education empowers franchisees. You know that too, because you are asking me how we—

Mr RICHARD EVANS—Where is the source, though? Where should that be coming from? Should it be through a small business advisory board or a franchise advisory board or centre?

Prof. Terry—The centre is in the process of planning a course for franchisees. But franchisees are a very difficult constituency in appreciating that they need the help. The FAA's own brochure, the franchisee's guide, is an excellent publication that costs $10. Franchisees have to be given it as a requirement of the code, but it is something that any prospective franchisee should be reading, not at the stage of signing the contract but months and months before. The centre will be working very hard to made education available for franchisees. I think there could be an area where there is a need for some more structured framework to do it. If I had half a day with prospective franchisees, I am sure I could—

Mr RICHARD EVANS—Talk them out of going into it!

Prof. Terry—Or put them in a position where they can ask the right questions and find out the right answers. One of the realities of franchising, which I am sure you are aware of, is that franchisees fall in love with the concept. They talk about franchising as being the business world's closest relationship to a marriage and it is like that. I have friends of friends of friends of friends who come to see me to talk about the franchise they want to get into. All you have to do is ask a couple of hard questions and they never come and see you again. They never follow it up. What they want you to say is that it is fantastic. Educating franchisees is probably the greatest priority of all but it is also the most difficult challenge of all.

Mr BEDDALL—In reality, the only person who educates the franchisee is the franchisor. You have to deal with the dilemma we have in, say, retail tenancy where everyone is rushing to buy the last space in the new shopping centre, even though it is behind the car park, because somebody else will take it. With the demand for franchising that we have seen in recent times, the comment is always, 'If I do not sign now, I will miss out.' We had evidence yesterday from franchisors, which I think was fairly honest, that even they missed 10 per cent. Even if they get 90 per cent of it right, they are still square pegs in round holes. I think all of that must come back to the franchisors because they are the ones who can say, 'I will marry you, but not yet.'

Ms GAMBARO—I would like to echo something Professor Terry said about franchisees falling in love with the concept. I remember from my short time working in the industry that franchisees were very excited about going into a particular franchise. They were willing to spend $200,000 on a franchise but when I would say to them, 'There is a $10 booklet'—I think it is still around—'that goes into all the different steps you need to take', many of them were unwilling to purchase it. You are right in that we need to look at educating franchisees.

I was interested when the question was asked about franchising studies, and what you do with regard to education. Do you feel that there is a need for greater professionalism in the industry, as in other professional bodies, and perhaps some form of accreditation for franchisors to attend some sort of training, say, once a year? Is there scope for that? Given the emphasis on traineeship for young people and job opportunities, do you see an opening in the sector for some sort of a training facility within the franchising industry and some sort of an apprenticeship scheme that could work effectively?

Prof. Terry—In relation to the accreditation point, I think that is an issue that does have to be faced. I made the point in my submission to this inquiry about advisers. At the moment, you pay a not very great amount of money to the Franchising Code Council to get your registration number. It looks very impressive on the wall, nicely framed. There is not necessarily any education, any experience, any knowledge or any competence sitting behind it. For most areas in the sector, I think there is a need for that to be considered very carefully. It follows on from education. I know that some sectors are doing something about it.

I was on the parallel street last week spending a couple of hours with the small business section of the Law Society of New South Wales. As part of their small business professional stream, they have continuing education programs which include franchising. But I am not sure that advisers and brokers and other sections of the franchising community show that level of professionalism.

I posed this question at the last franchising residential. We were talking about these sorts of issues and everybody there—the majority were franchisors—agreed that if it were possible to erect some barrier to entry into the franchising sector, it would be a very good thing. Maybe the only advantage of the US system, which is this massive regulatory regime, is that it does provide an impediment to casual or to sort of franchising. Even to enter you have got to have a certain level of sophistication or skill or sufficient finances to get over that hurdle to get into it. Now I am not suggesting that we should erect—

Mr BEDDALL—People say that today McDonald's could not start in the United States.

Prof. Terry—I think people say that, but I have never really believed it. For all that regulatory morass—and I am not suggesting for a second that we want anything like that here—franchising is still much more successful in the US than it is here in terms of the percentage of GDP and the percentage of retail.

Mr BEDDALL—What about start-ups in recent years? Franchising in the United States has been established for a long period of time, particularly straight after the Second World War, but the regulations are getting stronger and stronger now. Is there any study about whether the number of start-ups in Australia is commensurate with the number of start-ups in the United States for new franchises?

Prof. Terry—I do not have those figures handy. In fact, that is one of these interesting lines of research. But what I do know is that we do in Australia have twice as many franchise systems per head of population as the US. There is obviously good in that and the good in that is that there are opportunities for diversity and opportunities for entrepreneurs and opportunities for people to readily enter the sector.

