Commonwealth Parliament Inquiry into the Franchising Code of Conduct

Joint standing committee on Corporations and Financial Services

Submission from

FRANCHISE COUNCIL OF AUSTRALIA

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Executive Summary

Putting everything in context:

Franchising makes a very significant economic contribution. The economic impact of excessively regulating the sector to appease a small minority would be significant. 98% of franchisors, and virtually all franchisees, are small businesses, and therefore very vulnerable to over-regulation and excessive compliance costs.

Australia already has the most comprehensive regulatory framework in the world. In addition to the Code requirements (disclosure document, franchisees getting professional advice, dispute resolution, restrictions on termination) there are the very effective prohibitions on misleading or deceptive conduct and unconscionable conduct in the Trade Practices Act ("the TPA").

If prospective franchisees follow the existing Code process, taking professional advice and using the material included in the disclosure document (such as the list not only of current but since March 1 2008 past franchisees), they can undertake very effective due diligence. Franchisee due diligence is the key to improved outcomes in the sector, as franchisor misconduct is already addressed in a legislative sense by the Code, the TPA and having the ACCC as regulator.

Statistically far fewer franchised businesses fail than other small businesses, but franchise failure is more easily identified. The level of disputation, at between 2 - 4%, is very low, with 81% of disputes being resolved by mediation.

Many of the allegations of illegal franchisor behaviour provided to the recent State franchising inquiries have already been examined by the ACCC and others and found not to justify action. The ACCC has publicly noted that certain franchisee assertions have on examination been directly contradicted by other evidence.

Psychologists confirm it is expected that franchisees who fail will seek to blame others, as that is a fundamental human behavioural coping trait when trauma is experienced. This explains why franchisee complaints can be very passionate and compelling, but inaccurate when verified. Psychologists consider one of the key reasons why mediation has been effective is because it reduces trauma. Litigation and other adversarial mechanisms increase trauma.

The SA & WA franchising inquiries arose largely as a result of lobbying from Competitive Foods and a small group of disaffected former franchisees, rather than as a result of genuine endemic franchising problems.

Many complaints are old, and relate to concerns already remedied by most recent Code changes that took effect March 1, 2008.

What are the industry issues?

- franchisees are not getting advice in accordance with the Code requirements. Part of the problem relates to the cost of advice – with disclosure materials regularly in excess of 100 pages, and sometimes much more, it is difficult to keep the costs down.

- mismatched expectations – it would appear some franchisees see franchising as a guarantee of success and do not understand normal business risk. Some franchisors may (in breach of current law, notably s52 TPA) oversell the business opportunity. The ACCC needs to act here.

- franchisees in shopping centres are particularly vulnerable to inappropriate conduct by shopping centre owners such as end of term lease negotiations. The ACCC needs to continue to act here.

- full employment and high wages levels have meant that there are fewer quality franchisees in the market. Those remaining, including business migrants, may have a higher need for education.

- many prospective franchisees enter the sector with little knowledge of franchising, the regulatory framework or the risks of being in business. There is little coordinated training available.

What are the solutions?

- Improved pre-franchise education is critical so prospective franchisees better understand what to expect, the risks involved, their rights and their due diligence and other obligations.

- Simplification of the disclosure process so more people read disclosure documents and get advice. Training could also play a part assisting prospective franchisees to understand the disclosure document. Perhaps a summary document could be introduced where franchisors provide yes/no answers to identified key questions?

- Making mediation mandatory, and not introducing some new court or tribunal or other adversarial approach. Despite not being compulsory, mediation has been remarkably successful. Instead of developing other options, all of which are likely to be more adversarial, more traumatic, more costly and less effective, it makes sense to improve the operation of mediation;

- To further assist franchisees with due diligence and ensure no prospect is ignorant of business risk, the preparation by the ACCC with FCA input of a template risk statement or checklist which franchisors could be required to hand out to all prospects with a copy of the Code.

- Incremental improvement to disclosure by franchisors in certain areas, including experience of the franchisor in franchising and what happens at the end of term.

- Improving the operation of the existing enforcement framework. The existing regulatory framework is extremely comprehensive, featuring not only the Code but prohibitions on misleading or deceptive conduct and unconscionable conduct. If there is any inappropriate behaviour by franchisors the ACCC has ample power to intervene. If there are funding or other internal limitations these should be removed. There is no need for more legislation.

Unhelpful suggestions:

There is no need for a new statutory good faith provision in the Code. There is already an implied duty of good faith and fair dealing that is well understood by the courts. Many of those advocating “good faith” are really seeking to use the term to cloak a new statutory right to automatic renewal at end of term or compensation.

State regulation of franchising is inappropriate in any form, cannot be sensibly justified and must be rejected. Franchising is a national activity that should only be regulated at a Federal level.

Some suggested Code changes (notably many by the SA Inquiry) are unnecessary and simply add compliance cost and increase the likelihood franchisees will not seek professional advice.

Franchisors should not have to produce a risk statement of all risks relating to their individual franchise, as this would create major new cost. This issue is much more efficiently addressed through education, including through the publication by the ACCC of a booklet on franchise risk.

The FCA rejects ill-informed calls for new adversarial tribunals such as courts, arbitration, franchisee ombudsman etc. that simply add cost and will be much less effective than mediation.

A franchisor registration process will add substantial cost for no extra value, and could imply ACCC endorsement of the system and make it less likely franchisees will seek advice.

Changes to rebate disclosure will make public commercially sensitive information and ultimately disadvantage franchise networks compared to non-franchised competitors.

There is no need to extend the current definition of unconscionable conduct or to provide that the failure to pay compensation at end of franchise terms is unconscionable.

The FCA rejects the various obscure recommendations of SA Franchising Inquiry. Although well-intentioned, many of the SA Inquiry recommendations are either already covered by current law, would impose unnecessary additional compliance cost for no real benefit, or have been suggested as a solution to a non-existent problem.

1. Summary of Key Points in Response to the Terms of Reference

1.1 General observations on the Terms of Reference

The Terms of Reference for this Committee are very broad. The deliberations of this Committee follow hot on the heels of the Mathews Committee review of the disclosure provisions of the Code and the subsequent Code amendments which only took effect in March 2008. In 2006/07 there were also two State inquiries into franchising. The Code itself is relatively new, as it was only introduced in 1998. In the context of the deliberations of this Committee a number of points should therefore be made:-

(1) The New Deal Fair Deal Reforms that were introduced with bi-partisan support in 1998 were in response to a comprehensive Federal inquiry appointed to review the operation of the franchise sector and small business more broadly. These reforms specifically considered the balance between private contractual freedom and the need to protect franchisees from inappropriate behaviour. Recommendations to address the inequality of bargaining power between franchisor and franchisee and franchisor conduct issues were central to these reforms. The New Deal Fair Deal reforms contained a comprehensive mechanism to address these issues, being:-

   (a) the introduction of the Franchising Code of Conduct, which addressed any information imbalance, contained protection from pressure selling of franchises, addressed access to cost-effective dispute resolution and provided protection in the area of termination and transfer;

   (b) the introduction of the prohibition on unconscionable conduct in s51AC of the Trade Practices Act;

   (c) the appointment of the ACCC, fairly regarded as Australia's most effective corporate regulator, to oversee the legislation; and

   (d) the provision of specific funding to ensure the effective administration of the sector and fund test cases.

(2) The Code has been the subject of detailed ongoing review, and has been amended on three occasions – September 1999, June 2001 and March 2008.

(3) The Mathews Committee Report confirmed that the introduction of the Code had underpinned much of the growth and success of the Australian franchise sector, and was "*pivotal to the continued success of the franchising industry.*[1]

(4) Recent statements in Federal Parliament confirm that the recent State Government inquiries into franchising were established largely as a result of lobbying by interests associated with Competitive Foods, rather than as a result of any apparent endemic problem in franchising.

The State inquiries into franchising were conducted at a similar time, and many people made submissions to both inquiries. However the inquiries produced significantly different recommendations only some of which can sensibly be supported.[2]

The FCA supports changes that improve the Australian franchise sector, but cautions against enacting legislation without demonstrable proof that a problem exits and the proposed solution will be of meaningful benefit. The current regulatory regime has been thoughtfully developed, is comprehensive and has proven to be highly effective.

[1] Foreword by Graeme Mathews, p4, Review of the Disclosure Provisions of the Franchising Code of Conduct.
[2] The FCA response to those reports is contained in Appendix 3.

1.2 Overview of the FCA view on the issues noted in the Terms of Reference

(1) The FCA considers that the current regulatory framework operates very effectively, and only incremental improvements should be made. It strikes the right balance between the interests of franchisors and franchisees, providing a high level of protection for franchisees and facilitating the provision of extensive information to prospective franchisees to assist them in undertaking their due diligence. The Code and the Trade Practices Act support the twin pillars that have assisted the Australian franchise sector to grow and develop – responsible franchisor behaviour and effective franchisee due diligence.

The FCA does not consider there to be an imbalance in the rights of franchisors and franchisees. Perhaps the best evidence of this is the low levels of litigation, and the phenomenally successful settlement outcomes from mediation. If franchisors had a superior legal position than franchisees one would expect not to see over 81% of disputes settling at mediation. Indeed this settlement rate supports the view that franchisees have very strong legal rights, and franchisors are therefore highly inclined to avoid litigation.

(2) The FCA rejects the need for any inclusion of a statutory good faith obligation. As noted in part 4 of this submission, the courts have observed that it is inappropriate to undermine the certainty and sanctity of a bargain made by equals by implying a duty of good faith and fair dealing in all cases. The implication of an obligation of good faith may be appropriate in the context of a franchise relationship where there is a significant disparity of bargaining power or a franchisee is vulnerable or disadvantaged. Similarly there are obvious circumstances where a franchisee would not be vulnerable or disadvantaged - for example Master Franchisees or multi-unit franchisees are often powerful, well-resourced and hardly vulnerable or disadvantaged parties to the franchise relationship. Ultimately, each case needs to be determined upon its own facts. Franchisees therefore already have access to a powerful and flexible remedy. Further legislation is not only unnecessary, but would confuse the situation.

(3) The FCA considers that the Code and the Trade Practices Act form a well-integrated and comprehensive regulatory regime. That regime includes not just the Code and the s51AC prohibition on unconscionable conduct, but the very powerful prohibition on misleading or deceptive conduct in s52. Importantly the law already provides that there is also an implied duty of good faith and fair dealing that can in appropriate circumstances be implied into a franchise agreement to remedy any imbalance of bargaining power.

(4) The mediation based dispute resolution process is highly effective and considered world's best practice. It is quick, low cost and effective in over 81% of cases, which is a phenomenal result. The FCA believes that any new tribunal or any arbitration or ombudsman process is unlikely to offer any material benefits to franchisees, and is likely to be more costly. The FCA recommends focusing on possible improvements to the mediation process.

(5) In terms of other matters, the FCA is open to consider any suggestions that improve the sector for the benefit of franchisors and franchisees. However there have been some specific proposals flagged by interest groups or recommended by the SA State Franchising Inquiry which the FCA does not support. These issues are summarised in the Executive Summary to this submission, and discussed in detail in section 1.11 and 1.12 below.

2. The Nature of the Franchising Industry

2.1 The commercial impact of franchising

The commercial impact of franchising is well known. With gross national turnover of $128 billion, Australia is No.1 in the world, on the measure of franchise business per head of population. In nominal terms, the Australian franchising sector is bigger than any outside the Americas, including the UK and all European and Asian countries. The Australian franchise sector is broad and far reaching. It is made up of just over 1000 franchise systems, with 66,000 franchisees and over 600,000 employees. Franchising is one of the world's most efficient vehicles of small business growth, and the Australian franchise sector is one of the most successful globally.

Other franchising statistics are not as well known, and are worthy of note in the context of the current deliberations of the Committee. The Franchising Australia Surveys of 2004 and 2006 conducted by Griffith University observed an increased maturity in the sector, noting that:-

franchisees remained in their businesses for an average of 7 years. (This statistic is important in the context of allegations made by a small group of disaffected former franchisees in relation to "churning" and supports the FCA view that churning is a myth.)[3]

in the 2005 year 91% of franchisees experienced no change in ownership. Of the balance around 7% sold their businesses. Fewer than 2% of franchised units ceased to operate in 2005, supporting the proposition that franchisee failure rates are low;

29% of franchisors were in retail non-food, 21% in business services, 15% in food and 13.5% in personal and other services;

franchisors were predominantly home-grown Australian systems that have been in business on average 16 years, and franchising for 10 years;

the average system had only 22 franchised units, with 48% of survey respondents having fewer than 20 units. This statistic is important in reinforcing the need for franchise regulation to be sensitive to the impact of regulation on small business. It also helps demonstrate that there is generally little or no imbalance of bargaining power between franchisors and franchisees, in that most franchisors are themselves small businesses;

34% of units were in New South Wales, 24% in Victoria, 20% in Queensland, 13% in Western Australia, 6% in South Australia, 2% in Tasmania and 1% in the Northern Territory;

54% of franchised units were located in capital cities, compared to 64% of the population;

67% of franchised systems had some level of multiple unit ownership by franchisees;

The level of disputation in the sector was very low, with only 4% of franchisees in dispute with their franchisor. The most common causes of dispute were system compliance, communication problems and misrepresentation claims;

25% of franchise systems had expanded internationally;

Once seen predominately as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring

[3] Churning, or the deliberate sale of non-viable franchises with the objective of the franchisor taking them over and re-selling them, would constitute misleading conduct in breach of s52 of the Trade Practices Act. The 2008 Code amendments requiring franchisors to provide site or territory details and to list former franchisees were specifically designed to remove any risk that churning could occur.

competitive advantage to both franchisors and franchisees. Franchising is the preferred business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; speciality retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

2.2 Franchise regulation in Australia

Governments around the globe approach regulation of franchising in very different ways. Australia's nearest franchising neighbour, New Zealand, has no franchising regulation at all. Singapore and the United Kingdom also have not seen the need to regulate the sector specifically. Australia has followed the US model, and indeed Australia has the most comprehensive regulatory regime in the world, developed over three decades of world-class business evolution. The Franchise Council of Australia believes the many constructive aspects of the franchising regime and the way it is policed are strong contributors to Australia's position at the head of the world leader board in franchising success. At between 2-4%, the incidence of disputes is among the lowest, if not the lowest in the world. In the biggest and most long-running market, the US, disputes run at about 7%, with most of those taking place in the courts or through arbitration, and substantially greater cost to all parties. In Australia, we have a simple, quick and low-cost mediation based dispute resolution process which is simply unavailable in most countries in the world, including the US. In Australia, 81% of mediations are successful, meaning disputes are resolved, generally within a day, without need to go through expensive court proceedings. No other country can make this claim. The FCA was pleased that the recent inquiries into franchising in WA and SA noted some of these facts, adding, in the case of WA, that franchising was in a healthy state, that there were no endemic problems and that regulation did NOT disadvantage franchisees.

