

Chapter 8

Good faith in franchising

8.1 While the pre-contractual disclosure obligations of the Franchising Code of Conduct (the Code) have been, for the most part, adequately addressed by past inquiries, there remains concern at the continuing absence of an explicit overarching standard of conduct for parties entering a franchising agreement.¹

8.2 As described in Chapter 2, the interdependent nature of the franchise relationship leaves the parties to the agreement vulnerable to opportunistic conduct by either franchisors or franchisees. Franchisee opportunism may take the form of free riding, unauthorised use of franchisors' intellectual property rights, underperformance, or failure to accurately disclose income. However, the franchisor's control over the provisions in the contract enables franchisors to address opportunistic behaviour of this kind by enforcing the terms of the franchise agreement.²

8.3 Franchisor opportunism has been described as 'predatory conduct and strong arm tactics by franchisors' involving the exploitation of a pre-existing power relationship between the franchising parties, which makes the franchisee 'vulnerable or economically captive to the demands of the franchisor'.³ There is an inherent and necessary imbalance of power in franchise agreements in favour of the franchisor, but abuse of this power can lead to opportunistic practices including encroachment, kickbacks, churning⁴, non-renewal, transfer, termination at will, and unreasonable unilateral variations to the agreement.⁵

1 Competitive Foods Australia Pty Ltd (CFAL), *Submission 22*, p. 6. See also Mr Michael Delaney, Motor Trades Association of Australia (MTAA), *Proof Committee Hansard*, Canberra, 17 October 2008, p. 19

2 Dr Elizabeth Spencer, *Proof Committee Hansard*, Brisbane, 10 October 2008, p. 38 and *Submission 39*, p. 5

3 CFAL, *Submission 22*, p. 7

4 A number of submissions raised the issue of churning (see for example Mr Gavin Butler, *Submission 3*, Mr Michael Sheridan, *Submission 20*, Ms Deanne de Leeuw, *Submission 114*). Following the 2006 Matthews Review, a number of amendments were made to the disclosure provisions of the Code. The amendments were introduced in March this year and were, in part, aimed at reducing churning. See the government response to the Matthews Report, February 2007.

5 Dr Elizabeth Spencer, *Proof Committee Hansard*, Brisbane, 10 October 2008, p. 39 and *Submission 39*, pp. 4-5. See also for example CFAL, *Submission 22*, pp. 7-8. In response to the Matthews Report, the government agreed to address the issue of unilateral variation through reform of section 51AC of the Trade Practices Act where such clauses (either in relation to terms or termination of the agreement) would be a factor that may indicate that a corporation has engaged in unconscionable conduct.

8.4 Aside from the personal hardship that opportunistic conduct can cause, such behaviour may also have negative ramifications for individual franchise systems and the franchising sector as a whole. The imbalance of power in franchise agreements is not something that should be changed, but what does need to be checked is any abuse of this power.

8.5 The problem of opportunism in the franchising sector may be addressed through constraining the behaviour of franchisors, and empowering franchisees.⁶ The introduction of a statutory obligation of good faith within the Code has been suggested as one possible mechanism for regulating the conduct of franchising parties and, in particular, for preventing franchisor opportunism.⁷

8.6 The concept of good faith is not new and there is existing statutory precedent for recognising or imposing obligations of good faith, including in the 2006 Oil Code regulations, section 51AC of the *Trade Practices Act 1974* (TPA), the Victorian *Fair Trading Act 1999* and Native Title legislation.⁸

8.7 Although there is no clear definition of 'good faith', it would be generally understood to mean acting fairly, reasonably and honestly, encapsulating the concept of 'a fair go'.⁹ The South Australian Economic and Finance Committee concluded that '[w]hile an abstract formulation of a generalised concept of good faith may be indistinct, the courts have demonstrated that they are able to know it when they see it, or more properly, they know a breach of it when they see it.'¹⁰

8.8 However, the lack of a universally accepted specific definition of good faith has led to differing views on the implications of inserting an express good faith clause into the Code.