The downside of that is that some 65 per cent of franchise systems in Australia have fewer than 10 franchisees. I do not know what the threshold is, but obviously a system with fewer than 10 franchisees probably does not have the critical mass that it needs to deliver the benefits of joint marketing and assistance and development and all that sort of thing. Possibly, if there were some form of accreditation, that may achieve something, but in relation to the franchisors, that is obviously a debarring one.

Ms GAMBARO—Just going back to the second part of my question—we have sidetracked a little bit—this industry is highly sophisticated. It is not just a matter of being a great entrepreneur. With cash flow projections, preparing those operational manuals, all the disclosure documents, et cetera,—I understand you have outlined the US experience—do you think accreditation would be an impediment to the industry or do you feel that it would benefit the industry greatly?

Again, and I would see it quite often, people would ring me about some great scheme that they had and they wanted to go out and franchise it in a relatively short period of time before they had been properly established, and I would always caution them against that. So do you feel that that would improve the level of franchise or getting into the industry?

Going back to the second part, what about some sort of a training course where franchisors can send their employees off as trainees? I do not know what system we could work it under, whether a TAFE system or a university system, but they could do franchise studies and then work in the franchise industry.

Prof. Terry—One of the things that this sector would benefit from very much would be some sort of structured career path. I am working hard with the university to articulate the course that we have got, which is simply a certificate course, into the formal university graduate diploma or degree sort of program. But there is a need, as you say, way beyond that: not at the high management level but just at the hands-on level, for people to be able to study in this area. Things like that are happening. I am recording interviews with ABC Radio National on Monday as part of an Open Learning small business management program, of which franchising is one of the modules. That is a very small step, and it is not structured; but there is now a much greater awareness in education than there was before. But I did not answer your question, again.

Ms GAMBARO—You have answered that we could look at training young people, perhaps at a different level from a higher course. But accreditation and professionalism were really what I was asking you about. I have worked in the marketing area, and we introduced an accreditation system—and it is similar in accounting areas—where people have to go off work to participate in so much training per year. Franchisors may set up their systems and may be very good at what they are doing, but they need to be constantly updated to improve their skills, as well, so maybe some ongoing training is needed there. That is the sort of thing I was alluding to, basically.

Prof. Terry—I am sure that is right. A code of practice that governed every participant in the sector would effectively operate as an accreditation requirement. It would operate as a hurdle to casual, unconsidered or inappropriate franchising, possibly.

Ms GAMBARO—Do you feel that that code of practice is sufficient, and that no other accreditation should be looked at?

Prof. Terry—I can isolate the issues. I find that you people obviously have a very difficult job in trying to resolve those issues. Regulation, in whatever form, should cover everybody in the franchising sector. I do not think franchisors should have the choice of saying, 'I am going to comply with this' or 'I don't comply with this.' Not only do we require universal coverage, but the content of that regulation probably has to be a bit more sophisticated than it is in the code of practice. But, once you have got that, you are not far away: you can build accreditation into that a lot more easily.

Ms GAMBARO—Once you are at that first step?

Prof. Terry—Once you have got universal regulation. I do not think you can have accreditation with a scheme that governs 70 per cent of the sector and not the other 30 per cent. But, if you have got the regulatory base, you can build accreditation on it.

Mr BROADBENT—Professor Terry, when you described the relationship previously of franchisors with franchisees and the performance of the franchisees, were you not actually describing the broader Australian small business community as a whole, anyway? Was there not a parallel? I had a local dairy farmer come to me—I am a former draper—and suggest that he would like to go into the fashion industry or the clothing area, and I counselled him against that. He did not take my advice. He went into the industry and, over a seven-year period, trained himself, made $9 million and retired.

There is this whole process that I think Teresa was trying to get at of finding a way to educate the Australian small business community. In fact, a franchisee is less likely to fail than an ordinary small business person who takes small business on for the first time because built around the franchisee at the moment is a whole lot of experience and education owned by the franchisor. The current system under which we are working is flexible enough and deregulated enough to allow for opportunities for people, and common law is over the top of that as well.

Prof. Terry—You are describing there best practice in franchising. Certainly there is the franchise model of the small entrepreneur operating with someone's proven and established trademarks, systems,

methods, formula and training. When franchising conforms to the model then franchising is invariably a successful strategy.

McDonald's claims a 97 per cent success rate. So not even McDonald's makes the claim that there is a 100 per cent chance of success. This is where the biggest difficulty comes in. The franchise model you mentioned, operating under somebody else's system and trading off their success and everything else, works when the model is applied but the model is not always applied. With the smallest, the most inappropriate and unethical franchisor, what is their sales pitch to their franchisees? Their system bears no relationship at all to McDonald's. I think that is the challenge.