The Franchising Code of Conduct is the centrepiece of regulation in Australia. Since the Code was made compulsory in 1998, franchising has flourished. Under explicit mandatory disclosure rules and implicit good-faith negotiating rules, an increasing number of franchise businesses have been created and growing numbers of franchisees have entered the sector. In fact there was a significant jump in sector growth in the years immediately following 1998 – growth which has continued strongly, though moderating slightly to settle about 6-7% per annum for the past several years. Throughout this period, growth in franchising has outstripped growth in the broader small business community. As we enter a period of slower economic growth, most commentators believe franchising will be affected (as will almost all business), but that it is likely to be relatively less affected than stand alone small businesses. This is for a number of reasons: 'Flight to quality' and resort to trusted brands is a common phenomenon when discretionary spend drops in the retail sector or in service delivery. Ability to 'ride out the storm' is enhanced by group buying power, group marketing capability, collective buying power and business network support. In tough times, it is more often the case that the weaker fail or choose to make their exit rather than risk failure. Those that choose to try to drive through the storm, but fail to trim their sails and make whatever other adjustments are necessary are more inclined to fail. This has been and always will be the case in small business, including franchising.

Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. Since 1998 the sector has not only grown, but matured and developed into one of the primary engines for economic growth in Australia. We have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practice.

The FCA believes that Australia's regulatory framework represents world's best practice in terms of striking a balance between strong and effective regulation and the fundamental principles of free enterprise. It features the comprehensive Franchising Code of Conduct requirements, which are administered by the ACCC. In addition to the Code, the Commonwealth Trade Practices Act's prohibitions on misdealing or deceptive conduct and unconscionable conduct also apply to franchising transactions. The Australian regulatory environment for franchising is the most comprehensive of any nation, including the USA.

The FCA does not pretend that franchising is perfect, and indeed has been at pains to ensure that potential franchisees are not lured to the sector by a belief in the infallibility of a franchised business. The FCA, and more recently the ACCC have emphasised that franchising not only requires responsible franchisor behaviour, but proper franchisee due diligence. Many of the problems the FCA sees in franchising would not have arisen had the potential franchisee sought appropriate specialist legal and business advice and undertaken proper due diligence prior to purchasing the franchise. This remains probably the biggest ongoing challenge for the sector.

2.3 The features of franchising

Some positive features set franchising apart in tough economic times from the overall business community perspective and from that of new entrepreneurs coming into the business sector:

1. Franchise businesses have potential to grow more rapidly than non-franchise businesses because of an employee shift from PAYE to self employment (often resulting from Government and corporate staff cuts) combined with the greater perceived safety and attractiveness of established successful business brands as investment or business opportunities.

2. The franchising failure rate is lower than the broader small business community -- in which 40% of businesses fail within the first two years, compared to very little business failure in the first two years in franchising. This adds to the attractiveness of franchising as a 'destination' for new entrepreneurs.

3. The security of a regulated code of compliance with strong disclosure requirements provides confidence to a new entrant that he or she is entering business in an environment with many more built-in safeguards than the general small business community.

The above factors add to the attractiveness of franchising. On the other side of the coin, they can also add to the sense of disappointment when the business does not succeed. The unique structure of the franchise business model means that there is almost always a personal relationship at its heart, a link between franchisor and franchisee that is so strong, it is sometimes likened to a commercial marriage. When the business fails it is easy for either party to the 'marriage' to cry foul and blame the other. At such times, as with marriage breakdown, it can be difficult to separate fact from emotion. The involvement of a third party – the business broker or adviser – can both facilitate and, at times, complicate the issue.

2.4 Psychology and the reliability of evidence

The psychological impact of the failure of a franchise business should not be under-estimated. Greg Nathan from the Franchise Relationships Institute has observed that it is normal human coping behaviour for franchisees to seek to blame others in traumatic circumstances. This observation helps to explain why franchisees often appear to very genuinely believe that their failure has been due to the franchisor, and complainants therefore appear very credible to the uninitiated. Nathan explains that the contrary option for a franchisee – that the franchisee accepts total responsibility for the failure – is often too traumatic to be contemplated. It can have implications that can include marital breakdown and depression. Blaming others can in a broader and somewhat perverse way enable a franchisee to cope with the failure and move on.[4]

The FCA has examined many of the individual circumstances of people who made representations to the SA and WA franchising inquiries. Some of the assertions appear to be simply untrue, a matter upon which the ACCC felt moved to comment in relation to an investigation it conducted in relation to allegations by a former Baker's Delight franchisee. In a Press Release issued on April 22, 2008 the ACCC Chairman commented:-

> *Although there is no suggestion that the allegations made by the franchisees were made with any improper intent in many cases it was difficult to substantiate claims and in some cases information given was directly contradicted by documents or other evidence.*

Speaking more generally Mr Samuel went on to say:

> *It should not be assumed that where there is smoke there is always fire. The ACCC is experienced in testing matters raised with it and often its investigations lead to the conclusion that those matters cannot be substantiated or should not be pursued further.*

There will be evidence to the Committee that will include instances of significant individual financial hardship that will justifiably engender feelings of personal sympathy for the former franchisees. However the financial hardship should not automatically lead to attribution of fault to the franchisor involved, just like such a franchisor should have no entitlement to the profit and capital gains of successful franchisees. In view of the psychological issues involved, and the salutary warning of the ACCC, any evidence needs to be carefully tested. In the FCA's experience many of the assertions of former franchisees do not stand close scrutiny, and where there are instances of inappropriate conduct by franchisors they are addressed by current laws.

2.5 Continuous improvement and education

The FCA acknowledges that there are many good franchisors and many good franchisees at work in Australia, just as there are some on both sides who are not as diligent or adept. The same can be said of the many advisers in the fields of business broking, development, law and accounting who provide services to franchisors and franchisees. There is and always will be room for improvement in all these areas. The FCA regards it as its most important role to support the continuing improvement in standards in all three areas (franchisors, franchisees and advisers), noting the different needs of each group, but also, most importantly, their interdependence.

Education is a key element of lifting standards – from before new entrants arrive in the sector to the time they leave, no matter to which group they belong. To seek to promote the interests of one group over another without regard for the impact on the structure as a whole, is to encourage destabilisation of the sector, and, ultimately, a shift away from a co-operative, constructive, mutually beneficial approach to one which is adversarial, deriving benefit at the expense of the other party . The US provides a good example of the outcome of this type of approach: higher costs of entry, more disputes, more litigation and cases going to court. The understanding of the importance of the 'whole of sector' representative approach is reflected in the FCA board structure, which requires representation by franchisors, franchisees, service providers and women, as well as fairness of geographical representation (State chapter presidents sitting on the FCA

[4] See generally The Psychology of the Franchise Relationship, presented by Greg Nathan to the American Bar Association Annual Forum on Franchising in October 2006.

board). The emphasis on mandatory, low-cost mediation also reflects a positive 'whole of sector' approach.

The FCA contends that much of the current 'debate' about franchising is having a tendency to focus on the most dramatic of complaints with little attempt to place them in context of the functioning of the sector overall. This submission aims to provide the context which should be viewed at the same time as paying appropriate attention to complaints and accusations.

2.6 Recent commentary

Recent public commentary on the state of franchising in Australia has been highly varied and sometimes highly emotive. The West Australian Government recently declared the sector in good health, following an inquiry into franchising in that State. The South Australian Government has been mute in response to an inquiry conducted by MPs in that State – an inquiry which repeated serious accusations made in submission to it, but was unable to find evidence to support the accusations. At the same time as the WA and SA inquiries were progressing, the ACCC was conducting an investigation of two major franchise brands in the retail sector. Investigations centred on complaints aired extensively in submissions to the State inquiries. After investigating for many months, the ACCC found no wrongdoing. In one case, the chairman of the ACCC, Graeme Samuel, took the unusual step of issuing a public statement in which he said what the investigation outcome showed was that '…where there is smoke there is not always fire." In the other case, the ACCC recommended operational changes to improve aspects of dealings with franchisees with an emphasis on transparency.

MPs have made emotive statements in the Commonwealth Parliament which have alleged that bullying, exploitation and predatory behaviour is rife among franchisors. The FCA rejects these claims, but encourages those who claim to be so exploited to put their case to authorities. Collusion and allegations of deliberate 'churning' of franchisees by franchisors are the most heinous of accusations which can be made against franchisors. Such actions are illegal and should be prosecuted. It is the FCA's understanding that this belief is shared by the ACCC, which has a clear role to prosecute such behaviour should it occur.

It makes no sense to conclude that because such prosecutions have not taken place that this must mean that the ACCC is incompetent, as has been claimed in the House of Representatives on a number of occasions in 2008. It would be a serious reactionary misjudgement to base legislative or regulatory change on emotive claims which can not be substantiated openly or, apparently, found by the ACCC, after thorough investigation.
It should be noted that the ACCC has stated publicly that it does not believe it lacks any resource or legislative capability to prosecute any such case.

2.7 'Good faith' negotiations

The FCA believes it would be similar folly to take the step of introducing a non-specified legal clause into the Franchising Code, even where the clause has the apparent benign nature of "good faith negotiations".

'Good faith' is implied in a number of areas of the Trade Practices Act, and its opposite, 'Unconscionable conduct' is explicitly included in Section 51AC of the TPA. The FCA includes the concept in its Member Standards. It is a different matter, however, to introduce this phrase into the Code without precise description of its meaning, because this will have the effect of inviting legal argument over its meaning – especially in relation to the end of a the term of a franchise agreement.

Many experienced members of the franchising fraternity regard 'good faith negotiations' regarding end-of-term as a proxy for a 'good will' payment or a termination payment -- concepts which have not applied anywhere in the world in the history of franchising. To create doubt as to whether they may apply is to invite legal argument which will add to the cost of an agreement and increase the likelihood that end-of-term negotiations would routinely become matters of legal argument – a situation which is NOT the case at present. It is likely a franchisor anticipating some kind of termination payment at the end of an agreement would seek to recover this cost over the life of the agreement, probably from the very start of the agreement. This would have the effect of increasing the cost of entry and ongoing fees to the franchisee. The increased cost and legal uncertainty would be clear disincentives to invest.

It is important to note that there is little evidence of inability of franchisees to successfully transition through the end of a contract term and negotiate a new agreement on satisfactory terms. In fact, in most franchise systems renewal is sought by the franchisor and rarely on unfavourable terms for the franchisee. The exceptions are less than 3%. They commonly occur when the franchisor-franchisee relationship has broken down or the franchisee business has not been a success.

2.8 Franchisee failure

The failure of an individual franchise business does not prove systemic failure of either the particular franchise system or the regulatory framework. The failure of any business is regrettable and can be particularly so in cases of franchisee failure where unrealistic expectations have not been met. However, in many such cases, a thorough examination of cause of failure often points more to commercial/market issues rather than franchise-agreement issues.

As Professor Andrew Terry noted in his submission to the SA inquiry into franchising, "Regulation has a vital and acknowledged role in protecting franchisees but it cannot remove commercial risk. It cannot remove the possibility of failure or guarantee success. Ultimately a prospective franchisee's best protection against failure is educated, informed and conscientious due diligence." In many examples cited in the WA and SA reports, and in Federal Parliament recently, there is no indication given of whether the failed franchisee exercised any due diligence such as talking to other franchisees, obtaining professional advice etc. In the case of Bakers Delight, a case which has been raised numerous times, the ACCC conducted a thorough investigation and found no substantiated claims and no breach and therefore took no action. A legislative response must be based on clear and unambiguous evidence not on isolated instances (particularly when the facts have not been substantiated and the circumstances have not been analysed and evaluated).

The FCA accepts, indeed argues, that franchisors who breach the law should be held responsible. It considers the New Deal Fair Deal reforms which included the introduction of a prohibition in s51AC of the Trade Practices Act on unconscionable conduct, and the establishment of the ACCC as the designated regulator of the sector, as having made a very important contribution to the success of Australian franchising.

The FCA believes that Australia's regulatory framework represents world's best practice in terms of striking a balance between strong and effective regulation and the fundamental principles of free enterprise. In addition to the Franchising Code of Conduct requirements administered by the ACCC, the Commonwealth Trade Practices Act's prohibitions on misdealing or deceptive conduct and unconscionable conduct also apply to franchising transactions.

The FCA does not pretend that franchising is perfect, and indeed has been at pains to ensure that potential franchisees are not lured to the sector by a belief in the infallibility of a franchised business. The FCA, and more recently the ACCC have emphasised that franchising requires not only responsible franchisor behaviour, but proper franchisee due diligence where potential franchisees seek appropriate specialist legal and business advice and undertake proper due diligence prior to purchasing the franchise. The FCA was pleased to see some of these views reflected in the findings of the WA and SA inquiries.