Implied or explicit good faith

8.9 Professor Andrew Terry argued that 'the experience at common law with the implication of a good faith covenant is far from certain' and cautioned against the inclusion of a good faith obligation in the Code as the 'holy grail of franchise

6 Dr Elizabeth Spencer, *Proof Committee Hansard*, Brisbane, 10 October 2008, p. 37

7 Dr Elizabeth Spencer, *Submission 39*, p. 29

8 Dr Elizabeth Spencer, *Submission 39*, p. 37. Dr Spencer's submission also outlines a range of overseas jurisdictions, both civil and common law, where good faith is incorporated, including the US Uniform Commercial Code, Restatement (Second) of Contracts, UNDRIT Principles of International Commercial Contracts, and the UN Convention on Contracts for the International Sale of Goods (CISG).

9 See for example, Mr Kim Rosenwald, *Submission 44*, p. 3, Mr Scott Cooper, *Submission 15*, p. 16, and Mr Howard Bellin, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 80.

10 SA Parliamentary Economic and Finance Committee, *Franchises*, May 2008 (SA Report), p. 55

relationship reform'.¹¹ He considered that a more appropriate response to specific and substantiated problems in the sector would be a targeted response.¹²

8.10 The Australian Competition & Consumer Commission (ACCC) noted that there was a 'degree of uncertainty' about a statutory obligation to act in good faith, and it would be difficult to independently define or reduce to a 'rigid rule':

... if an obligation to act in good faith were included in the code, the meaning of good faith would have to be considered separately in each case depending on its particular facts. This may introduce ambiguity and confusion about the rights and responsibilities of franchisors and franchisees, and potentially increase disputes and conflict among franchising participants.¹³

8.11 The National Retail Association (NRA) opposed the explicit inclusion of a good faith clause in the Code:

An implied duty of good faith may already exist in the common law and the concept continues to evolve as courts decide relevant matters. The Auto Masters case found, for example, that the precise nature of any good faith obligation depends on the circumstances of the case and the context of the contract as a whole. NRA doubts whether much benefit will accrue from the introduction of a statutory concept of "good faith" and suggests that the more sensible course would be to allow the current legal processes to continue to resolve argument around the concept.¹⁴

8.12 DLA Phillips Fox concurred:

...the current state of our common and statutory law provide adequate protection and any attempt to introduce an explicit good faith obligation into the Code may not only be unnecessary but an unfortunate legislative indication that 'good faith' has a different meaning as currently understood, applied and continually further developed by our Courts.¹⁵

8.13 In addition to potentially creating legal uncertainty, there were concerns that an explicit good faith clause in the Code may add to the expectation gap in franchise relationships:

I think it would significantly increase the expectation gap. I am not sure whether that is a wise thing to do. The expectation gap is significant at the moment....

...On top of the prescriptive requirements of the Franchising Code of Conduct and of the relatively low threshold of misleading and deceptive

11 Professor Andrew Terry, *Submission 91*, p. 4

12 Professor Andrew Terry, *Submission 91*, p. 5

13 ACCC, *Submission 60*, p. 19

14 NRA, *Submission 109*, p. 10

15 DLA Phillips Fox, *Submission 81*, p. 4

conduct, that is, have you been honest or have you been dishonest, layer on top of that this somewhat hazy, woolly concept of good faith, and all I can say to you is that we will end up having is an increased expectation gap where people will say, 'But I believe that the franchisor did not act in good faith, and the ACCC wouldn't deal with it.'¹⁶

8.14 The Law Society of Western Australia stated that, as a franchise agreement contains an implied duty of cooperation and good faith is generally implied in contract law, 'each party will normally be expected to act in good faith towards the other'.¹⁷

8.15 Ms Deanne de Leeuw, who detailed her experiences as a franchisee, argued that 'the lack of Good Faith and Goodwill provisions within the Code enable franchisors to act unethically, protected by the franchise contract'. She observed that many franchisees believe that franchisors will act in good faith towards them when they enter franchise agreements, but the 'implied' duty 'means little if a franchisor acts in an abusive or opportunistic manner towards them'.¹⁸