Good franchising is very good. It is undoubtedly the most efficient, effective distribution system ever invented. It is the greatest invention of Western capitalism since the invention of the corporation. Good franchising is so much better than independent small business operation and bad franchising is so much worse.

Mr BROADBENT—From your earlier comments, you believe that further regulation is appropriate. Do you think it is appropriate that the federal government should be heavily involved in the regulation of the industry or should it be involved in the education of people moving towards entering the industry?

Prof. Terry—I have a preliminary comment before I answer that. The franchise or lobby group has been very effective over the years in answering a possible perceived threat from legislation by saying, 'Look at what is happening in America. There are 51 jurisdictions and this mass of law.' Regulation in Australia would obviously be much more simple than that. There presumably would be federal legislation and we would have one set of franchising laws and not a diverse range.

Having said that, franchising can be regulated by the code of practice as it operates now. Because it does not have 100 per cent coverage, despite the best efforts of the FAA and the Franchising Code Council, it is my view that that is not acceptable. On the other extreme, you have dedicated franchising legislation. I think it is possibly from in between that the best solution is going to come. One would be a statutory formula to mandate compliance with the code of practice. I suppose the other option is the better business conduct proposal of the previous government of statutory underpinning to the code through harsh or oppressive provisions.

One of the difficulties of the 'harsh or oppressive' provision is that it may be an effective provision for curing problems in franchising but it is not a solution that provides a preventative mechanism. The preventative mechanism can only come through some sort of regulatory code, be it co-regulation or of a legislative kind. But you are right: that on its own is not sufficient. Education and continuing education in these things are obviously part of it, too.

Mr BROADBENT—One last question, Mr Chairman. If such legislation were put in place and mandatory proposals were put forward regarding the code, do you think we would still have 10 per cent of shonky operators as franchisors?

Prof. Terry—I do not think so. Obviously, shonky operators unfortunately are probably always going to be there. Possibly in franchising there are shonky operators but maybe the more dangerous category is not

the shonky ones so much as the inexperienced, incompetent ones with more hope than expectation. At the moment, any franchise consultant or solicitor can tell you that there are any number of phone calls saying, 'Look, I want a franchise agreement. I have got this idea and I need the agreement.' We really need to put an impediment in the way of that. People are not necessarily shonky, but they have more enthusiasm than anything else.

Mr BEDDALL—They are using franchise to raise capital, rather than having the capital to start the franchise.

Prof. Terry—Yes.

CHAIR—Regrettably, we will have to draw this segment to a close. I wonder if you might make some information regarding your course programs available to the committee, if you would not mind, so that we could consider that.

Prof. Terry—I would be very happy to do that.

CHAIR—Do you want to follow up on something?

Mr RICHARD EVANS—This will be quick and short. Do you see the growth of franchisee associations, where they have had their own code of practice and the associations are in fact competing with the franchisors association, as an evolutionary thing?

Prof. Terry—Yes; I do. One of the big trends in America at the moment is really a coalescing of the franchisee power base. The reality is in America, where systems of 5,000 or 6,000 are not uncommon, that the franchisee lobby is a massively powerful lobby. It will never be as powerful here, because we have got more systems, but they are smaller.

Mr RICHARD EVANS—Unless they went across businesses: the McDonald's Association combining with the Dog Washing Association!

Prof. Terry—But I am sure that franchisees are unable to coalesce into a very effective lobby. I remember that years ago, with the 1986-87 proposals to enact franchising legislation, under the Freedom of Information Act, I got a copy of all the submissions. Franchisees just did not have a chance, effectively. The franchisor submissions were drafted by the leading firms of solicitors and everything else, and the franchisees' ones were handwritten or typed. You could even see, in those days, the holes in the paper where the old typewriter had done the job. The franchise associations that you see growing are probably a bit of a problem, too, because they are very aggressively pushing franchisee rights when they might not be particularly helpful. I would like to see a very strong franchise lobby, which is not necessarily a franchisee or a franchisor one.

CHAIR—Thank you very much for your time this morning.

Mr BROADBENT—Before you close off, Mr Chairman, does Professor Terry have a model that he

believes would be appropriate for the Australian condition?

CHAIR—Perhaps, if you have, you might include that with my earlier request. Could you provide that to the committee in writing?

Prof. Terry—Yes.

CHAIR—It would be helpful if you could. Thank you very much. Thank you for your attendance this morning and for your participation in the question period.

Prof. Terry—Thank you for the opportunity.