2.9 Positive points emerging from WA and SA inquiries:

Although established largely as a result of lobbying from interests associated with Competitive Foods, the WA and SA Governments conducted recent inquiries into franchising that produced some useful suggestions to improve the sector. The FCA's response to those inquiries is included as Appendix 3. The following conclusions are worthy of note:

- Education provided to the franchise sector has succeeded in ensuring there are no endemic problems in franchising
- Current laws do not disadvantage franchisees
- Disclosure documents prepared in accordance with requirements of the Franchising Code of Conduct provide sufficient information to assist prospective franchisees in making informed decisions in relation to the franchise
- Pre-entry education of prospective franchisees is the most important improvement that could be made to the regulatory framework

The FCA is supportive of the following suggestions emanating from the State inquiries:

- Incremental improvements to the quality of information provided to franchisees as part of the disclosure process
- Franchisees may benefit from receiving more information on the possible risks of a franchised business (best provided by the ACCC)
- Measures to augment and further streamline dispute resolution
- Periodic review of the Franchising Code of Conduct
- Freedom for parties to a franchise agreement to negotiate the commercial terms to bind them in their business relationship
- Enhanced information to franchisees concerning retail tenancies
- Recommendation to amend the SA Retail and Commercial Leases Act 1995 (SA)
- Minister for Consumer Affairs providing educational information relating to franchising to all businesses registered as franchises
- Item 11 of Annexures 1 and 2 of the Franchising Code of Conduct being amended to require the franchisor to disclose a summary of its particular experience operating a franchise business.
- ACCC or other bodies describing the risks and consequences of franchisor failure, and indeed the operation of businesses generally
- Court having broad discretion to determine the sanctions that ought to apply to breaches of the Code
- Publication by the ACCC of the outcomes of any investigations in which franchisors are found to be acting unlawfully or persistently in breach of the Franchising Code of Conduct
- Current practice of the ACCC of publishing the outcomes of investigations which have found franchisors had no case to answer
- ACCC providing further resources for the explicit purpose of providing educational support to the franchise industry

2.10 WA and SA Inquiry matters that will negatively impact franchising:

The FCA believes the following issues couched in terms of improving outcomes for franchisees are important areas to avoid as they may have a negative impact on both franchisees and franchisors:

- Any process which requires that all franchisors register their franchise systems and lodge their disclosure document annually with the ACCC
- Amendment of franchise legislation to provide guaranteed rights of renewal to existing franchisees
- Obligation on parties in a franchise agreement to negotiate franchise agreements "in good faith"
- Mandatory disclosure of rebate amounts

- State regulation of franchising
- Prospective franchisees and franchisors having to identify their proposed business as a franchise when they register their business name with the Office of Consumer and Business Affairs
- Code amendment to require franchisors to provide further continuous disclosure as this already exists in the Code
- Amendment to the Code regarding communication between prospective and existing franchises
- Requirement that a franchisor must produce a risk statement for every franchisee
- Removal of the exception in item 20.3
- Amendment of Section 51AC of the Trade Practices Act 1974 (Cth)
- Creation of a Franchise Ombudsman, or a Franchise Tribunal, or a specific Franchise Arbitration Unit within the ACCC
- Code amendment to include a provision mandating that franchise agreements must include the basis on which termination payments or goodwill or other such exit payments will be paid at the end of the agreement.
- Recommendation that the exclusion or inadequate determination of goodwill or other such exit payments by a franchisor during negotiations with a franchisee regarding a franchise agreement constitute “unconscionable conduct”

3. Understanding the Current Regulatory Framework

It is critical that the Committee properly understand the current regulatory environment so that it can make informed decisions on reform suggestions. From past experience, particularly with the SA Franchising Inquiry, those advocating reform do not appreciate the extent of protection provided by the current regime. Indeed the SA Report contains recommendations that appear to ignore changes made to the Code with effect from March 1, 200.

Australian franchising is regulated by the Trade Practices Act and the Franchising Code of Conduct, as well as the contractual relationship between the parties. The Matthews Committee comprehensively reviewed the regulatory framework of Australian franchising in late 2006. The effect was a series of amendments to the Trade Practices (Industry Codes – Franchising) Regulations 1998. These changes took affect on March 1, 2008. The Code amendments have bi-partisan support, and are well accepted in the franchise sector (notwithstanding some concerns about some areas of unintended compliance burden, which the FCA is discussing with Government and the ACCC).

As a result, Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of this framework are:

(1) the Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. Typical requirements include disclosure of the franchisor's business background, relevant financial information, previous litigation and solvency history. Other relevant matters the Code uniquely requires of the franchisor include:

- (a) a list and contact details of existing and former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence; and
- (b) a certification of solvency signed by the director of the franchisor, as at the end of the last financial year, which provides considerable additional comfort to prospective franchisees.

(2) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(3) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(4) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to provide it had reasonable grounds for making any representation as to a future event;

(5) the prohibition on unconscionable conduct in s51AC of the TPA; and

(6) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct.

Remedies for breach of the Code or the Trade Practices Act are comprehensive and include injunctions, declarations, damages, orders rendering an agreement void in whole or in part, corrective advertising and such other orders as a court shall think fit.

4. Explicit Good Faith Obligation

The FCA considers that the proponents of the introductions of an explicit good faith obligation into the Code are in fact using the term "good faith" to cloak a different issue. In reality they are seeking legislation to alter the commercial arrangements that have successfully governed franchising in Australia and globally since its inception. Specifically they are endeavouring to cloak as "good faith" an explicit right to perpetual renewal of franchise agreements or compensation at the end of the franchise term. The FCA is categorically opposed to the creation of such an explicit contractual right which would result in immediate wealth transfer and impact the majority of the 50,000 plus existing franchise agreements.

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.

Misleading or deceptive conduct and unconscionable conduct are already prohibited, with lack of good faith one factor to which a court is directed to have regard in considering whether unconscionable conduct has occurred. More importantly there is already a duty of good faith and fair dealing that a court is able to imply into every franchise agreement, as the cases listed in the footnote demonstrate[5]. There is an existing body of law built up around this implied duty which the FCA has summarised below. The existing law is clear, flexible and certain, and strikes the ideal balance. Any statutory definition of good faith, far from clarifying the position, will in fact create massive uncertainty where none currently exists. The courts have set out clear and fair guidelines that address the legal position and protect franchisees from exploitative conduct whilst preserving the rights of the parties to contract freely and enforce their legitimate contractual rights.

The approach taken by the courts in considering whether an implied duty of good faith and fair dealing has been breached is generally reflected in Finkelstein J's comments in *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd*[6]. His Honour stated that[7]:

> (5) Recent cases made it clear that in appropriate contracts, and perhaps in all commercial contracts, a term requiring good faith and fair dealing would ordinarily be implied as a legal incident of the relationship;
>
> (6) The implied term would require a contacting party to act in good faith and fairly, not only in relation to the performance of a contractual obligation but also in the exercise of a power conferred by the contract;
>
> (7) The implied term imposes an obligation upon the party not to act capriciously. However, it would not operate so as to restrict actions designed to promote the legitimate interests of the party. Provided that the party exercising the power acts reasonably in all of the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied.

A similar approach was taken by Byrne J in *Far Horizons Pty Ltd v McDonalds Australia*[8]. His Honour noted that there is to be implied into a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the

[5] *Renard Constructions Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1; *Alcatel Australia Ltd v Scarsella* [1998] 44 NSWLR 349.
[6] (1999) ATPR 41-703.
[7] At [10-11].
[8] [2000] VSC 310.

agreement in good faith or reasonably, and not capriciously or for some extraneous purpose. His Honour considered that such a term was a legal incident of a contract of this nature.[9]

The most recent consideration of the issue was in the decision of the Victorian Court of Appeal in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL*[10]*.* A court has the discretion to intervene where the facts and circumstances of a particular case warrant it. Specifically, such a duty would arise where it was necessary to protect a vulnerable party from exploitative conduct, which would subvert the original purpose for which the contract was made. The court considered the desirability of imposing a broader duty and observed that a contractual right or power should not always be fettered by an implied obligation of good faith, and an obligation of good faith should not apply indiscriminately to all the rights and powers conferred by a commercial contract. It is only where in all the circumstances it is appropriate to protect a vulnerable party from exploitative conduct which subverts the original purpose for which the contract was made. Warren CJ commented that the interests of certainty in contractual activity should be interfered with only when the relationship between the parties is unbalanced and one party is at a substantial disadvantage, or is particularly vulnerable in the prevailing context.

The application of the *Esso* decision to a franchise relationship was recently considered by the Victorian Supreme Court in *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd*[11]. In *Meridian*, the Court[12] observed that it was inappropriate to undermine the certainty and sanctity of a bargain made by equals. However the court noted that the implication of an obligation of good faith may be particularly appropriate in the context of a franchise relationship because it frequently embodies a significant disparity of bargaining power. Franchisees therefore already have access to a powerful remedy. Further legislation is not only unnecessary, but would confuse the situation. Similarly it would be wrong for the duty to apply in all cases. There are obviously circumstances in which it may be argued that a franchisee should not automatically be determined to be relevantly vulnerable or disadvantaged and therefore not entitled to the benefit of an implied term of good faith and fair dealing. For example, Master Franchisees or multi-unit franchisees are often powerful, well-resourced and hardly vulnerable or disadvantaged parties to the franchise relationship. Ultimately, each case is likely to be determined upon its own facts.

The extent to which a party has acted in good faith in its commercial dealings with another is also a specific matter to which a court is directed to take notice under section 51AC of the Trade Practices Act in determining whether that party has engaged in unconscionable conduct in all of the circumstances.[13]

A good faith obligation of indeterminate scope and meaning being imposed on franchisors, and presumably franchisees, as an explicit Code obligation would be inappropriate without explicit definition, and would invite disputation. Further, 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.

The FCA considers that the current debate has been largely ill-informed and superficial, with the concept of "good faith" having gained traction as the apparently simple solution to all the real and imagined ills within the franchise sector. It has assumed symbolic significance and if introduced would be argued to accommodate circumstances beyond any appropriate sphere of influence, eg: to give a right of renewal where such a right is not granted by the contract. If there are real, substantial and substantiated concerns they should be answered by targeted legislative responses which directly address the particular issue. There is no authoritative High Court decision and to impose a duty of good faith without clearly and precisely addressing its content would be highly undesirable. The current inquiry is, with respect, not

[9] At 30.
[10] [2004] VSC 477
[11] June 2006 - Unreported BC200605745 of Dodds-Streeton J.
[12] At paragraphs 210 – 214.
[13] Section 51AC(3)(k) & (4)(k) *Trade Practices Act* 1974 (Cth).

equipped to address these issues, which are highly technical in nature and have implications beyond the franchise sector. (For example if a franchisor has to provide a right to negotiate a new agreement at end of term to a franchisee, or compensation for not providing a new agreement, so presumably should a landlord.)

5. Interaction between the Code and Part IVA and Part V Division 1 of the Trade Practices Act 1974

The Code interacts comprehensively and logically with the other parts of the Trade Practices Act and with the law generally.

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. The FCA supports the twin pillars of the regulatory framework – to encourage responsible franchisor behaviour and effective franchisee due diligence. Both pillars are essential to ensuring the effective operation of the sector in a manner which balances regulatory intervention with commercial responsibility for business decisions.

As discussed in part 3 of this submission, the Code facilitates effective franchisee due diligence by ensuring franchisees have access to extensive information concerning the franchise and the franchisor. The Code also facilitates the validation of the information by ensuring franchisees have access to current franchisees, as well as past franchisees. If there has been history at a site or territory that specific information is also required. And importantly the Code provides for timeframes that facilitate the provision of advice prior to signing, and even a change of mind after a cooling off period.

The section 52 prohibition on misleading or deceptive conduct ensures that information must be accurate and truthful, and the prohibition on unconscionable conduct and the implied duty of good faith and fair dealing (discussed in detail in part 4 of this submission) prohibits any bullying, oppressive or grossly unreasonable conduct. These remedies are supported by the ACCC, which is an effective and well-resourced regulator. The FCA's experience of the ACCC has been overwhelmingly positive. They have not hesitated to take appropriate action when matters have been drawn to their attention, and we have seen no evidence of any claimed failure to follow through on complaints. At the same time the ACCC has acted fairly, and has not been afraid to indicate where investigations have failed to substantiate claims made by aggrieved franchisees.

Section 52 is a powerful provision that gives franchisees access to the most powerful antidote to misleading conduct in the world:-

- Reliance on misleading conduct gives rise to a variety of civil remedies including damages, rescission and contract variation.
- A s52 action can be made in respect of misleading Code disclosure or for representations external to the disclosure document.
- Actions can be brought against the company on whose behalf the representations were made or against the individual who made them.
- Actions can be private or can be brought by the ACCC in which case a representative action can be brought to obtain damages for affected parties.
- The ACCC also has a powerful instrument in s87B which provides for enforceable undertakings.
- While s52 does not give rise to criminal consequences, a serious s52 breach will probably also constitute a false representation in breach of s53, which does attract criminal liability.

The s51AC prohibition on unconscionable conduct provides further support:-

- While s52 is available for a Code disclosure misrepresentation as it is for any other misrepresentation, s51AC expressly acknowledges Code compliance. "The requirements of any applicable industry code" is one of the factors that the court may take into account in determining whether conduct is unconscionable. In the franchising context the Code is an "applicable industry code' and non-compliance with may be considered in making the overall assessment of whether conduct was, in all the circumstances, unconscionable.

Although "unconscionable conduct" has no defined or settled meaning, in the context of franchising there have been several examples where the ACCC has successfully initiated action against franchisors.

It should of course be noted that s51AC is not a franchise specific provision and applies to business generally. Therefore any recasting of the prohibition naturally transcends the current inquiry. It should also be noted that the Productivity Commission *Final Report on The Market for Retail Tenancy Leases in Australia* (27 August 2008) is unsympathetic to widespread allegations of unconscionable conduct made to it in submissions. The Overview notes that "hard bargaining and varying business fortunes should not be confused with market failure warranting government intervention to set lease terms and conditions" (pxxv) and "in this environment … it is unlikely that market tensions will be resolved or eliminated by government intervention into contracts through retail tenancy or other regulation. Regulation is not a good substitute for due diligence, the appropriate use of commercial lease advisory services and lease information---and sound business judgment".

Interestingly the Productivity Commission acknowledged that "some have suggested that the current concept of unconscionable conduct sets too high a hurdle" but concluded that "given the substantial incentive for centre landlords to settle an accusation of unconscionable conduct before it proceeds to court" the current provisions are influencing conduct and reducing costs associated with unnecessary disputation" (pxxiv). If that conclusion can be reached in relation to retail tenancies, where the negotiating imbalance and instances of behaviour are so stark, there is no justification for considering an extension of unconscionable conduct in franchising. There is indeed more evidence that the sections are having a substantial deterrent effect in franchising.

6. Dispute Resolution

The FCA supports measures to augment and further streamline dispute resolution. However we note that the level of disputation in Australian franchising is statistically very low, and compares very favourably with the levels of disputation in other jurisdictions including the USA. The FCA is comfortable with the recommendation that mediation of disputes be made mandatory, and that additional alternative dispute resolution mechanisms be considered, to allow a timely and cost effective resolution that would not disadvantage franchisees.