8.16 The Motor Trades Association of Australia (MTAA) expressed concern at the apparent ability of franchisors to effectively 'write out' an implied duty to act in good faith through an express clause in the contract. While it has been argued that franchisees do not have to sign up to an agreement containing such a clause,¹⁹ the MTAA submitted that 'due to the bargaining power imbalance, the franchisee, as the more vulnerable party to the agreement, will continue to voluntarily enter into agreements despite the existence of unfavourable terms and clauses.'²⁰ For this reason, the MTAA argued, 'legislation should intervene to set the minimum standard of conduct to protect the parties to the franchise agreement.'²¹

8.17 IndCorp Franchisees' Association of Australasia argued that currently, the concept of good faith is arbitrary and determined by whoever is in charge at the time:

The problem that I think we have with the good faith, especially with a company that is an American-based company, is that good faith is determined by whoever seems to be captaining the ship at the time...so good faith is determined at the time by whatever that person determines is good faith, not by any set guidelines as to what good faith should entail.²²

16 Mr Graeme Samuel, ACCC, *Proof Committee Hansard*, Melbourne, 5 November 2008, pp. 95-96.

17 Law Society of Western Australia, *Submission 58*, p. 2

18 Ms Deanne de Leeuw, *Submission 114*, p. 5

19 See for example ACCC, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 83

20 MTAA, *Submission 90*, p. 6

21 MTAA, *Submission 90*, p. 6

22 Mr Greg Fisher, IndCorp Franchisees Association of Australasia, *Proof Committee Hansard*, Brisbane, 10 October 2008, p. 85

8.18 This view was supported by Mr Tony Piccolo MP, Member of the South Australian Economics and Finance Committee:

The reason we say it should be 'explicit' is that it is implied in law already. Given that it is implied in law, the difference between it being an implied provision and an explicit provision is that an implied provision can actually be written out. It is still there but it has to be fought for in the courts. An explicit provision states up front the standard of behaviour we require.²³

8.19 In contrast, Professor Terry argued that an 'open-ended obligation of good faith' would invite disputation, as there is 'no scope for good faith in the face of express contractual provisions':

Good faith basically hangs off contractual provisions to make sure that those contractual powers are not exercised in a capricious manner. Good faith is not going to solve the problem.²⁴

8.20 The Shopping Centre Council of Australia (SCCA) concurred with Professor Terry's position, arguing that:

Good faith, as developed by the courts, needs to be understood in that context, because it is only limited, it is only case specific and it is only in that context and it is not contrary to the express words. You need a surrounding contract and you need a common purpose to in fact imply such a term.²⁵

8.21 In not objecting to an express provision of 'good faith' being included in the Franchising Code, without first seeing how it is defined and then implemented, Australia Post could not see how it would materially advance the interests of franchisees.²⁶ This position was supported by the Federal Chamber of Automotive Industries who argued that 'to introduce a statutory concept of "good faith and fair dealing" into the Code is unnecessary and would not add any certainty or clarity to the rights of franchisors or franchisees.'²⁷

8.22 The Law Council of Australia Trade Practices Committee, Business Law Section, drew upon the current case law to support their claim that:

23 Mr Tony Piccolo MP, Economic and Finance Committee, Parliament of South Australia, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 58

24 Professor Andrew Terry, *Proof Committee Hansard*, Sydney, 9 October 2008, p. 76

25 Mr Peter Speed, SCCA, *Proof Committee Hansard*, Sydney, 9 October 2008, p. 49

26 Mr Scott Staunton, Australia Post, *Proof Committee Hansard*, Canberra, 17 October 2008, p. 99

27 Federal Chamber of Automotive Industries, *Submission 155*, p. 12

Australian Courts have recognised that a franchise agreement includes an implied term requiring parties to act in good faith and reasonably, and not to act capriciously or for some extraneous purpose.²⁸

8.23 However, they also noted that the courts had made clear that the implied duty did not require franchising parties to act against their legitimate business interests consistent with the terms of the agreement, but were uncertain whether an express obligation to act in good faith would be interpreted in the same way.²⁹

8.24 The MTAA argued that the interdependent nature of the franchising relationship, in which the 'long-term success of one party is reliant on the cooperation and performance of the other', requires a 'greater degree of consideration with respect to the "good faith" in dealings between parties.'