[11.16 a.m.]

ZUMBO, Mr Frank, c/- School of Business Law and Taxation, University of New South Wales, Sydney, New South Wales 2052

CHAIR—Welcome. In what capacity are you appearing before the committee?

Mr Zumbo—As a private citizen.

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. 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. Would you like to make an opening statement, Mr Zumbo?

Mr Zumbo—Yes, I would.

CHAIR—Thank you.

Mr Zumbo—Thank you for the opportunity to appear before the committee. My submission is based on wide ranging research that I have undertaken over a number of years and through consulting work I have done in more recent years. I have some key points that I have prepared to coincide with my introductory remarks. The starting off proposition I would like to put to the committee is that I believe through the research and the consultancy that section 51AA, as it currently is enacted, is generally ineffective and potentially unconstitutional. The constitutional point was raised in the native title litigation before the High Court in recent times.

Given the concern that there is in relation to section 51AA, in terms of the effectiveness and a constitutional point, I would like to put to the committee that giving the ACCC more time to make section 51AA work does not address the constitutional point. That is a question mark hanging over 51AA. Furthermore, allowing the commission more time does not address the limitations that are part and parcel of the equitable doctrine of unconscionability.

At that point I have to pause very briefly to indicate that there is a difference between what is known as the equitable doctrine of unconscionability and what is known as the statutory doctrine of unconscionability. The equitable doctrine has been there for hundreds of years. The courts have always recognised that in limited circumstances they would grant relief.

The limited circumstances relate to the existence of a special disability: illiteracy, drunkenness, insanity or emotional dependence, as in a recent case. The statutory doctrine of unconscionability is a much broader doctrine, traditionally being limited to consumers, and is evidenced in the Contracts Review Act in

New South Wales and in the Trade Practices Act as 51AB. So the concerns with 51AA go beyond the constitutional dilemma; that is, the limitations of the equitable doctrine.

The submission I would like to put to the committee is that one general provision dealing with unconscionable, harsh or oppressive conduct in the Trade Practices Act is arguably the most effective way of dealing with it. You can have industry specific legislation but, unfortunately, that is limited to the industry and creates artificial distinctions in terms of defining the particular industry and what have you.

Having one provision that applies across the board means that there is a general norm of conduct—an ethical norm of conduct that is provided. I submit that with minor amendments 51AB could be made into a general provision. At the moment, 51AB is limited to consumers and applies a broad statutory concept to consumer transactions. With minor changes, and I have provided those changes—I have given you a copy on page 3 of this supplementary submission, which is also part of my main submission—I have given you an indication of how the general provision would be enacted.

There is concern that people may use a modified 51AB to go straight to court; that is, litigation as a first resort. I put to the committee that in New South Wales with the recent enactment of the Industrial Relations Act 1996, which has been enacted but is yet to be proclaimed, the New South Wales parliament has indicated that there should be recourse to conciliation.

You may recall that there has been a provision in the Industrial Relations Act in New South Wales which has covered franchise arrangements, even though it is in an industrial piece of legislation. That legislation was previously 88(f), then 275, and now is 106 of the Industrial Relations Act 1996. The major difference with the new provision is that there is a statutory requirement for the Industrial Commission in court session to refer the matter to conciliation before the commission actually hears the case in court session. So there is a statutory requirement for conciliation. That may provide a good compromise, an excellent compromise, between having litigation as a first resort and promoting alternative dispute resolution.

A modified 51AB could underpin self-regulatory codes; that is, if those codes were not adhered to, there would be recourse to the courts. The franchising code in terms of standards of conduct provides for no disciplinary action in relation to breaches of standards of conduct. So you cannot be deregistered. Having to modify 51AB means that there could be recourse to the courts and, in particular, recourse to conciliation.

Unconscionability is a versatile concept. What is unconscionable in one circumstance may not be unconscionable in another circumstance. It does depend on the facts and should be considered on a fact by fact basis. That provides flexibility that a number of the submissions have argued against. They suggest that harsh, oppressive or unconscionable conduct would be an inflexible concept that is really about big and small.

The point I would like to make emphatically is that unconscionability is not about big versus small business. It is concerned with providing a minimum standard of conduct; it is about providing an ethical norm of conduct. One general provision prohibiting unconscionable, harsh or oppressive conduct would provide that ethical norm of conduct. Where there is a prohibition against unconscionable, harsh or oppressive conduct, that would arguably lead to the raising of business standards and the opportunity for people to have access to the courts where those ethical standards are missing.

Unconscionability is not about ensuring equality of power. The bargaining process is unequal. There are winners and there are losers; there are big and there are small; there are stronger and there are weaker. Unconscionability is general provisions concerned about abuses of what are substantial and unjustifiable disproportionate contractual rights and obligations.