The FCA notes that the existing mediation based dispute resolution mechanisms are highly effective, and very low cost. The Code provides for the appointment of a mediator within three weeks from the time the complaint is issued.[14] If the parties cannot agree on who should be the mediator, the mediation advisor will appoint a mediator within 14 days.[15] The mediation based dispute resolution procedure has been extremely successful, with the Office of Mediation Adviser reporting over 80% of disputes are successfully resolved. The average cost of participation in mediation, including legal representation, would be well under $5,000, and it is possible for parties to represent themselves and reduce costs still further. In the context of an investment of several hundreds of thousands of dollars this would not seem to be prohibitive. The costs of court action, even involving an administrative tribunal, would be far higher. It is hard to imagine an effective structure that would operate at a lower average cost.

The mediation process is augmented by other dispute mechanisms. The ACCC has been an active and efficient regulator. An aggrieved franchisee can at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or Trade Practices Act. The ACCC is well regarded, is duty bound to investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act, and has a strong track record of taking enforcement action where necessary. The FCA has supplemented the ACCC and the Codes procedures with an informal dispute resolution mechanism pursuant to FCA Member standards. This includes peer counselling and mandated education.

The FCA remains open to the idea of a separate franchising arbitration system. However the FCA considers this is likely to be more costly, and there would need to be substantial further work done in relation to issues such as:

- the source of its authority;
- whether it would be legal or administrative;
- would decisions or awards be enforceable in the courts in Australia and overseas;
- how it would be funded;
- who would be appointed to it;
- where it would sit;
- how frequently it would sit;
- an indication of time frames, including waiting periods to have a matter heard, and how long a decision would take; and
- how much it would cost parties to appear before it.

Without more specific detail, it is difficult to ascertain how the current system can be further improved.

The FCA notes that the Victorian Small Business Commission provides a highly efficient and effective service that could be replicated, although the FCA is concerned that much of the success of the Victorian system has been as a result of the personal attributes of

[14] *Code*, s.29(3)(a)
[15] *Code*, s.30(1)

the incumbent. The FCA remains strongly of the view that any regulation should be solely at the Federal level.

7. The Nature of the Franchising Sector

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers involved in franchising in Australia. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. Details of the activities of the FCA can be found at www.franchise.org.au.

The FCA has as its core aim the promotion of the growth and development of franchising in Australia. The FCA believes collaboration (as opposed to an adversarial relationship) between franchisors and franchisees has been one of the reasons for the success of the Australian franchise sector, and remains critical to its future success. The FCA represents franchising, and the joint and separate interest of all stakeholders, as opposed to the interests of one component of the sector over another component.

The FCA is strongly committed to working collaboratively with Government at all levels to promote the growth and development of Australian franchising. It enjoys a productive relationship with the ACCC and the Office of Small Business, as well as other organisations such as Austrade, the Australian Taxation Office and State Government Small Business departments in each State

The FCA has always been very concerned at any allegations of inappropriate conduct in franchising. As a result, in its submission to the 2006 Federal Government Inquiry into franchising, the FCA made several recommendations to improve the Franchising Code of Conduct and provide additional information and protection to franchisees. The FCA supported the legislative amendments to the Code made by the previous Federal Government (with bi-partisan support) and which took effect March 1, 2008. Further, the FCA has introduced its own Member Standards to provide additional guidance to FCA members on what is required of franchisors, franchisees and service providers to ensure responsible franchising. The Member Standards are supported by educational programs and a complaints process that enables the FCA to remain in touch with the issues causing concern in the franchising community.

The FCA has always supported initiatives which acknowledge the need for entrepreneurial and contractual freedom but promote the two pillars upon which the current regulatory framework has been built – responsible franchisor behaviour and effective franchisee due diligence. The FCA remains committed to the promotion and development of franchising in Australia. In particular the FCA supports any improvements that can assist prospective franchisees to be better informed.

The FCA has long recognised that the success of the franchise sector is fundamentally dependent on both the entrepreneurial spirit of franchisors and the operational success of the vast majority of franchisees. It is critical that the regulatory environment give potential franchisees the confidence and security to invest without burdening franchisors, as small businesses themselves, with excessive regulatory cost or rules which stifle their entrepreneurial activities. The FCA board has identified franchisee inclusiveness as one of its top priorities. To give effect to this priority franchisee representatives have been appointed in each State, and Gloria Jeans franchisee Tony Melhem has been appointed to the FCA board to specifically represent the franchisee interests in view of the recent retirement of long time franchisee director John Longmire.

The FCA looks forward to working with this Committee and Government at all levels to assist them to understand the dynamics of franchising, improve the profitability of franchisors and franchisees, continually review the effectiveness of the regulatory framework and foster the growth and development of franchising in Australia.

Appendix 1

TERMS OF REFERENCE

The Committee is to inquire and report on the operation of the Franchising Code of Conduct, and to identify, where justified, improvements to the Code, with particular reference to:

1. the nature of the franchising industry, including the rights of both franchisors and franchisees;
2. whether an obligation for franchisors, franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code (having regard to its presence as an element in paragraph 51AC(4)(k) of the *Trade Practices Act 1974*);
3. interaction between the Code and Part IVA and Part V Division 1 of the *Trade Practices Act 1974*, particularly with regard to the obligations in section 51AC of the Act;
4. the operation of the dispute resolution provisions under Part 4 of the Code; and
5. any other related matters.

Appendix 2

Parliament of South Australia Economic and Finance Committee Inquiry into Franchises

Submission from

FRANCHISE COUNCIL OF AUSTRALIA

21 January 2008

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Executive Summary

As the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising the Franchise Council of Australia welcomes the opportunity to provide input to this Inquiry.

Industry statistics confirm that franchising continues to prosper throughout Australia, including in South Australia. The FCA does not believe there are any endemic problems in franchising, a view confirmed by the recent Federal review of the Franchising Code of Conduct. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public.

All participants in the franchise sector acknowledge that the current Federal regulatory framework is working well. The *New Deal Fair Deal* Reforms were introduced in 1998 with bi-partisan support, and the Government's legislative response which takes effect March 1, 2008 also has bi-partisan approval. The Mathews Committee Report on the operation of the Franchising Code of Conduct noted as follows:-

> "*Strong support for the Code has been registered throughout the review process. It is widely seen as pivotal to the continued success of the franchising industry".*[16]

The FCA has been strongly supportive of the current Federal regulatory framework, including the recent reforms which will provide additional protection for prospective franchisees. The FCA believes the current regulatory environment creates a fair balance between the need for effective regulation supported by a strong and well resourced regulator, and the importance of minimising compliance costs for this entrepreneurial sector. A summary of the current regulatory regime is included in section 5 of this submission, as the extent of existing protection available is often not understood by critics or the media.

The FCA is concerned to ensure that the franchise sector operates efficiently and fairly, and there is a strong positive perception of franchising in South Australia. Based on information collected by the FCA as part of its franchisee forums and in policing the FCA Member Standards the FCA does not believe there are any endemic problems in franchising that are not addressed by current regulation. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public. The FCA is not privy to the detail of complaints received by members of the Inquiry. We have endeavoured to anticipate some of the matters that might be raised, and would be pleased to provide further comment on any specific issues.

The broad position of the FCA in relation to the terms of reference for the inquiry can be summarised as follows:-

(8) The FCA does not believe that current laws disadvantage franchisees. Indeed the laws provide strong protection for franchisees. Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of that framework are discussed in detail in paragraph 4.3, and can be summarised as follows:-

- (i) the Franchising Code of Conduct requirement to provide a comprehensive disclosure document prior to a franchisee signing a franchise agreement;

[16] Foreword by Graeme Mathews, p4, Review of the Disclosure Provisions of the Franchising Code of Conduct.

(ii) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(iii) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(iv) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to prove it had reasonable grounds for making any representation as to a future event;

(v) the prohibition on unconscionable conduct in s51AC of the TPA; and

(vi) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

(9) A disclosure document prepared in accordance with the comprehensive requirements of the Franchising Code of Conduct provides sufficient information to assist a prospective franchisee to make an informed decision in relation to the franchise. The disclosure process has been further strengthened by the recent amendments to the Code which take effect March 1, 2008;

(10) The current disclosure process seems to be working well:-

(a) The FCA is not aware of any endemic problem with information quality in disclosure documentation. The Code is highly prescriptive as to the information required, the format and layout and even the headings to be used, so any deficiencies in information are readily apparent. The provision of inaccurate information would either be a breach of the Code or a breach of the Trade Practices Act. Strong sanctions apply in the event of breach, and the ACCC is a vigilant and effective regulator;

(b) The disclosure document is not intended to be the sole or authoritative source of all information. It is a starting point for the franchisee's due diligence.[17]

(11) The mediation based dispute resolution procedure set out in the Code has been extremely successful, with over 80% of disputes being successfully resolved. The cost of mediation is minimal, and far less than even the simplest court or tribunal procedure;

[17] The Code expressly notes in clause 6A the purpose of the disclosure document, being to give to a prospective franchisee "<u>information</u> from the franchisor to <u>help</u> the franchisee make a reasonably informed decision about the franchise". On the front page of every disclosure document as a mandatory requirement is a detailed statement advising that the disclosure document contains "<u>some</u> of the information you need in order to make an informed decision", and telling prospective franchisees "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>" (Underlining added to demonstrate key points.)

(12) Any aggrieved franchisee can, at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act. The ACCC is well resourced, is duty bound to investigate all claims where there is a breach of the Code or the TPA, and has a strong track record of taking enforcement action where necessary.[18]

(13) The FCA is strongly supportive of the current Federal regulatory environment. The FCA is opposed to State regulation of franchising, as franchising is essentially a national activity and there would be no issue in franchising in South Australia that would not apply across State borders.

[18] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

The Franchise Council of Australia

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers involved in franchising in Australia. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. Details of the activities of the FCA can be found at www.franchise.org.au Additional information on the FCA and a list of current members of the FCA are set out in the Report on the Current State of Australian Franchising in Appendix 1.

The FCA has as its core aim the promotion of the growth and development of franchising in Australia.

The FCA believes collaboration (as opposed to an adversarial relationship) between franchisors and franchisees has been one of the reasons for the success of the Australian franchise sector, and remains critical to its future success. The FCA represents franchising, and the joint and separate interests of all stakeholders, as opposed to the interests of one component of the sector over another component.

The Parliament of South Australia has indicated it wishes to consider existing laws in terms of whether they disadvantage franchisees or provide insufficient protection for franchisees. Press reports have quoted instances of alleged inappropriate behaviour by franchisors as the cause of failure of some franchisees, although no specific detail has been provided. These are important issues for the franchising community. The FCA would like to work with the members of the Inquiry to better understand the nature of the issues that have been raised with them, and provide input into the best manner of resolving any identified problems. The FCA can also play an important role in helping the Inquiry to verify the accuracy of representations made to the Inquiry, as in our experience there can often be a divergence between assertions and fact. Some of the franchising matters that have received extensive media publicity are being promoted by people with an often undisclosed self-interest in fermenting discontent and an adversarial approach to franchising. The FCA can help the Inquiry to sift through to the real facts.

The FCA has always been very concerned at any allegations of inappropriate conduct in franchising. As a result, in its submission to the recent Federal Government Inquiry into franchising, the FCA made several recommendations to improve the Franchising Code of Conduct and provide additional information and protection to franchisees. The FCA supported the legislative amendments to the Code made by the Federal Government (with bi-partisan support) and which take effect March 1, 2008. Further, the FCA has introduced its own Member Standards to provide additional guidance to FCA members on what is required of franchisors, franchisees and service providers to ensure responsible franchising. The Member Standards are supported by educational programs and a complaints process that enables the FCA to remain in touch with the issues causing concern in the franchising community.

The FCA is actively seeking information from its franchisee community as to the issues relevant to its franchisee stakeholders, including matters before this Inquiry. It has already conducted franchisee forums around the country, and this submission has drawn from that input. More broadly the FCA board has identified franchisee inclusiveness as one of its top priorities for the ensuing year. To give effect to this priority franchisee representatives have been appointed in each State, and Gloria Jeans franchisee Tony Melhem has been appointed to the FCA board to specifically represent the franchisee interests in view of the recent retirement of long time franchisee director John Longmire.

The FCA looks forward to working with the Inquiry and the South Australian Government to assist them to meet the objectives of the Inquiry and more broadly to foster the growth and development of franchising in South Australia.

The Development of Australian Franchising

The franchise sector in Australia makes a very substantial contribution to the Australian economy. Industry turnover is estimated at $111.5 Billion, or 3.2% of Australian Gross Domestic Product. The sector has around 1,000 franchise systems, 60,000 units and employs 600,000 people. The indirect impact of franchising is estimated at 1.5 times these figures.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. Since 1998 the sector has not only grown, but matured and developed into one of the primary engines for economic growth in Australia. We have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practice.

The FCA is a strong supporter of the regulatory framework established by the Federal Government in 1998. It considers the *New Deal Fair Deal* reforms have made a very important contribution to the success of Australian franchising. The FCA believes that Australia's regulatory framework represents world's best practice in terms of striking a balance between strong and effective regulation and the fundamental principles of free enterprise. It features the comprehensive Franchising Code of Conduct requirements, which are administered by the ACCC. In addition to the Code, the Commonwealth Trade Practices Act's prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions.

The FCA believes that franchisors that break the law must be strongly punished, as their conduct affects the general reputation of the sector and the value of the assets of reputable franchisors and franchisees. The FCA has been supportive of ACCC enforcement action. The ACCC has moved quickly, such that there has not often been a need for civil action by franchisees. Interestingly, in the vast majority of cases where either a franchisee or the ACCC have taken court action they have been successful. Importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA does not pretend that franchising is perfect, and indeed has been at pains to ensure that potential franchisees are not lured to the sector by a belief in the infallibility of a franchised business. The FCA, and more recently the ACCC, have emphasised that franchising not only requires responsible franchisor behaviour, but proper franchisee due diligence. Many of the problems the FCA sees in franchising would not have arisen had the potential franchisee sought appropriate specialist legal and business advice and undertaken proper due diligence prior to purchasing the franchise. This remains probably the biggest ongoing challenge for the sector.

The Current Regulatory Environment

5.2 Balancing contractual freedom and regulation

The FCA is strongly supportive of the current regulatory environment. In our view it strikes an ideal balance between contractual freedom and flexibility that encourages growth and entrepreneurial behaviour, and regulatory intervention to support the contractual process and ensure informed and fair bargains are made.