...the usual commercial conduct of 'acting at arms length' and the 'pursuit of individual interests' can not be expected or tolerated by the parties to a franchise agreement. Rather, the franchise relationship should be co-operative, enduring and guided by the principle of good faith.³⁰

8.25 The Franchise Council of Australia (FCA) rejected the claim that an express clause would merely reflect the implied duty to act in good faith that currently exists:

There has been no rational argument advanced to justify the introduction of a new statutory obligation to act in good faith, and no effort made to define such a term. Rather the proposal has been misrepresented as a codification of the existing law, or a simple change that will have minimal effect. This is not the case.³¹

8.26 However, the FCA subsequently conceded:

... we are concerned that the definition is appropriate. If, for example, there were simply a reiteration of the current implied position so that it were said that in the conduct of the franchise relationship the parties will act in good faith, or something like that, then that is just a repeat of the current state of the law. If you are asking, 'Would the FCA object to repeating the current state of the law and the statutory framework?', I think the answer to that would be, no. Our concern is extending it.³²

8.27 According to Associate Professor Frank Zumbo, an explicit good faith provision would set the standard of conduct expected of franchising parties:

28 Law Council of Australia Trade Practices Committee, Business Law Section, *Submission 141*, p. 2

29 Law Council of Australia Trade Practices Committee, Business Law Section, *Submission 141*, p. 2

30 MTAA, *Submission 90*, p. 5

31 FCA, *Submission 103*, p. 17

32 Mr Stephen Giles, FCA, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 27

...the concept of good faith has not only received strong judicial support, but now has reached the point in Australia where its nature and scope is being defined with an increasing degree of precision. Consequently, there is a ready body of law on which a statutory duty of good faith could quite readily and usefully draw upon in seeking to promote ethical business conduct.³³

A statutory duty of good faith would represent a positive statement of what is considered ethical conduct within a franchising context and provides an appropriate and well accepted benchmark of appropriate standards of ethical behaviour. This is particularly relevant in a franchising relationship given the inter-dependency of the franchisor and franchisee. The ongoing success of the relationship requires that they act in a mutually respectful and cooperative manner throughout the course of the relationship. A statutory duty of good faith would set out the boundaries of acceptable conduct in a positive manner for the benefit of both franchisors and franchisees.³⁴

8.28 This view was supported by Mr Piccolo MP, who claimed that in addition to making the current law easier to enforce, requiring the parties to a franchise agreement to act in good faith would also promote 'business integrity and ethics'.³⁵

8.29 An express good faith obligation would also be consistent with the policy objectives for which the Code was established.³⁶

Good faith in section 51AC of the Trade Practices Act

8.30 The extent to which a party has acted in good faith is already a factor to be taken into account by courts in determining whether conduct is considered to be unconscionable under section 51AC of the Trade Practices Act (TPA).