Where the transaction is so one-sided that because the person has been offered the transaction on a take it or leave it basis, with no choice in many cases to reject it because of substantial investment, the contract may be more one-sided. There seems to be a relationship between the level of concentration in an industry and the one-sided nature of contractual arrangements; that is, the more highly concentrated the industry, the more likely that the transactions are going to be excessively one-sided, and unjustifiably so.

It has been put to the committee that there is a small level of disputation in the franchising sector. The suggestion has been put that that small level of disputation suggests that everything is hunky-dory or going well. There is an alternative perspective that could be put on a small level of disputation, and that is the fact that there is an absence of a general prohibition against unconscionable, harsh or oppressive conduct. People are now being denied access to the courts. Because there is a denial of access to the courts in this area, there may be the suggestion that people just do not have the access to the courts. Given that they do not have the access to the courts, there is no opportunity to raise the issues within the court.

Finally, I would like to stress what a modified section 51AB would not do. It would not mean that commercial contracts would become uncertain. There are numerous precedents in New South Wales in the industrial court and in the United States that clearly evidence the fact that such a provision would not provide for uncertainty.

A general provision would not prohibit tough bargaining. The bargaining process is tough. As I said, there are winners and losers; however, that is premised on the fact that there is a genuine process of bargaining. In some instances there is not a genuine process of bargaining where contracts are offered on a take it or leave it basis.

A general provision would not create business uncertainty. Once again, I point to those precedents. More importantly, and obviously the key factor, a general provision would not provide a guarantee of business success. There are winners and losers and as a result the courts would not allow, given those precedents, for a general provision to become a guarantee of business success.

CHAIR—Thank you very much. Thank you for your attendance at the last two days of hearings and for your interest in this particular topic and this particular matter which we are coming to grips with as a committee. I think what you have presented to us is an interesting concept, as is the suggestion you are putting forward to modify the Trade Practices Act. I understand that you had earlier written some articles for some journals on the Trade Practices Amendment (Better Business Conduct) Bill and you had some reservations about that bill. Would you care to expand on that?

Mr Zumbo—As an introductory point, the better business conduct bill was a compromise in the sense that it was trying to balance the interests of what were perceived to be stronger parties and weaker parties. Given that scenario, the bill gave rise to a number of potential problems. Many of those problems relate to

definitional aspects.

There are other aspects that are also difficult to come to grips with in relation to the better business conduct bill. The fact that the starting date was a number of months later and the fact that contracts entered into before that starting date were excluded from the provisions of the legislation meant that there was a substantial loophole. Parties arguably had a great deal of time to enter into what may be regarded to be, or alleged to be, harsh or oppressive contracts. Once they were entered into before the commencement date, those agreements were in effect grandfathered. They were excluded from the ambit of the provision.

Getting into the actual provisions themselves, there were definitional aspects in terms of limiting freedom of action. What did that mean? There were further concerns in terms of what is meant by major business activities, commercial activities. One of my articles details the difficulties of a commercial relationship. Perhaps you could define a commercial relationship. That was not actually defined in the bill. In relation to the supply of goods and services, that would mean that, although most cases would be caught because there would be a supply of goods and services, there may be instances where there was not a supply of goods and services, which meant that the provisions would be excluded.

What was meant by major significance to commercial activities? Was that a relative term or was that an absolute term? If I was a business person with a number of interests but in relation to one activity I had difficulties with the other side, how would I prove commercial activities? The person's freedom of action was substantially reduced. How would you prove that?

Basically, what I was emphasising was that, in terms of the better business conduct bill, there would be enormous difficulties proving some of those aspects as required by the bill. Enormous expense would be taken to collect evidence and some evidence would be difficult to obtain in relation to some of those points.

The other difficulty was that there were a number of possibilities for an action to be knocked out on what would be described as a technical situation. A technical problem meant that an action would be knocked out. So you would end up going to court, you would have to go through these numerous hurdles and at any point you would be knocked out because you could not prove that your relationship was a substantial commercial relationship.

There were other criteria that were difficult; for instance, impact of the conduct on the other person. A lot of the provisions gave rise to definitional aspects, defining those provisions and collecting evidence in relation to those provisions.

CHAIR—Is it the wish of the committee that the document be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The document read as follows—

Mr Zumbo—One point of clarification is that the Industrial Relations Bill, as I said, is now an act that has not been proclaimed. The terms of the bill are the exact terms of what was finally enacted. So the documents say 'bill', even though it has been enacted. It just has not been proclaimed.

CHAIR—It has not been proclaimed but has been through the parliament.