The FCA believes that the two key principles that underlie effective franchising are responsible franchisor behaviour, and proper franchisee due diligence and risk awareness. The Code and the TPA prohibitions on misleading or deceptive conduct and unconscionable conduct support these principles, and do not undermine the important principle of freedom of contract. The Code requires responsible and lawful franchisor behaviour through a comprehensive disclosure regime, mandatory mediation based dispute resolution, constraints on restricting transfer and controls on termination. The Code facilitates proper franchisee due diligence and risk awareness by providing extensive information and franchisee contact details in the disclosure document, and creating a framework for franchisees to obtain independent advice and then sign (with the protection of the 14 day disclosure period and the 7 day cooling off period) without undue haste.

The FCA believes the Franchising Code of Conduct and the Trade Practices Act provide important protection for franchisees, and the ACCC has been a highly effective industry regulator. Australia's level of disputation, at just over 1%, is substantially lower than the US, which is estimated by the International Franchise Association at around 6%. Further, over 80% of disputes in Australia are successful resolved by mediation, whereas in the US arbitration and litigation are the more dispute resolution common methods. Another encouraging statistic is that the level of franchising complaints to the ACCC continue to fall, and is at historically low levels notwithstanding the substantially increased high profile of the ACCC. As a consequence the FCA considers Australian franchising is world's best practice.

The regulatory framework has only recently been comprehensively reviewed at a Federal level. The FCA supported the review of the Code conducted in 2006, and the Federal Government's response. These amendments take effect March 1, 2008. Obviously any review by this Inquiry needs to take into consideration the fact that these reforms, which include additional disclosure requirements in areas such as rebates and former franchisee information, have yet to take effect. Fundamentally the FCA believes the recently improved disclosure provisions in the Code are adequate and work well for the market.

The danger with any review is that regulatory change will be recommended without proper analysis of the nature and extent of any problem or assessment of the regulatory impact and cost. Given the objective evidence available as to the overall healthy state of the sector any recommendations should only be made after very careful analysis, properly tested evidence and having regard to the impact and cost of any proposed change.

5.3 State regulation of franchising

Although the FCA welcomes the interest shown by the South Australian Government in franchising, and is appreciative of the opportunity to discuss franchising issues with the Inquiry, the FCA is strongly supportive of the regulation of franchising solely at a national level.

There would be no issues in franchising in South Australia that would be unique to the South Australian market. Over 95% of franchisors are small businesses, and they have limited capacity to absorb the costs of excessive regulation. Most franchise systems operate, or at the very least intend to operate, across State boundaries. State regulation of franchising would create unnecessary duplication and cost at a time when all Governments are championing a reduction in regulatory red tape.

On this point, and although only generally relevant, we note that the costs of regulatory duplication have been independently recognised quite recently. In early December the Productivity Commission released a report that estimated that the concurrent regulation of consumer affairs at Federal and State level cost an estimated $4.9 billion above the cost of a unified Federal scheme. The franchise sector cannot afford even a fraction of this additional cost, and the FCA and its members would strongly resist any attempt to regulate at a State level given the existence of the current Federal regime.

It is also useful to consider the US experience, where they do have concurrent Federal and State regulation. According to the International Franchise Association the consequence of inappropriate State legislation is not only substantial extra compliance cost, but often that franchise systems simply withdraw from business activities in that State. For example the damage to the State of Iowa due to the introduction of its franchise legislation has been significant, with 135 companies reducing or halting expansion in Iowa, with a consequent cost of $207 million in lost sales and 7,500 jobs. 27 US States have since rejected Iowa type laws, and the legislation has been broadly condemned.

5.4 Understanding the current regulatory environment

Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of that framework are:-

(1) the Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. In addition to typical requirements to disclose the franchisor's business background, relevant financial information, previous litigation and solvency history and other relevant matters the Code uniquely requires the franchisor to:

   (a) include a list and contact details of existing franchisees, which facilitates contact with those parties as part of due diligence. As of March 1, 2008 franchisors will also have to disclose details of former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence; and

   (b) requires a director to certify the solvency of the franchisor as at the end of the last financial year, which provides considerable additional comfort to prospective franchisees.

(2) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(3) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(4) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to prove it had reasonable grounds for making any representation as to a future event;

(5) the prohibition on unconscionable conduct in s51AC of the TPA; and

(6) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct.

The history of litigation in franchising shows that this protection is meaningful and effective. In the vast majority of cases where either a franchisee or the ACCC has taken court action they have been successful.[19] More importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA contends that these statistics clearly demonstrate that franchisees are not disadvantaged by current laws, and that current laws provide strong protection against franchisors that act unlawfully. The dispute resolution mechanisms are world's best practice in terms of success and cost effectiveness, and franchisees have ready access to low cost remedies such as mediation. The ACCC is an active, expert and well-resourced regulator that is duty bound to investigate, at no cost to a franchisee, any allegation that a franchisor has breached the Code or the TPA.

The FCA has enacted its own Member Standards to supplement these statutory remedies, and provide some additional remedies. Again there is no cost to a complainant.

5.5 Disclosure as part of the contractual process

The Code not only facilitates the provision of extensive information through the disclosure document, but does so as part of a process that is designed to ensure as far as is reasonably possible that a prospective franchisee makes an informed decision to purchase the franchise. The information to be disclosed includes a list with contact details of existing franchisees, which enables a prospective franchisee to make contact with those actually involved in the business to verify any information provided by the franchisor. From March 1, 2008 this requirement is extended to include a list of former franchisees. The disclosure document must be provided at least 14 days prior to signing the franchise agreement, which allows ample time to obtain advice and avoids the risk of high pressure selling. Even then there is a mandatory 7 day cooling off period, so that a franchisee can essentially change its mind and exit the arrangement without penalty.

Importantly disclosure is intended only as part of the franchisee's due diligence process. The Code expressly notes in clause 6A the purpose of the disclosure document, being to give to a prospective franchisee "<u>information</u> from the franchisor to <u>help</u> the franchisee make a reasonably informed decision about the franchise". On the front page of every disclosure document as a mandatory requirement is a detailed statement advising that the disclosure document contains "<u>some</u> of the information you need in order to make an informed decision", and telling prospective franchisees "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

[19] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

The advice process established by the Code is intended to reinforce the disclosure process by endeavouring to ensure the disclosure document and other information is not only read and understood by the franchisee, but considered by an independent legal, business and accounting adviser. A franchisor must receive from a prospective franchisee before signing the franchise agreement a certificate that the franchisee has either obtained advice, or been told that the advice should be sought but has decided not to seek it. It is hard to imagine a more comprehensive process. Indeed no other regulatory regime in Australia, and probably in the world, combines the concepts of disclosure, advice and pre-contractual certification so comprehensively. The concepts of cooling off, legal and business advice and disclosure of former franchisees are uniquely Australian.

5.6 Disclosure and compliance costs

There are currently over 250 separate pieces of information to be included in the disclosure document, which must be in a prescribed order and layout. No doubt there are other pieces of information that could be included. However any change to the current format will result in compliance costs not just in making changes to the document, but in accessing the necessary information and recording information for future documents. Depending on the nature of the information franchisors may not have kept records on the matter, so information may need to be accessed from archives or other records, at substantial cost. Any additional disclosure obligations must be considered in the context of the relevant compliance costs. This issue is particularly relevant given the stated purpose of the Code, being to provide “some” of the relevant information, as opposed to “all” relevant information.

5.7 Current complaints

Current research and anecdotal evidence from those associated with franchise complaints confirms that the level of complaints is low. Statistically franchisee non-compliance with the system has in fact been identified as the most significant cause of disputes. Anecdotally there also appears to be a strong correlation between complaints and a failure on the part of the franchisee to conduct due diligence and obtain independent legal, accounting and business advice.

As mentioned above, the FCA has itself received complaints from various parties involved in franchising since the launch of its Member Standards in 2005. On investigation many of the allegations of franchisor misconduct, including those that have achieved significant press coverage, have not in fact been substantiated. Further, where misconduct may have occurred, existing legal remedies were already available and appeared adequate. Interestingly, on a cursory analysis, few of the apparent root causes for the complaint appeared to relate to inadequate disclosure, but rather:-

- unwise investment decisions where a franchisee failed to undertake due diligence or seek independent legal, business and accounting advice prior to entering into the commercial arrangements;

- differences of commercial opinion as part of the ongoing franchise relationship;

- conduct by a franchisor that would appear to be illegal by virtue either of the Code or s52 of the Trade Practices Act;

- conduct of third parties such as landlords;

- mismatched expectations of business success or an underestimation of the amount of work required to achieve success;

- cost overruns in establishment costs or underestimation of start-up costs including working capital.

The FCA recognises that there have been in recent times a handful of quite public allegations of inappropriate business conduct in franchising. No doubt there are instances of inappropriate behaviour that have not come to our attention. However these complaints need to be considered in the context of the 60,000 franchisees and almost 1,000 franchise systems. Given the size of the market and the interdependent and long-term nature of the franchise relationship, often described as a business marriage, the divorce statistics in franchising are remarkably low.

5.8 Consultation and member input

The FCA submission was prepared after extensive consultation with its membership and is intended to compliment and provide background for the formal meetings with the Inquiry. It provides an overview of the sector and will identify many of the issues before the market at the moment and will also suggest some of the weaknesses in the current system.

The FCA has included with this submission some additional material providing background, or addressing specific issues. Although these documents have been prepared for other purposes it was felt that their inclusion was appropriate to assist the Inquiry in its deliberations and enable the Inquiry to gain a greater understanding of the issues before the sector. These important appendices include:

- An industry report on the current state of Australian franchising; and
- The FCA Member Standards and complaint process

We have also provided in section 5 below a commentary on the existing disclosure provisions to help the Inquiry in its deliberations.

We would welcome the opportunity to address any queries arising from our submission, or to respond to matters raised by any other submissions. We would also welcome the opportunity to provide input form the perspective of practising franchisors and franchisees to any proposed recommendations of the Inquiry to Government. Our position, and indeed our corporate objective as an organisation, is that we will support any initiative that is in the best interests of Australian franchising.

Disclosure Under the Franchising Code of Conduct

5.9 Introduction

The Franchising Code of Conduct provides a comprehensive regime of disclosure unparalleled in the Australian legal system.

Disclosure underpins the operation and effectiveness of the Code, and supports the fundamental legal principle that whilst freedom of contract should apply, contracts should be made between informed parties. The disclosure process is supplemented by a legal advice process to further ensure the parties have the opportunity to be fully informed.

This regime is even more effective when seen in the context of the general prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act and supporting provisions. Even without the disclosure obligation contained in the Code, the prohibition on misleading or deceptive conduct as interpreted by Australian courts of itself prevents a franchisor from providing information that is false, misleading or deceptive. It also probably prevents a franchisor from withholding information that is material and relevant to the decision, as in relationships such as a franchise relationship the courts have been prepared to find that silence of itself can be misleading. This would particularly be the case given the existence of the Code – if the franchisor is in possession of any material and relevant information that contradicts or renders misleading any information contained in the disclosure document the franchisor would be exposed to a misleading conduct claim if the franchisor did not disclose it.

5.10 The Effectiveness of Disclosure

The effectiveness of the Code's disclosure process should fairly be judged against the stated purpose contained in clause 6A of the Code, which provides (paraphrased, and with emphasis added):

The purposes of a disclosure document are:-

*1.1.1.1 to give to a prospective franchisee … **information** from the franchisor to **help** the franchisee make a **reasonably informed** decision about the franchise; and*

*1.1.1.2 to give a franchisee **current information** from the franchisor that is material to the running of the franchised business.*

It is clear from an analysis of this purpose, noting in particular words that have deliberately not been used, that:-

(1) the requirement is to provide "information", which can fairly be read as meaning "some" as opposed to "all" or even "current" information. [20]

(2) The disclosure document is intended to "help", not "ensure" the franchisee makes a reasonably informed decision; and

(3) The decision is to be "reasonably informed", as opposed to "fully" informed.

In other words the Code sees the disclosure document as an aid to the decision, and a starting point for the franchisee's own due diligence. Clause 11 supports this intention by establishing an advice process aimed at ensuring prospective franchisees understand that they should obtain legal, business and accounting advice.

[20] The requirement in (b) for "current" information relates only to information relevant to running the business, as opposed to the decision to purchase. The generally accepted interpretation of (b) is that it is intended to provide a purpose to renewal and extension of an existing franchise, as opposed to a grant of a new franchise where (a) is relevant, and to the obligation contained in clause 19 to provide a current disclosure document to any existing franchisee on request.

The disclosure document is clearly not intended to be exhaustive. Further the specific obligation to update the document annually, and for only limited continuous disclosure of materially relevant facts under clause 18 of the Code, shows it is only intended to be relatively current. The information is intended to relate to the franchise system and agreement generally and the business history and other details of the franchisor. Investment information is intended to show a range and relate to the overall nature of the business as opposed to the specific franchisee being purchased by an individual franchisee.

In evaluating the effectiveness of disclosure against the stated purposes, it is suggested that there should be two main criteria – the structure of the disclosure requirements, and the substance of disclosure. Each factor is considered below.

5.11 The Structure of Disclosure

The requirement to provide a disclosure document and make ongoing disclosure of certain materially relevant facts is similar to disclosure regimes applying under the Corporations Act in the fundraising and financial services arena. However the franchising disclosure regime is supplemented by a requirement for advice before entering into a franchise agreement that is unique in Australia, and indeed in the world. This system is further supplemented by a 7 day cooling off process that enables the franchisee to terminate the franchise agreement without cause.

Conceptually it is difficult to see how the structure of the disclosure arrangements could be improved:-

- The disclosure document is in writing, the format and layout of the document is prescribed and the document is indexed, thereby facilitating ease of review and comparison with other systems. (Interestingly no such requirements apply under corporate law disclosure.)

- The disclosure process allows a mandatory 14 day period between provision of disclosure and signing, which is ample time for consideration and to obtain advice. (Again no such requirement exists under corporate disclosure.)

- The disclosure process applies not just to grants of franchises, but renewals and extensions and to the making of any non-refundable payment. It is therefore comprehensive;

- The requirement for advice extends to legal, business and accounting advice, which is all that any prospective franchisee would fairly expect to require. (By way of comparison the advice certificate process instituted by many banks, which is generally considered to be an industry best practice benchmark, relates only to legal advice. No legal advice requirement exists under corporate law disclosure.)