8.31 The FCA stated that 'at a conceptual level the Code supports the basic principles of freedom of contract, but provides additional specific protection beyond the already powerful remedies of misleading or deceptive conduct and unconscionable conduct contained in the Trade Practices Act'.³⁷ DLA Phillips Fox also submitted that the interrelation between the Code and the relevant parts of the TPA as they apply to franchising are 'robust and broad enough in scope and application to provide adequate protection to franchisees'.³⁸

33 Associate Professor Zumbo, *Submission 140*, p. 39

34 Associate Professor Zumbo, *Submission 140*, p. 39

35 Mr Tony Piccolo MP, Economics and Finance Committee, Parliament of South Australia, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 58

36 MTAA, *Submission 90*, p. 7

37 FCA, *Submission 103*, p. 20

38 DLA Phillips Fox, *Submission 81*, p. 6

8.32 Competitive Foods Australia Pty Ltd (CFAL) maintained that the Code and section 51AC of the TPA were inadequate in preventing unethical or 'rogue' franchisors, who did not act consistently with accepted industry norms and practices, from 'abusing their stronger bargaining and contractual powers to the disadvantage of franchisees'.³⁹ The MTAA also rejected the argument that the existence of good faith in section 51AC of the Trade Practices Act provided sufficient protection to franchising parties:

...the reference to good faith is not sufficient for the requirements under the Code, as the unconscionability provision of the TPA is a difficult benchmark to meet. Often the conduct of franchisors, whilst significantly detrimental to a franchisee, may fall short of the scope of 51AC.⁴⁰

8.33 Mr Robert Gardini concurred with this view, noting legal advice he had received that a motor dealer agreement that allowed termination at will with 12 months notice fell outside the scope of section 51AC because 'the conduct of the distributor was within the confines of its original contractual rights under the agreement and not in breach of the Code'.⁴¹ He submitted:

...section 51AC has an extremely high benchmark and distributors operating within their contractual rights will prima facie fall short of breaching the unconscionability provisions.⁴²

8.34 The Motor Traders Association of NSW also submitted that the current regulatory framework was inadequate, noting that the TPA's unconscionability provisions have 'eluded objective interpretation'. Concepts of 'good faith' and 'fair dealing' other than 'peripheral mention in section 51AC of the TPA, had also 'eluded general application to franchise legislation in Australia' despite being introduced in international jurisdictions.⁴³

8.35 The Franchisees Association of Australia (FAA) was critical of the limitations of considering good faith when interpreting section 51AC:

The current 51AC has characteristics which are listed as (a) through (k) to help identify contributing elements to unconscionable conduct, but the courts seem to take the view of guidance from the phrase "in all the circumstances" as meaning all elements, not just some, or the majority, must be present.

Clearly there is a gross failure of the intent of 'unconscionable conduct' under current Trade Practice Laws. The FAA requests that Section 51AC

39 CFAL, *Submission 22*, p. 3

40 Motor Trades Association of Australia, *Submission 90*, p. 7

41 Mr Robert Gardini, *Submission 92*, p. 2

42 Mr Robert Gardini, *Submission 92*, p. 2

43 Motor Traders Association of NSW, *Submission 99*, pp. 11-12

should be redrafted and then re-tested by the ACCC so that a fairer balance is obtained.⁴⁴

8.36 The Australian Competition & Consumer Commission (ACCC) advised that there is a difference between unfair and unconscionable conduct and that, while not designed to prohibit merely unfair conduct, section 51AC:

...recognises there may be an inequality of bargaining position in arrangements between small business and larger, more powerful organisations (such as large franchisors), and aims to afford small businesses protection from exploitation from a stronger party. This exploitation, however, must go beyond normal hard commercial dealings to be unconscionable conduct.⁴⁵

8.37 Yum! Restaurants Australia (YRA) also commented on whether unconscionable conduct provisions should be extended to 'unfair' conduct. It noted that franchisors make decisions not only in their own interest but also in the interest of the franchise system as a whole. YRA observed:

In a business setting, things can and do happen which may seem "unfair" from one person's perspective but which clearly are not fraudulent, abhorrent or beyond all good conscience. Any attempt to prevent businesses from exercising their business judgment within these bounds would be inappropriate and could seriously impact the development of the industry in question.⁴⁶

8.38 While noting the intention of the unconscionable provisions in the TPA was to provide a level playing field for commercial parties of different sizes and bargaining strengths, Ms de Leeuw observed that 'the lack of clarity surrounding its definition has meant that it is rarely used and is therefore ineffective.'⁴⁷