Mr Zumbo—Yes, and received royal assent.

CHAIR—I ask in relation to section 51AB(2)(c) and the proposal that you put forward, whether the other person was able to understand any documents. Is there not some conflict there? Is it not covered by law, anyway, under the provisions of responsibility of the party when they enter into any normal business arrangement? How do you see that resting in terms of common law processes?

Mr Zumbo—There are a number of points. Firstly, (c) already exists in 51AB as it applies to consumers. So (c) has been included because 51AB would apply to all transactions, not simply commercial transactions and not simply consumer transactions. It would apply across the board. So (c) would probably be of greater importance in a consumer transaction.

In relation to subsection (2), these are simply factors that the court may have regard to. Some of those factors may be irrelevant and will be irrelevant. In terms of understanding documents, there is a possibility that in a commercial relationship there are bulky documents running into hundreds of pages in fine print and at that point that may be relevant. But as a general statement it would not be relevant. That point is already covered under the equitable doctrine of unconscionability.

The point that needs to be remembered is that 51AB would apply across the board. These factors are only guidelines to look at. They can look at other factors; they could ignore these factors. It is simply providing a checklist.

There are two ways in which a general provision could be enacted. One is simply to do what New South Wales has done and have a general prohibition on unfair contracts and that is it—simply leave it to the courts to decide what that means. The alternative is to provide a checklist; that is, factors. That has been done in the Contracts Review Act and in 51AB. These guidelines are simply guidelines which may or may not be relevant and that would be up to the court to decide.

Mr BROADBENT—Because you have been present at the hearings over the last two days, are there any matters that have been raised to the committee that you would like to comment on?

Mr Zumbo—In drafting these key points last night I took into account many of the points that were raised. There are always two sides to every story. In putting one side of the story, there is the concern for those parties who do not have time to put the submissions together and those parties who do not have time to deal with them. That then leaves the risk that the views put by some participants may suggest that there is no problem.

The overall perception I have been getting over the last two days is the suggestion that there is no problem, the suggestion that there is no need for government regulation. The difficulty that gives rise to is

that there are a number of diverse sectors that are being looked at. In relation to franchising, for example, there is a code there that is voluntary and it does need statutory underpinning. Do you enact that code or do you simply provide an ethical norm of conduct? Picking up on that point, the suggestion could be made that having a modified 51AB would underpin that code, provide a forum and some recourse to the courts, providing access.

There has been, I think, a process of denial in terms of there being disputes in various industries. I am sure, from my consulting and from my general experience, that there are disputes there now. Some of those disputes may be because a person feels that they deserve some sort of guarantee of business success. The point that needs to be made is that having a general provision will allow people to have access to the courts, so the courts could resolve those issues. At the moment it is simply a case that there is unconscionable conduct. That issue, I think, needs to get into the court. Through those cases, through the reliance on the American cases, through the reliance on the industrial commission cases in New South Wales, there would be those precedents available.

There seems to be the suggestion that uncertainty would be created, that it is an issue about big versus small. It is not. Unconscionability can be used by a large entity just as well as a small entity. What we are talking about is an ethical norm of conduct.

There was a point made in relation to the franchise association taking over carriage of the code. There are severe reservations with that suggestion because a self-regulatory code must be seen to be independent, so there needs to be an independent body. The difficulty in enacting the regulation is that if you start enacting specific regulations people are going to be over-regulated. That leads to compliance costs. It is important that the marketplace be left to operate with one major proviso; that is, there should be some minimum standards within that marketplace.

Courts have long given effect to contracts as vehicles for ordering people's affairs so people know where they stand. In doing that, the courts have given effect to those contracts. But that protection of contracts should not be used as a cloak for abusive behaviour. There is a distinction between abuses of economic power and abuses of contractual power—abuses of economic power tend to be dealt with under part 4 of the Trade Practices Act—but there is very little in terms of commercial transactions that deals with the abuses of contractual power.

Suggestions have been made that there are no disputes, that there are small level disputes, that there is no need for access to the courts and that alternative dispute resolution is the better mode of conduct. Alternative dispute resolution works to an extent. The difficulty with alternative dispute resolution is that if there is a pre-existing imbalance in the power relationship between people that will be translated into the alternative dispute resolution forum. If someone has greater access to resources and what have you, and has the benefit of legal resources and monetary resources, that power imbalance will be implemented into that alternative dispute resolution.

Mr BEDDALL—That power imbalance is also present if you go through the legal system. The power imbalance does not disappear because you go to a court.