- Although the franchisor is entitled to enter into a franchise agreement if advice is not obtained, it is only able to do so if the franchisee confirms in writing that the franchisee has been told that the particular kind of advice should be sought, “but has elected not to seek it.” This places a strong obligation on the franchisor to “tell” the franchisee advice “should be sought”, and is a clear warning to prospective franchisees. Arguably any prospective franchisee that proceeds without getting advice could legitimately be expected to accept responsibility for such a decision.

The only area for possible structural improvement would be to remove the discretion for a franchisee to elect not to seek advice. The proposal to make the obtaining of advice a mandatory requirement is supported by the FCA because the FCA believes that this would in fact actually reduce even further the opportunity for mismatched expectations. However the FCA considers that some due diligence responsibility must be accepted by prospective franchisees. Arguably this responsibility should apply to a franchisee that elects at the franchisee's peril not to seek advice despite being told to do so.

5.12 The Substance of Disclosure

The franchisor and franchisee are entering into a written contractual relationship. The fundamental rights and obligations of the parties will be set out in the contract, and the parties are free to include in the contract such provisions as they shall consider appropriate, subject to law and the specific requirements of the Code. The principle of freedom of contract underpins all business dealings, and is recognised by the nature of the disclosure obligations under the Code.

The Code also acknowledges that the principles of privity of contract are relevant to disclosure. For the most part disclosure needs to focus on the intended party to the franchise agreement, being the franchisor. Any departure from this principle needs to be justifiable in terms of relevance to the overall relationship or the decision to purchase the franchise.

5.13 The prescriptive nature of disclosure

Annexure 1 to the Code sets out the substantive disclosure requirements. The disclosure document must be in the form and order and using the headings set out in Annexure 1. The following comments are offered in the context of considering the substance of disclosure:

1. First page

The mandatory preamble reinforces the intent that the decision is "**a serious undertaking"** and "**legally binding"**, the disclosure document contains "**some"** of the information you need and the decision should be "**informed"**.

The preamble specifically advises franchisees to **"read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with the requirements of a franchised business."**

The franchisor contact detail, signature and preparation date requirements are non-controversial and sensible.

2. Franchisor details

These requirements are relatively standard internationally. They provide information on the franchisor and all associates. Further information could be obtained by company and other searches as part of due diligence if relevant.

3. Business experience

Again these requirements are relatively standard internationally. They provide information on the business experience of the people likely to be involved in the business. Further information could be obtained if desired as part of due diligence by seeking references, asking questions to the franchisor or via industry associations.

It may be useful to extend clause 3.2(b) beyond just the franchisor to at least associated companies if not associated individuals as well.

4. Litigation

These requirements are relatively standard internationally. They provide information on the franchisor. Further information could be obtained by company, court record and other searches as part of due diligence if relevant. The nature of proceedings to be disclosed is extensive and would appear to cover any claim likely to be relevant to a franchisor.

At the suggestion of the FCA the Federal Government has extended (with effect from March 1, 2008) the obligations in clause 4.1 beyond just the franchisor to franchisor directors, enhancing disclosure.

5. Payments to agents

The FCA suggested to the Mathews Committee that it may be appropriate to add the words “and the nature or purpose of the payment” at the end of the sentence concerning disclosure to agents. This is not known to be an area of great concern for prospective franchisees, and was not either recommended by the Mathews Committee or implemented by the Government.

6. Existing franchisees

This is a comprehensive and important provision that supports and facilitates the exhortation contained in clause 1 for the prospective franchisee to contact existing franchisees.

The FCA suggested to the Mathews Committee that clause 6.4 may be able to be improved, as the categories are somewhat ambiguous and overlapping. There is some argument that the substance of disclosure could be improved in this area. To assist franchisors complete this section accurately perhaps additional guidance could be provided, and franchisor’s encouraged to choose the primary category. However compliance costs need to be considered, as franchisor’s current recordkeeping systems will be structured around the existing categories and some adjustment time would be required should any changes be made.

The FCA supports the Government’s changes (effective March 1, 2008) to include a requirement for the franchisor to disclose contact details of former franchisees as well as existing franchisees.

7. Intellectual property

This section is comprehensive and important. We are not aware of any compliance issues.

8. Franchise site or territory

This section is comprehensive and important. We are not aware of any compliance issues.

9. Supply of goods or services to a franchisee

Disclosure in this section is comprehensive and important. It links in to other sections of the Trade Practices Act, in that admissions made in answer to what are very specific questions can immediately alert advisors or indeed any investigating regulator to any potential breaches of the law. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

The March 2008 Code changes will further tighten the requirements concerning disclosure of rebates to require disclosure of the name of the business providing the rebate.

The FCA’s view is that the Trade Practices Act has a comprehensive and powerful array of remedies relating to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct to address pricing and supply issues. Franchising is no different to other forms of commerce, and no further action is required in this area.

10. Supply of goods or services by a franchisee

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

11. Sites or territories

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

12. Marketing or other cooperative funds

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

13. Payments

13.1 Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

13.2 As above.

13.3 The difficulty with disclosure in this area is that the disclosure is an overarching document intended to apply to every franchise granted. It is not intended to provide exact or specific information on the particular franchise involved, as to do so would be impossible. The information provided is a "range", and is intended only as a guide. Prospective franchisees and their advisors would secure more than enough initial information to make their own calculations and seek any additional information. Although at first glance there is potential for a prospective franchisee to be misled as to actual costs in relation to their particular investment, the s52 prohibition on misleading or deceptive conduct would provide a more than adequate remedy. The Code provides an excellent starting point, and the categories are comprehensive.

13.4 See above.

13.5 See above.

13.6 See above.

13.7 See above.

13.8 See above

14. Financing

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

15. Franchisor's obligations

A copy of the franchise agreement must be provided with the disclosure document. The franchise agreement is normally already indexed, and it is a legitimate expectation of the franchisor that the prospective franchisee will read the agreement before signing.

16. Franchisee's obligations

See 15 above.

17. Summary of other conditions of agreement

See 15 above.

18. Obligations to sign related agreements

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

19. Earnings information

This clause largely repeats existing law, and fundamentally serves as a reminder to franchisors in the context of potential claims under s52 and s51A of the Trade Practices Act. Any breach of this section of the Code would almost certainly be a breach of s52 or s51A. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

20. Financial details

20.1 This is an important and often overlooked additional protection provided to franchisees, as it is in effect an annual solvency warranty. It goes far beyond disclosure, and gives franchisees substantial additional legal rights.

20.2 Although there are practical problems sometimes encountered under this section, for the purposes of the current disclosure review disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

20.3 See above.

21. Updates

Disclosure is adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

22. Other relevant disclosure information

This clause is procedural and self-explanatory.

23. Receipt

This clause is procedural and self-explanatory.

General remarks and observations

The FCA has learnt from past experience that a number of matters are consistently raised by people who make representation to franchising inquiries. We felt it may assist the Inquiry if we provided our comments on some of these issues in anticipation. We would of course be prepared to expand upon our comments at any time.

The substance of previous inquiries into franchising.	The Howard Government in 1998 introduced the New Deal Fair Deal reform package, which was focused on improving trading conditions for small business. This followed a comprehensive Parliamentary Inquiry into the franchise sector. This Inquiry took evidence from all major cities and recorded over two hundred submissions. The Mathews Committee review of the Franchising Code of Conduct commenced in late 2006, and the Government's legislative response will take effect March 1, 2008. The Code amendments have bi-partisan support, and are well accepted in the franchise sector.
Disputation in franchising	Disputation is low by world standards. Research indicates a significant drop in disputation and an increase in mediation services to resolve franchise disputes as forecasted by the Parliamentary Committee when it recommended such action. Griffith University research indicates that disputes are less than 1%, with 30% of that 1% being listed as action taken by the franchisor for lack of system compliance by the franchisee. This means that the majority of disputes happen when franchisees do not follow the prescribed system, the very essence of franchising.
Good faith should apply on termination of a franchise agreement	There is currently a dispute between a major franchisee of KFC restaurants and franchisor Yum brands that has been a significant reason behind the establishment of the WA inquiry into franchising. In summary, the franchisee (which is a very substantial corporation) is arguing that Yum should have to negotiate with it at the end of a franchise term to either grant a further term, or pay compensation including goodwill if the franchisor wishes to take over the sites. It is being suggested that Government legislate to create a specific statutory good faith obligation to negotiate at the end of term for a renewal. The High Court of Australia has ruled on this issue, and the law is clear – once a franchise term ends, it ends. This level of certainty enables all those involved in franchising to understand their legal rights, and negotiate accordingly. The FCA strongly opposes any move to create a statutory right that would thereby advantage one party to a contract over another. The FCA understands that this is not a significant issue in the eyes of the SA Inquiry. If it is, the FCA would be pleased to expand upon its views.
Media coverage of alleged problems	In recent times, amongst the overwhelmingly positive coverage the franchise sector has received, some media commentators have reported alleged problems within the franchise sector. A number of major franchise systems have been named as having ongoing franchise disputes, but little has been provided by way of specifics. The FCA has seen little factual support for these claims. Indeed to date the FCA has been satisfied with all explanations provided when it contacted the franchise systems in question for their comment. It would appear that there has been a rather orchestrated and consistent email campaign from a small group of

disgruntled former franchisees, and encouraged by journalists keen to publish unsubstantiated assertions rather than investigate the facts.

Some media commentators have questioned the Code, without conducting any real analysis of indeed demonstrating any real understanding of how the Code operates, and called in a very non-specific way for reform. Others have criticised the ACCC, and challenged the effectiveness of the mediation system.

This is legitimate media behaviour, and to some extent a consequence of the many success stories in franchising. Journalists feel the need to try and balance the ledger. However media reports should not be the basis of policy changes. The FCA accepts that media comment may have played a part in the convening of the Inquiry, but it should play no part in its recommendations or the action Government takes in response to the Inquiries recommendations.

Questions on the effectiveness of the ACCC

The ACCC has been active in taking action against franchisors that have breached the law, having undertaken around 20 effective prosecutions. Complainants who challenge the effectiveness of the ACCC seem to treat this number as proof of the ACCC's inaction, when in the FCA's opinion it is reflective of the generally excellent standards of behaviour within the sector. The ACCC has moved very quickly in all cases, and set clear precedent in the areas of Code compliance and unconscionable conduct that benefit all in the franchise sector.

The ACCC has recently instituted a process for providing a more transparent record of its enforcement activity. To some extent this was driven by a desire to correct misinformation being publicly circulated about the ACCC's activities, and the behaviour of franchisors entities under investigation. A review of this section of the ACCC website will show that the ACCC has been thorough and professional in its activities. The ACCC has also commented publicly that there have been significant differences between assertions of fact published in the media in relation to various companies, and the facts as established by ACCC investigations.

Since 2002 the ACCC has provided leadership on the management of the Code with regular meetings with the franchise sector with its Franchise Consultative Committee. This Committee meets twice a year to discuss issues pertaining to the sector. From these meetings there have been a number of initiatives have been instigated. The FCA Member Standards were introduced to endeavour to further improve industry behaviour and address matters that, whilst not breaches of the law, might benefit from some form of third party intervention. The ACCC has recently introduced its Franchisee Start Up Checklist, and there are various educational initiatives in progress.

Is there sufficient pre-entry education of franchisees?

No. Education has been determined to be critically important for the future development of the sector, in particular education of pre-entry franchisees. The FCA has proposed many initiatives, but funding has not been made available. The FCA focuses upon educating our franchisor members about best practice, and those initiatives are ongoing. We, the ACCC and others have also focused on providing extensive information to prospective franchisees via our participation at franchise exhibitions, our FCA website and our publications. Prospective franchisees these days are as a result much better informed than has ever been the case, a fact verified by our franchisor members in industry forums. With full employment, franchisee recruitment is a competitive business and standards are continually rising not to meet compliance obligations, but to secure the best franchisees by providing the best returns and security of investment.

Do existing laws prevent “churning” in franchising.

Yes they do. Prior to 1998 there were allegations of "churning" in franchising in Australia. What was happening, in a small number of franchise systems, was that franchisors were in essence selling franchises that were not viable. When the franchisee failed, the franchisor in essence resold the same franchise. This happened in particular in the service sector, where the costs of the franchise were relatively low and there were not premises or other complications. Although franchisees lost money, and would have had a pretty good legal claim under s52 of the Trade Practices Act, the cost of legal action to recover perhaps $20,000 - $30,000 was somewhat prohibitive, particularly as the franchisors themselves were often marginal in terms of asset backing.

The Government quite rightly addressed these issues in the New Deal Fair Deal reforms, which included the Franchising Code of Conduct but also featured a new prohibition on unconscionable conduct and provided increased funding for the ACCC to regulate the sector. The Franchise Council of Australia also acted, including a specific prohibition in their Member Standards on selling a franchise when there was no reasonable prospect of it being profitable.

The reforms in 1998 have strengthened the law and protected franchisees in the following specific areas:-

the mere introduction of the Code, backed by the ACCC's careful supervisory eye, has introduced barriers to entry for franchise systems that keep out most of the marginal operators;

any allegation of "churning" in Australia post 1998 would constitute a clear breach of not just the Code, but s52 of the TPA and probably s51AC (unconscionable conduct). The ACCC would therefore have to become involved on receipt of any complaint;

the ACCC has done an excellent job of enforcement. As soon as the ACCC receives a complaint alleging breach of the law they act promptly and professionally.

the Code requires specific disclosure of the history of a particular premises or site. This has been augmented by the most recent reforms;

the franchisor has to provide substantial information concerning its financial history, in fact over 250 separate pieces of information;

the Code requires specific disclosure of franchisee exits. This has been further augmented by the most recent reforms, which in effect enable a prospective franchisee to contact all recent previous franchisees including those who may have departed the system.

The commercial reality is that franchise systems get no financial or other joy from the business failure of a franchisee. Invariably the franchisors lose money as well, through unpaid royalties, the costs of operating the business while a solution is sought, the costs of recruiting and training a new franchisee, the cost of concessions given to any new franchisee to get the business back up and running etc.

Systematic failure, or unsolvable problems?