8.39 Post Office Agents Association Ltd (POAAL) suggested that the inclusion of an explicit good faith clause in the Code would give the franchisee 'something to point to' and, while not necessarily stronger than the current requirements, 'would be more immediate and certainly be cheaper'.⁴⁸

8.40 Ms Jenny Buchan noted that although the absence or presence of good faith is a factor courts may consider when determining whether conduct has been unconscionable, this was 'not the same as imposing a mandatory requirement that

44 FAA, *Submission 51*, p. 14

45 ACCC, *Submission 60*, p. 16. See also Shopping Centre Council of Australia, *Submission 115*, p. 11

46 Yum! Restaurants Australia, *Submission 118*, pp. 14-15

47 Ms Deanne de Leeuw, *Submission 114*, p. 17

48 Mrs Marie McGrath-Kerr, POAAL, *Proof Committee Hansard*, Melbourne, 5 November 2008, p. 46

business relationships that fall under 51AC must be entered into, conducted or prematurely terminated with good faith by all parties.⁴⁹

Defined versus general good faith

8.41 While there was general support among franchisees for the inclusion in the Code of a broad requirement to act in good faith, some considered that good faith should be defined.

8.42 Professor Warren Pengilley supported a general obligation on franchising parties to 'disclose material facts and act in good faith'.⁵⁰ This could be accomplished by either a short statement to the effect that 'parties shall deal in utmost good faith' or a more expansive statement such as the one found in a Texas Bill, namely:

The franchisor and franchisee shall prior and subsequent to the execution of a binding franchise or other agreement have the mutual obligation to deal fairly, openly, honestly and in good faith and to exercise reasonable care and diligence in complying with all provisions of the franchise and other agreements between them.⁵¹

8.43 Professor Pengilley argued that:

...a requirement that parties act in good faith...would cover any omissions in legal remedies which may exist. It would fulfil much the same role as s.52 of the Trade Practices Act (i.e. as an overarching provision to cater for conduct not within other black letter law prohibitions).⁵²

8.44 The FCA expressed concerns about the potential scope of an undefined good faith clause. Early in their appearance before the committee they said that without a 'precise description' a good faith clause would have the effect of inviting legal argument about its meaning and application, especially with respect to the end of the term of a franchising agreement.⁵³ The committee notes, however, that the FCA later indicated that they would not object to a good faith clause that simply reiterated any existing implied common law requirement to act in good faith (see paragraph 8.26).

8.45 The Motor Traders Association of NSW concluded that, while the requirement to act fairly and in good faith would be hoped to cure current deficiencies, in reality 'terms such as these will import a subjective element to conduct assessment which will be a breeding ground for disputes'. It suggested that it was

49 Ms Jenny Buchan, *Submission 89*, p. 6

50 Professor Warren Pengilley, *Submission 27*, p. 21

51 Professor Warren Pengilley, *Submission 27*, p. 21, citing Texas Senate Bill s.18.06 (1971)

52 Professor Warren Pengilley, *Submission 27*, p. 7

53 FCA, *Submission 103*, p. 11

necessary, therefore, to underpin these concepts with an 'objective proscription of categories of conduct which are regarded as inappropriate'.⁵⁴

8.46 Professor Andrew Terry also supported the need to provide a clear definition of good faith:

If there is to be an obligation of good faith enshrined in the Franchising Code of Conduct, I strongly impress on the committee the importance of trying to spell out what good faith means rather than just throwing the general motherhood, feel good sort of statement up there and probably giving false hope to a lot of franchisees that now they are protected by an obligation of good faith and can pay less attention to education, due diligence or talking to other franchisees.⁵⁵

8.47 7-Eleven Stores argued that as there is no 'concluded definition of "good faith" in the Trade Practices Act or the law, a requirement for franchisors and franchisees to act generally in good faith would not assist the franchise relationship'. They suggested instead that if a duty of good faith is included in the Code it should be on the following basis:

- (a) it is imposed in a way that does not derogate from otherwise lawful terms of franchise agreements but only to assist the parties exercise them;
- (b) the duty applies equally to Franchisees and Franchisors;
- (c) the duty is defined in some way. For example, "good faith means the Franchisee and Franchisor cooperating to achieve the objects of the franchise agreement honestly and in compliance with reasonable standards of conduct" (adopted from Sir Anthony Mason "Contract, good faith and equitable standards in fair dealing" (2000) 116 LQR66 (2000)); and
- (d) the duty applies to discreet aspects of the Franchisee/Franchisor relationship and not generally. For example, "the prospective Franchisee and the Franchisor will negotiate in good faith in relation to the renewal of the franchise agreement".⁵⁶

8.48 CFAL sought to define the concept of good faith as a proposed new section of the Code.⁵⁷ The draft provisions, modelled on the standards of conduct outlined in clause 12 of the 1993 voluntary code of conduct, would provide in part that:

23A Obligation to act in good faith

- (1) A franchisor and a franchisee shall act towards each other in good faith in the exercise of any rights or powers arising under, or in relation to, a franchise or the renewal of a franchise.

54 Motor Traders Association of NSW, *Submission 99*, p. 68

55 Professor Andrew Terry, *Proof Committee Hansard*, Sydney, 9 October 2008, p. 69

56 7-Eleven Stores, *Submission 105*, p. 4

57 CFAL, *Submission 22*, Attachment 1

- (2) For the purposes of sub-clause (1), good faith in relation to conduct by a franchisor or a franchisee means that the party has acted:
- (a) honestly and reasonably; and
 - (b) with regard to the interests of the other parties to the franchise,
in all the circumstances, including without limitation:
 - (c) the commercial and business objects of the franchise;
 - (d) the legitimate business interests of each of the parties, and what is reasonably necessary for the protection of those interests;
 - (e) the respective financial and non-financial contributions made by each of the parties to the establishment and conduct of the franchised business;
 - (f) the risks taken by each of the parties in the establishment and conduct of the franchised business;
 - (g) the alternative courses of action available to the parties in respect of the matter under consideration; and
 - (h) the usual practices in the industry to which the franchise relates.⁵⁸

8.49 Yum! Restaurants Australia Group (YRA) did not, in principle, oppose a statutory definition of good faith. However, in recognising that good faith generally means 'acting honestly and reasonably during the course of the relationship', YRA made the following observation:

The principal criteria YRA would place upon a legislative concept of good faith is that it must be sufficiently certain and it must not unduly interfere with the contractual rights of the parties. These are not inconsiderable hurdles to overcome...it is not an easy concept to define without risky imposition upon the ordinary operation of business in a market-based economy.⁵⁹

8.50 YRA addressed the relative merits of a general versus a defined obligation to act in good faith, noting that a general statutory duty to act in good faith would confirm that good faith is imported into franchise agreements but it would not remove uncertainty surrounding its meaning. It would, however, enable the concept to 'develop organically and incrementally, based on actual, rather than hypothetical scenarios'.⁶⁰ Alternatively, achieving greater certainty via a specified set of factors

58 CFAL, *Submission 22*, Attachment 1. The proposed new Part 3A *Franchising in good faith* also includes 23B and 23C which deal with renewal and non-renewal of franchise agreement. These issues are discussed in Chapter 6.

59 YRA, *Submission 118*, p. 7

60 YRA, *Submission 118*, p. 7

would depend on the factors chosen and on whether they were proscriptive or allowed for discretionary decision making.⁶¹

Implications for current agreements and other sectors

8.51 Several submissions raised concerns about the possible effect that the inclusion in the Franchising Code of Conduct of an express obligation to act in good faith would have on existing agreements and other commercial arrangements.