Mr Zumbo—In the context of a court there are appeal mechanisms. There is the ability to rely on perhaps legal aid in remote circumstances. Industry associations may be able to assist in bringing in a case. The point that needs to be stressed is that simply having a general provision would not mean people would run off to court. The greatest benefit of having a general provision is the educative effect, the fact that there will be test cases. Whilst they are being undertaken there are precedents available in other jurisdictions. People will realise that if they abuse their contractual power there will be recourse to the courts. That will be a limiting factor on their behaviour to some degree.

The main benefit of a general provision would be the educative effect—rather than running off to court. The fact that there is little access to courts means that a person with a contractual arrangement which gives that person a lot of power would have very little incentive to come to some compromise. That lack of willingness to come to a compromise would also be reflected in alternative dispute resolution. They feel that if there is no recourse to the court they will just string out the behaviour.

Self-regulatory codes are to be encouraged, simply because they are flexible. They adapt to the particular relationships in the particular industry. The industry has responsibility. But there has to be some recourse to the courts to define some of the parameters of the commercial relationship. Having the general unconscionability provision with some court endorsed conciliation may be a balance between having specific legislation and simply having a self-regulatory code that does not have a hundred per cent coverage, that does not have disciplinary proceedings in relation to standards of conduct.

CHAIR—You would have heard Professor Terry's evidence to the committee. Would you be in agreement with the proposition he put forward on a mandatory self-regulation through the code underpinned by the legislation? Do you agree totally with that or do you have some doubts about it?

Mr Zumbo—A mandatory self-regulatory code would entail legislation that would generally suggest that this code is compulsory in this industry. You obviously still have a definitional problem about what is a franchise. Then you have to look at what mechanism you are putting into place. Are you simply using legislation as a vehicle to empower a code or does the code then come under the umbrella of some government organisation? Having legislation that gives it mandatory effect would presuppose that there is some government organisation that would pursue that. That is one alternative. The other alternative could be simply enacting a franchising code as legislation. In that way, the courts would be the arbitrators of that legislation as such.

There is a third alternative where you have a code that is run by the franchising code, for example, or some independent body, and have legislative requirements in terms of standards of conduct. It would have the court endorsed conciliation tacked on so that if those standards of conduct are not followed within the code someone has access to court as a fall-back position. So when you say 'mandatory', there are alternative views on mandatory. Does the government want to go to the extent of providing an infrastructure for that? Is it able to provide funding to the franchising code council and as such act as an administrative delegate of the minister in a sense as it does now through a corporate structure?

It is a difficult issue. I do believe that a starting point is to have those standards of conduct in legislation. I think the system of government we have dictates a rule of law, meaning access to the courts for

these allegations to be tested.

I will give you a copy of the industrial relations legislation. Section 109 is an interesting requirement. The commission must endeavour to settle the matter by conciliation. That is different from the previous legislation in New South Wales which puts on the commission a statutory requirement to have this matter dealt with by conciliation. That, I suppose, is premised on the view that it is important to maintain the continuity of a business relationship. Court action may tend to spoil that. Maybe there should be one last attempt at conciliation where there is a suggestion that if the parties are not willing to conciliate, if they stifle that conciliation process, there is an independent neutral judicial body there that will consider that situation.

There are a number of issues that have been raised over the last two days, some of which I have noted and others I have made notes on and will make a supplementary submission. The real danger is that only snippets of particular areas are revealed through submissions and perhaps the overall picture is not obtained. So what I have done through my research and through articles is try to give an overall perspective on this issue.

I have often said that there is really no middle ground. I walk into a class of students or group of professionals or members of a professional organisation I consult for and I say, 'Half of you will agree that there is a need for protection against unconscionable, harsh and oppressive conduct. The other half will say no, there isn't a need.' There is no middle ground in a sense. There are compromises, sure, but in terms of dealing with this issue once and for all—the suggestion is that if it is put into the court domain it is simply dealt with rather than going backwards and forwards.

In relation to section 51AA, the commission has brought proceedings in terms of getting undertakings. It has had a number of years. It has been there since 1992, so it has been there a long while. But, having regard to that, there is still the issue. I have no doubt that the government would support the constitutional argument. I give the opposite view, but the question mark still remains. So one day there may be a constitutional point raised that will have to be resolved. If section 51AA is to be maintained, then the constitutional dilemma has to be dealt with, which may be an intractable problem. There may need to be a re-enactment.

The other suggestion was the difficulty with better business conduct. The point I have put is that if that bill was enacted there would be three provisions dealing with unconscionable conduct. There would be section 51AA, there would be section 51AB and there would be section 51AC. It is a duplication. I have referred to it as legislative schizophrenia. You are not really knowing what you are doing. So you go for various alternatives when one simple provision would do.