The Inquiry will no doubt receive submissions from various parties asserting that the current regulatory framework is inadequate. The real issue to determine is whether, in the context of the stated objectives of the Code, there is a systemic problem within the sector that requires change to a successful regulatory structure. The FCA is not privy to all submissions, so cannot provide a pre-determined response. However our own experiences with the FCA Member Standards provides some insight into the likely nature of submissions you will receive. To the extent that they are of commercial substance they are likely in the main to relate to matters already covered within the Code, to matters that would be a breach of existing law such as the Trade Practices Act, to conduct of third parties such as landlords, to matters that resulted from poor franchisee due diligence or to matters for which it would be almost impossible to provide any legislative protection.

Any change will create costs

It should be recognised the cost of compliance is already quite high, and any changes at all will add to the cost. The FCA and its members would strongly resist any proposal which increased compliance cost in a sector already burdened with comprehensive Federal Government compliance.

"Franchisor does not fully disclose"

The Code requires franchisors to disclose more than 250 items as a starting point to the franchisee's due diligence. The disclosure document is not intended to be an exhaustive source of all information – as stated on the front page it provide "<u>some</u>" of the information required to make an informed decision. Franchisees must accept responsibility for the investment decision. They cannot simply assert that the franchisor did not "fully disclose." Franchisees are clearly warned to "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

Further,s52 of the TPA applies to disclosure. Irrespective of the Code requirements, if a franchisor provides a compliance disclosure document but fails to disclosure a material fact that would have altered the franchisee's decision to proceed the franchisor is likely to have breached s52 of the TPA. The Code does not provide a defence to a s52 claim – that claim is judged on its separate merits.

The Code provides for the franchisee to seek legal, business and accounting advice. If advice is obtained any non-disclosure would be apparent to the relevant expert, and therefore the franchisee.

"Franchisor does not disclose trading figures"

Many franchise systems do provide historical trading figures as a matter of course, whilst others will provide them on request. There is no obligation on a franchisor to do so, and considerable risk in the context of a potential s52 claim should the franchisor provide any financial information. Such an obligation could not be mandated in the Code, as it would expose franchisors to unreasonable compliance costs and liability. A prospective franchisee has access to existing franchisees, and can thereby obtain much of this information other than via the franchisor. Ultimately this is a factor for the franchisee to consider when making an informed decision – if figures can not be substantiated, the franchisee should not proceed.

The franchisor is restricted in providing income projections by the Code and is restricted to historical information unless the franchisor wishes to take on the additional liability for projections contained in s51A of the TPA. Some franchisors provide a variety of trading actuals from franchisees within the system. Others provide full disclosure of all franchisees trading. Others provide nothing fearing the implications of Section 51A and 52 of the Trade Practices Act.

"Poor advice received"

Such an assertion should be treated with caution. It is true that the quality of understanding of franchising outside the franchise sector, and indeed possibly within it, is variable. However most advisers would have professional indemnity cover should poor advise be provided.

A far bigger problem is franchisees failing to seek advice.

There is an argument that franchise advice and education should be mandatory prior to entry into a franchise system however this then becomes a philosophical question which raises issues of government control in the economic structure of the country. Education is vital but should it be mandatory?

The FCA is currently establishing an accreditation system for those providing advice to franchisees, and is broadening its educational activities to legal and accounting professional bodies. The FCA considers no other action is necessary.

"the Franchisor has too much power"

The relationship between the franchisor and the franchisee is a contractual relationship akin to a commercial partnership. It is not a relationship of equals. The franchisor generally has more risk and money invested, has developed the brand and requires trading consistency within the market. Therefore the franchise business format model requires the franchisor to control aspects of the franchisee's behaviour that are relevant to the brand and the performance of the network. Decisions may need to be made that could affect the franchisee. This is the nature of franchising, and is clearly outlined within the franchise agreement. It should not be a surprise if a franchisee has undertaken appropriate due diligence.

Understanding the franchise relationship and the rights the franchisee has is a vital element within the relationship and this is why the Government advised franchisees to seek advice prior to entering the agreement. If a franchisee does not seek advice and then disputes the franchise agreement and the Disclosure document - is this the franchisor's responsibility of the franchisee's?

Retail Leasing Issues

As identified in the Fair Trading Inquiry in 1997, the practice of the landlords in major shopping centres continues to impact upon the relationship between the franchisor and the franchisee. The Landlord has monopolistic powers within standalone shopping centres and although most state legislation seems adequate the manipulative powers of the landlord prevails.

State legislation does not address the three major issues:

excessive rent reviews;

inadequate tenure and lease terms; and

- unequal information and bargaining power.

Issues of lease renewal and other tenancy matters can impact upon a franchisee and they can remain captive to a site because of the power the landlord has which therefore impacts upon the Franchising Code of Conduct provisions and the relationship between the franchisor and franchisee.

In its submission to the Mathews Committee the FCA recommended that the Federal Government review the retail leasing market and introduce a Code of Conduct for Shopping Centre management. This Code should provide that:

(4) landlords cannot increase rent beyond a specified multiple, say 15%, without providing clear written justification and being subject to an appeal process to ensure franchisors and franchisees are not held to ransom in their captive market;

(5) lease terms must be such as to ensure an adequate return or investment for a tenant;

(6) landlords must provide on request all available rental information in a shopping centre in the event of any rental dispute.

Appendices

1. FCA Industry Report

(Please note that the information, statistics and list of members in this Industry Report were accurate as at May 2006. Some aspects of the Report are no longer current. The FCA Chairman is now Mr John O'Brien, and some of the statistics have been superseded by the statistics contained in the body of this submission. However the essence of the Report remains relevant.)

2. FCA Member Standards

Appendix 1

FCA Industry Report

FRANCHISE COUNCIL OF AUSTRALIA REPORT ON THE CURRENT STATE OF AUSTRALIAN FRANCHISING

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The Franchise Council of Australia

The Franchise Council of Australia (FCA) was formed in 1983 and is the peak industry body in Australia, with responsibility for representing all sectors of the franchise community. It is a not-for-profit membership based association, and does not receive ongoing government funding.

As franchising is a global activity, the FCA is affiliated with franchise associations around the world and was a founding member of the Asia Pacific Franchise Confederation. It is also an active member of the World Franchise Council. This enables the FCA to have access to the latest global information on franchising, and to receive information on any franchising trends that may have relevance to the Australian market. The international links are also intended to assist Australian systems to enter foreign markets.

The FCA has excellent relations with the Australian Competition & Consumer Commission (ACCC), the Office of Small Business, Austrade and other industry bodies. The FCA meets regularly with the ACCC and is a key member of the ACCC Franchising Consultative Committee.

Membership of the FCA is open to individuals and organisations that are involved in franchising. There are several membership categories designed to accommodate franchisors, franchisees, advisors and service providers. A list of current members of the FCA is included at Appendix 1.

The FCA is structured to enable the organisation’s professional management team to access the collective intellect of its members to supplement the skills and experience they bring to the FCA. Chief Executive Richard Evans, a former Federal parliamentarian with extensive franchising and small business experience, has day-to-day responsibility for the operations of the FCA, with his personal focus being the interface between the franchise sector and other stakeholders such as Government and the public. Other FCA employees have specific skills in education, event management and member services.

At a strategic level, a board of ten directors manages the FCA. Five directors are State Chapter Presidents, who each preside over a State Chapter Committee and are elected by the respective state chapter members. The other five directors are elected on a national basis at the Annual General Meeting. At least three of the five nationally elected directors must be either a franchisor or franchisee. There are State chapters in New South Wales, Queensland, South Australia, Victoria and Western Australia, with a National Secretariat based in Melbourne.

A list of current directors and senior executives of the FCA is set out in the table below. A brief summary of their franchising experience has been included to illustrate the skills and experience available to the FCA.

Chief Executive Officer	Richard Evans	A former franchisee who entered Federal politics as the Member for Cowan in 1993. Richard served on the House of Representatives Committee that handed down the landmark Fair Trading Report, which resulted in the introduction of the Franchising Code of Conduct and other reforms.
Chairman	Stephen Giles	Partner with Deacons and generally acknowledged as Australia's leading franchising lawyer. Author of numerous publications including Franchising Law & Practice, The Franchisor's Manual and Going International – A Guide for Australian Franchise Systems.
Deputy Chairman	John O'Brien	Managing Director and owner of Poolwerx Corporation, John O'Brien (PoolWerx Corporation) has the unique distinction of having been an Australian Franchise Council Franchisee of the Year (Queensland), inaugural Australian Master Franchisor of the Year, Franchisor of the Year (services category – twice), and current Australian Franchisor of the Year outright. His experience in the franchising sector spans more than 20 years.
Victorian President & Finance Director	George Yammouni	George Yammouni, B.Bus., Director, George Yammouni, B.Bus., Director, George is the CEO of the Bathroom Werx Group (which includes Mend-A-Bathroom) - a National Franchise System which specialises in bathroom restorations and renovations. Having started life as a Franchisee in 1986, he acquired the Australian Franchise in 1988 and then began franchising in 1990. Serving on Victorian Chapter Committee since 1993 and is currently Chair of the FCA Board Finance Committee.
NSW President	Ken Roseberry	Ken Roseberry is Chief Executive Office of Fastway Couriers, a position he has held since 2002. Fastway was established in Australia in 1993, boasts nearly 500 franchisees Australia-wide, and is a previous winner of the FCA's 'Franchise System of The Year'. Fastway now operates in 12 countries. Ken's other career highlights include being the CEO of; Australian Geographic, Qantas Holidays, Tourism Queensland, the Gold Coast Indycar Grand Prix, and promoter of the 1988 Bicentennial First Fleet Re-Enactment. Ken holds an MBA and has served on the FCA NSW Chapter for the past two years, being elected as Vice President in 2005.
Qld President	Philip Ciniglio	Philip has over 30 years of business, sales and marketing experience through his involvement with large global corporate organisations such as Bridgestone, Century Yuasa Batteries and Retail Food Group, having held senior positions in General Management, marketing, sales management and franchising. Philip has been associated for over 20 years with the Franchise Council of Australia and is currently a Director on the National Board and President for the Queensland Chapter.
WA President	Steve Hansen	Stephen is the Managing Director of the fast food chicken chain "Chooks Fresh & Tasty", formerly River Rooster. Steve started his career in banking, spending 4 years in PNG and many branches in the West. Steve started in franchising in 1983 as a franchisee, becoming a franchisor in 1991 with the River Rooster Brand. Steve has been involved with the FCA WA chapter for over 8 years and is passionate about franchising.
SA President	Steve Butler	Steve Butler is the National Franchise Manager for Beaumont Tiles, who are the largest distributor of ceramic wall and floor tiles in Australia. He has been in this position for 5 years. Prior to this he owned 3 South Australian Beaumont Tiles franchise outlets for a period of 15 years and has been in this industry for just under 30 years. He has served on the committee of the FCA in South Australia for 3 years, Vice President last year and recently taking on the role of President.
	Chris Malcolm	Chris Malcolm has been active in franchising for over 15 years. Initially with Solomon's carpets, he has more recently been involved with the Clark Rubber brand and has reinvented it as a vibrant modern retail network. Chris had a 2-year chairmanship of the Franchise Council of Australia during the mid 1990s and guided the Association through a restructuring process that resulted in a reinvigorated organisation with a national focus. Chris served for 5 years on the national board of the FCA, and is an active participant in the franchising debate.
	John Longmire	John owns five Just Cuts salons in the ACT and employs 80 staff. Prior to entering franchising John worked in government for 15 years. He started in franchising in June 1994 with the first Just Cuts salon outside of Sydney and is now part of an Australia-wide network of 120 salons. John was Highly Commended Franchisee of the Year in 1995 and 1996, the NSW/ACT Franchisee of the Year in 1998, and 1999 and the National Franchisee of the Year in 1999.
	Noel Carroll	Noel Carroll co-founded Michel's Patisserie, a multi-award winning franchise system he built to over 350 outlets. Michel's was Franchise System of the Year in 2003 and 2004. Noel has recently also taken an interest in two emerging franchise systems in the health and hairdressing field. Prior to Michel's, Noel's 15 year corporate career included senior management roles with S.A. Frozen Foods, R.M. Gow Frozen Food Division, McCain Foods, Sara Lee and Defiance Milling.

Executive Summary

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers to the franchise sector. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. A list of current members of the FCA is set out in Appendix 1.

The franchise sector in Australia makes a very substantial contribution to the Australian economy. Industry turnover is estimated at $111.5 Billion, or 3.2% of Australian Gross Domestic Product. The sector has around 900 franchise systems, 53,500 units and employs 550,000. The indirect impact of franchising is estimated at 1.5 times these figures.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has changed in recent years, with the sector maturing substantially since 1998 both in terms of size and conduct. Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished to some extent by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. The predecessor body to the FCA, the Franchisors Association of Australia, was fundamentally a franchisor networking group, and was described in Federal Parliament as unrepresentative and “controlled by a small cabal of franchisors”. This is a far cry from the multi-representative and highly professional industry body the FCA is today.

The regulatory framework established by the Federal Government in 1998 has made a very important contribution to the success of Australian franchising. It provides strong regulatory protection for franchisees through the Franchising Code of Conduct, which is administered by the Australian Competition and Consumer Commission. A copy of the Franchising Code of Conduct is in Appendix 2. In addition to the Code, the Commonwealth Trade Practices Act's prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions. As a consequence we have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practices.

The FCA worked closely with the Government in preparing the Franchising Code of Conduct. This work continues today to ensure there is ongoing review and amendment of the Code as required. There is also a strong ongoing collaborative relationship with the Australian Competition and Consumer Commission in regard to the Code, and the application of the Trade Practices Act within franchising.

The current regulatory environment finds the correct balance, providing a strong regulatory framework without unnecessarily impeding the flair of franchising entrepreneurs. Mr. Peter Reith, Federal Minister for Workplace Relations & Small Business, in his Foreword to the Franchising Code of Conduct commented as follows:

> *"Franchising is one of the fastest growing business sectors in Australia. Franchising is a unique way of doing business, built on mutual trust. The growth and development of franchise systems is dependent upon the relationship between the franchisor and its franchisees…. The Commonwealth Government is strongly committed to the growth and prosperity of the franchising sector."*

Although growth slowed for a very short period while the sector came to grips with the new compliance obligations, growth has continued since 1999 at similar rates to the pre-Code period. Importantly the regulatory framework has dramatically reduced the levels of disputation and enhanced the public perceptions of franchising. Largely as a result of the mediation based dispute resolution process contained in the Code, strong enforcement oversight by the ACCC and pro-active educational activities conducted by the FCA, disputation in Australian franchising is now extremely low. The Franchising Australia 2004 Survey estimates that around only 1% of franchisees are in "substantial dispute", with "substantial dispute" being very broadly defined beyond just litigation to include anything involving a solicitors letter or above. This compares extremely favourably with the United States, where the level of disputes is estimated at around 6% and many disputes are resolved in the courts. The Code's mediation based dispute resolution process has been an outstanding success, with around 75% of all franchise disputes in Australia resolved by mediation.