8.52 The FCA cautioned that the lack of an authoritative High Court decision, combined with a duty to act in good faith that did not 'clearly and precisely' address its content, would be 'highly undesirable' and would have wider implications beyond the franchise sector:

... the imposition of a statutory good faith obligation would discriminate unfairly against franchising when compared to distribution, licensing, agency, joint venture and other commercial arrangements. The current law strikes a sensible balance, and provides greater certainty.⁶²

8.53 For similar reasons, Ms Buchan suggested consideration should be given to inserting a good faith requirement into Part V Division 2 of the TPA to make it a requirement for all consumer contracts:

If a requirement of good faith is inserted into the Code the risk is that, by deduction, good faith is not required in other consumer contracts as it is franchise contracts that have been singled out for imposing the obligation.⁶³

She noted that:

For me there are risks in inserting good faith in the code and I suppose the risk is that, in that twisted way that we lawyers operate, it might be interpreted that it is not so important in non-franchise agreements.⁶⁴

8.54 The MTAA considered that the inclusion of the explicit provision would 'have very serious moral and educative benefits for any agreements on foot'.⁶⁵ The MTAA did not consider that the inclusion of a good faith provision into the Code would have a retrospective impact in terms of existing contracts, except where the implied term had been excluded from the contract:

If you said that it was a simple description of good faith, the impact on existing agreements would be to say that the courts already imply a term of good faith into those agreements. So it would be just providing statutory backing to the implied term that already exists....However, it might apply

61 YRA, *Submission 118*, p. 7

62 FCA, *Submission 103*, pp. 18-19

63 Ms Jenny Buchan, *Submission 89*, p. 6

64 Ms Jenny Buchan, *Proof Committee Hansard*, Sydney, 9 October 2008, p. 83

65 Mr Robert Gardini, MTAA, *Proof Committee Hansard*, Canberra, 17 October 2008, p. 21

to some agreements where that implied term had been excluded from the agreement.⁶⁶

8.55 In relation to the implications for existing contracts, CFAL sought advice on whether the inclusion into the Code of provisions relating to good faith and fair dealing would involve any retrospective alteration to existing franchise agreements.⁶⁷ Mr Robertson SC advised:

In my opinion such an amendment would be unlikely to be regarded by the courts as involving a retrospective alteration of existing franchise agreements....

There is a distinction to be drawn between conduct, on the one hand, and contract on the other. To regulate future conduct does not involve the retrospective alteration of the contract pursuant to which that conduct will be or might otherwise would be engaged in.

In my opinion therefore any such amendment would do no more than regulate future conduct of existing franchisees and franchisors.⁶⁸

Committee view

8.56 The committee is of the opinion that the optimal way to provide a deterrent against opportunistic conduct in the franchising sector is to explicitly incorporate, in its simplest form, the existing and widely accepted implied duty of parties to a franchise agreement to act in good faith.

8.57 The committee notes that a number of submissions recommended specific changes to the Code to address a range of opportunistic conduct. While some of these recommendations may warrant further investigation, the diverse nature of the franchising sector presents the potential problem that a specific change, while beneficial for one system, may have unintended consequences for another.

8.58 The committee envisages that the role the insertion of 'good faith' in the Code will have on termination and renewal is to ensure that what has already been stated in the courts will be uppermost in franchisors' minds when contemplating non-renewal or termination without breach—that is, that any decision to do so should not be made capriciously and without consideration for the reasonable rights of the other party to the agreement.

8.59 The express obligation to act in good faith is not designed to alter the current rights of franchisors to maintain control over the integrity of their brand. It will, instead, provide a clear, overarching statement of expectation as to the standard of

66 Mr Robert Gardini, MTAA, *Proof Committee Hansard*, Canberra, 17 October 2008, p. 22

67 See recommendations 7.2.13 and 7.2.14 on good faith and fair dealing of the report of the SA Report

68 CFAL, *Submission 22*, Attachment 4

conduct that should be adopted by franchisors, franchisees and prospective franchisees.

Recommendation 8

8.60 The committee recommends that the following new clause be inserted into the Franchising Code of Conduct:

6 Standard of Conduct

Franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.