Having dealt with this issue over a number of years, people say, 'Frank, it is too simple. You are telling us 51AB as you have drafted it is too simple. It cannot be that simple.' Quite simply, I say, 'With all due respect, yes, it can be that simple—having access to the courts.' There has been a provision in the United States for 50 years—the bashing of capitalism. It is interesting that through the research in the late 1940s when the provision was being enacted some commentators would say, 'This is the end of western civilisation. This provision would blow contracts out of the water. It would create uncertainty.'

But it is somewhat interesting that 10 years later the same commentators—after the provision has been enacted and accepted in all American jurisdictions—come back and say, 'It wasn't as bad as we thought. The courts have applied this wisely.' So the fear of the commentator is the fear that the courts will use this general feel-good power and use it willy-nilly. That is not the case. The courts are very careful. The common law tradition is to protect contracts, to give effect to contracts, but the courts will see where that power has been abused.

The other alternative suggestion being made is that the courts have always been willing to intervene in hard cases, in cases where there are substantial abuses of contractual power. The way they do that is by using some notion of mistake or duress or unconscionability. So they try to force this difficult, harsh and oppressive case into another category to justify their granting relief.

The commentators in America—and I have picked up on this point—have indicated that it is best to bring all those issues to the fore, have one provision where the courts are given specific power to deal with this rather than find some underhanded way of slipping it into some category. So it is simply one provision—the courts have an exclusive power. If they feel there is an abuse of contractual power, it is so one-sided and unjustifiably so that they can intervene and they will not feel compelled to fight it and slot it into some other category.

Mr BEDDALL—I accept that you have great faith in the court system. The problem we have, and we had evidence to this yesterday, is that to go to the Federal Court is now going to cost a minimum of $1,500. There is at least a 12-month delay and, whilst it may be in theory very good, in practice for small and medium sized players both the time delay and the cost factor exclude them from the process. That is why, as I put to the gentleman yesterday, perhaps what we need is a mandatory middle step before anything like that happens.

Mr Zumbo—And that mandatory middle step I would submit is the court endorsed conciliation. So whilst the court has a long waiting list, the court may in the meantime order the players to go off to conciliation. They are off to conciliation and they maybe resolved. That is fine. If it is happily resolved, it falls out of the court list. If it does not, then it is in a queue.

Secondly, the cost of the courts is also reflected in the cost of alternative dispute resolution. You have to pay for a mediator. You have to pay for the conciliator. You have to pay for hearing rooms. If you want transcription you have to pay for that. So the costs of the courts may also be reflected in alternative dispute resolution because people have to fund that—that has to be funded in some way. Suggesting that an alternative dispute resolution may be cheaper may not be borne out by the evidence in some cases.

Mr BEDDALL—You do not usually get a barrister though, do you?

Mr Zumbo—Maybe not in the hearing room but you may wish to get advice on a particular point. The concern is that some players may feel that these contracts have to be defended to the last because that is the way they perceive that they can extend their control. There are two ways of having control over a franchise system—or petroleum distributors in relation to the area I have been working with. You can own the physical assets, you can own the sites—in the petroleum industry you can own the depot. In franchising

you can own the lease and sublease of the franchisee, so you can have control through physical means. But the other way is through contractual means. Having tightly drawn contractual arrangements that simply are one-sided—take it or leave it—is another way of exerting that control.

The other problem that has arisen through the debate on this issue is the suggestion that people can walk away from a transaction. In some cases when they are coming up to the transaction and they have got no expenses they can walk away and they would be stupid not to. If they foolishly enter into a transaction, a modified provision would not help them. But if people are in a relationship—and this is where it is dangerous to generalise, as some of the submissions have done—in some industries, and the petroleum industry is an excellent example, where people may have a substantial investment in that business, to say no to an oil company because they do not like a particular contract means disaster. It means termination with 30-days notice.

That reminds me, I was particularly taken aback by the comments made by the Franchise Association where disputes are about the colour of the building—if it is blue, we want it to be pink. I think that is a dismissive approach to some of the key issues and disputes that arise. Termination periods are excessively short. Mr Evans raised in relation to retail tenancy that no goodwill is payable. So it is not simply about the colour of a building. That marginalises and trivialises the disputes. Sometimes it is a substantial investment that is at stake.

CHAIR—Thank you very much for your contribution. I think what you have added today has obviously been added to by your attendance at yesterday's hearings. I thank you for giving your up-to-date thoughts on the events of yesterday's and also today's hearings. I take the opportunity to thank the *Hansard* staff for their attention and cooperation, also the secretary to the committee, Gill Gould, and Frances for your help, and members of the committee for attending.

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.

Committee adjourned at 11.53 a.m.