The FCA has further strengthened the franchise sector framework by introducing its Member Standards of Conduct. The Member Standards do not impose new legal obligations on franchisors, but they provide greater detail in terms of typical expectations of franchisors and service providers and introduce additional mechanisms for the FCA to be able to monitor behaviour and intervene pro-actively to ensure disputes are resolved quickly and cost effectively. A copy of the FCA Member Standards is in Appendix 3. Most franchise complaints today do not involve breaches of the law, but rather mismatched expectations. By taking control of the complaints process, the FCA aims to ensure such mismatched expectations do not escalate into court cases or media field days that harm the hard earned good reputation of Australian franchising.

With the prospect of an enhanced compliance process, and widespread adoption of comprehensive risk management systems, business risk for franchisees and franchisors is likely to further reduce. New developments in the area of specific franchise insurance products and further innovations in franchise sector lending are likely to drive further growth and development of the sector. Franchise systems are well placed to surf the wave of industry mega-trends, and meet the increasingly demanding needs of customers due to the unique relationship of the franchisor and franchisee. Franchisors can focus on branding, systems design and compliance management, while franchisees can concentrate on the customer relationship, delivering superior customer service and providing the coalface information needed to drive innovation and system improvements.

The Economic Impact of Franchising in Australia

5.14 Franchising Australia 2002

The FCA has commissioned regular independent surveys of the franchise sector. All paint a similar picture of growth, development and business success. One of the most relevant remains *Franchising Australia 2002, the Commonwealth Bank Franchising Survey*, released in August 2002. The survey was undertaken by Griffith University and sponsored by the Commonwealth Bank, and provided one of the most comprehensive reports on the status of the franchising sector in Australia. Much of the information remains relevant today.

The report confirmed the continued growth and increasing maturity of franchising in Australia. It also provided an insight into the economic contribution, development, trends and concerns of the sector. Speaking at the FCA national conference, FCA Chairman Stephen Giles welcomed the survey as further evidence of the value of the franchise sector to the Australia economy:

"It is now beyond rational argument that franchising delivers competitive advantage to the franchisors and franchisees that embrace best practice franchising principles in their business. The franchise sector delivers $80 billion in annual turnover, employs 500,000 people, has around 420,000 permanent employees, generates $292 million in annual export earnings, and has 90% of its business owners earning profits beyond wages. These are stunning figures."

The FCA Chairman went on to note that the survey confirmed, contrary to some perceptions, that there is a very low level of disputes in franchising.

"It is pleasing to see that less than 1% of franchisees were involved in a "substantial dispute" with their franchisor, meaning a dispute involving litigation, mediation or correspondence with a solicitor. 81% of franchisors recorded no substantial disputes at all in their system in the past 12 months. These are important statistics for those thinking of buying a franchise, and further signs of the increased maturity of the sector."

The key points of the Franchising Australia 2002 Survey, which was the first of its kind since 1999, were summarised as follows:

- There were approximately 700 franchise systems in Australia, or 3 times as many per head of population as in the USA. (This figure has now risen to around 900 according to Franchising Australia 2004 and the IBISWorld Report.) Over 90% of these systems were home grown. On average, Australian franchisors have been operating for 15 years, and franchising for 9 years.

- There were almost 50,000 franchised outlets. (This figure has now risen to around 60,000.) The number of franchised units had grown by 8.5% since 1999. An indicator of the success of franchising, and indeed the increasing maturity of the sector, was that the average number of franchised units per franchise units had grown by 100% since 1999.

- Franchising was big business in terms or export earnings, much bigger than had previously been appreciated. $292 million per annum was generated from overseas operations of Australian franchisors in 2001. 25% of Australian franchisors had expanded overseas, with 62% indicating an intention to do so in the next 3 years. This was up from 22% in 1999. New Zealand was the most popular destination (74%) followed by the UK (36%), USA (34%), Singapore (34%), South Africa (26%) and Europe (26%).

- The sector employed approximately 500,000 people, with permanent employment having risen dramatically to 83.5% of the workforce. This figure is now estimated at around 600,000.

- The level of disputation in franchising continued to fall, with less than 1% of franchisees in serious dispute with their franchisor. As with the 1999 survey, the top causes of substantial disputes were lack of compliance with the system (27%) and payment of fees (15%). Franchise re-sales provided further evidence of the strength of the sector, with 74% of franchisee exits resulting from sale of their business. Where the exit was due to franchisor or franchisee termination, lack of suitability to franchising and personal/family reasons were the main exit reasons identified.

- Franchised businesses remained affordable, with average start up costs being $62,500 for mobile and $208, 000 for fixed location franchisees (excluding GST).

- Although there is risk attaching to every business, 90% of franchisees were reported as earning profits beyond employee wages. This figure compared extremely favourably with the small business sector generally.

- Although the Franchising Code of Conduct had improved franchisor/franchisee relationships (53%), been beneficial to the sector (79%) and required franchisors to keep more detailed records (62%), there remained issues to be addressed to improve the effectiveness of the Code. The embryonic nature of the franchise mediation was demonstrated by the survey finding that, despite the requirements of the Code to attempt to resolve disputes through mediation, more disputes were in fact resolved through litigation (23%) than mediation (17%). It is important to note that this figure has now changed very dramatically, with most franchising disputes referred to mediation, and mediation achieving success in around 75% of cases.

- Cost of compliance, difficulty and uncertainty in compliance, excessive disclosure requirements and the ACCC influence over the sector rated highly as concerns in the regulatory area. These concerns have largely evaporated.

- Lack of suitable franchisees and insurance cover and cost were rated the most critical business issues by franchisors.

5.1 Franchising Australia 2004

The results of the Franchising Australia 2004 Survey conducted by Griffith University confirmed the continued growth in franchising in Australia and revealed that franchising techniques were in use in most industry sectors.

The research identified a total of 850 business format franchisors in Australia. The sector comprised 50,600 franchised outlets, together with around 3,400 company owned outlets. The growth from 1994 had been substantial, as the Australian Bureau of Statistics reported a total of only 24,500 franchised outlets in 1994. The growth in franchised outlets was 14 percent per annum from 1991 to 1994 (ABS) and 15.5 percent from 1989 to 1991, confirming a decade of strong performance.

Probably as a result of compliance responsibilities associated with the introduction of the Franchising Code of Conduct, the growth in 1999 reduced to around 6%. However, between 2002 and 2004 growth increased again to 14%.

The 1998 Survey revealed that the total turnover of business format franchised outlets was $22.4 billion, with $14.1 billion in turnover for company outlets, yielding a combined total of $36.5 billion. Motor vehicle and automotive fuel retailers were not included in these figures. If these groups are added, the estimated turnover is in excess of $80 billion. The total number of people employed in business format franchise systems (including motor vehicle retail franchises and automotive fuel retail franchises) at the time of the 2004 survey was around 600,000. 33% were permanent full-time employees, 50% permanent part-time and 17% casual employees.

5.2 Other relevant statistics

The various franchising surveys have provided the following additional information on franchising in Australia:-

- 10% of franchises are owned by couples, 74% are owned by men and 9% by women. A significant proportion (43%) of those owners are in the 41-50 years age group. Single unit franchise ownership is the norm in Australia, although the number of multi-unit franchise owners continues to grow. Master franchising and sub-franchising are common expansion methods, particularly for mobile or service franchise systems.

- Franchising continues to expand through all regions of Australia. New South Wales and Australian Capital Territory (31%) have the greatest concentration of outlets, similar to the population distribution. However, Queensland (22%) and Western Australia (13%) continue to exhibit a greater acceptance of franchise systems in that they host noticeably larger proportions than their populations.

- Of the total franchise systems in Australia, 95% were business format franchise systems, 0.4% were motor vehicle franchise systems and 0.1% were major auto fuel retail franchise systems.

- Australia is the most franchised nation per head of population in the world. That is, there are more franchise systems in Australia compared to our population than any other country, and Australia has at least three times as many franchise systems per head of population than the United States.

- The average length of time that current franchise systems have been franchising is 8 years.

- Franchising enjoys a small business success rate more than 2 and a ½ times greater than stand-alone small business. Each year, only 1% of franchisees leave their businesses.

- In 2002 24% of Australian franchise systems operated overseas, with a further 27% of systems planning to commence foreign operations within the next 3 years.

5.3 IBISWorld Report information

The IBISWorld Industry Report of 3 February 2006, which is the most recent industry report, confirmed the substantial contribution of franchising to the Australia economy. IBISWorld estimated that in 2004/05:

- the sector generated gross revenue of $111.5 billion;

- gross domestic product was $27.3 billion, or 3.2% of total Australian GDP;

- this turnover was an increase of 9.7% on 2003/04;

- there were 53,500 units;

- there were 900 franchise systems; and
- the sector employed 550,000 people, for a total wage bill of $15.9 billion.

Strong growth had been experienced in previous years, with turnover growth rates of 16.1%, 11.0% and 9.7% in the past 3 years. In the same period the number of franchise units had grown by 5.1%, 8.5% and 5.7% and the number of franchise systems by 10.7%, 9.7% and 5.9%. Employment had grown by 15.8%, 12.7% and 8.4%, and total wages by 18.3%, 12.4% and 8.1%.

The IBISWorld Industry Report determined food retailing to be the leading segment at 31.0%, with non-food retailing (furniture, books, whitegoods and clothing) at 30.0% and property and business services (real estate, finance, building) at 24.0% and other including education, training, domestic services, automotive and childcare) at 15.0%. It noted that financial services and retail food had experienced the strongest growth in recent years, but every area of commercial activity had been subject to some growth via franchising.

The distribution of franchise units amongst the States and Territories was generally consistent with population levels and availability of suitable premises. New South Wales had 31% of franchise units, followed by Queensland and Victoria at 22% each, Western Australia at 9%, South Australia at 8%, Tasmania at 4% and ACT and Northern Territory at 2% each.

In the 5 years to 2004/05:

- the sector experienced average revenue growth of 5.5%;
- gross domestic product grew by 4.0% per annum; and
- the number of systems grew by an average of 5.8%.

Turning to the future, IBIS World offered the following predictions:

	Revenue	**Growth**	**GDP**	**Growth**
2005	$111.5 Billion	9.7%	$27.3 Billion	8.3%
2006	119.3 Billion	7.8%	$29 Billion	6.0%
2007	$125.3 Billion	5.0%	$30.3 Billion	4.5%
2008	$132.8 Billion	6.0%	$31.9 Billion	5.5%
2009	$139.4 Billion	5.0%	$33.6 Billion	5.2%
2010	$145.7 Billion	4.5%	$35.2 Billion	4.8%

This yields an average annual growth of 5.5% in revenue, and 5.2% in GDP, which compares favourably to the predicted growth in Australian GDP of 3.5% over the same period.

IBISWorld concludes that the sector will transcend from the growth to mature stage of its lifecycle, but notes that “there is still room for the domestic growth in the franchising sector as low failure rates and low levels of disputation along with the relative security and stability of the sector attract small business investors. Investors are increasingly looking for new expansion opportunities internationally….as much future industry growth will come from offshore opportunities” (p39). BRW (June 23-29, 2005) predicts that the sector is set to continue experiencing strong growth, and IBIS World quotes PriceWaterhouseCoopers as predicting that the sector will double in the next 15 years and account for around 24.0% of Australian GDP.

5.4 Indirect impact of franchising

The International Franchise Association released a report on the direct and indirect impact of franchising in the United States by PriceWaterhouseCoopers. PWC determined that the direct and indirect impact of franchising in the US economy was approximately 1.5 times the direct impact. Although no similar report has been conducted in Australia, there are such strong similarities between US and Australian franchising that the indirect impact of franchising in Australia is likely to also be around 1.5 times the direct impact.

5.5 International statistics

The growth and development of franchising has been a global mega trend. The following information extracted from statistics provided by the World Franchise Council in 2004 indicate the penetration of franchising into many developed economies.

Country	**Franchise Brands**	**Total Outlets**	**Sector Turnover (Billions)**	**Sector Employment**	**Total Population**
EUROPE					
Austria	330	4,700	EU 3.00	60,000	8,174,000
Belgium	100	3,500	US 2.80	30,000	10,348,000
Czech Rep.	90	300			10,246,000
Denmark	128		US 0.07	22,316	5,413,000
Finland	177	3,666	EU 4.88	46,000	5,214,000
France	835	62,981	EU 94.78	400,000	60,424,000
Germany	845	45,200	EU 28.00	406,000	82,424,000
Great Britain	718	31,300	EU 13.30	327,000	60,270,000
Greece	430	6,540			10,647,000
Hungary	300				10,032,000
Italy	708	44,426	EU 16.90	117,783	58,057,000
Latvia	8				2,306,000
Netherlands	453	19,600	EU 18.80	187,000	16,318,000
Poland	210	13,500	EU 1.10		38,626,000
Portugal	489	8,500	US 3.40	53,000	10,524,000
Russia	95	1,850			143,782,000

Slovenia	106	980			2,011,000
Spain	650	42,554	EU 14.00	186,000	40,280,000
Sweden	300	9,600	EU 8.42	67,000	8,986,000
Switzerland	180				7,450,000
Canada	850	80,000	US 90.00	1,000,000	32,507,000
USA	1500	760,000	US 1,500.00	9,700,000	293,027,000
LATIN AMERICA					
Argentina	300	10,000	US 2.00	180,000	39,144,000
Brazil	814	59,028	US 1.00	531,000	184,101,000
Columbia	120	4,667		35,000	42,310,000
Mexico (year 2005)	720	462,000	US 50.00	500,000	104,959,000
ASIA					
PPR China	2,100	120,000	US 29.60	2,400,000	1,298,847,000
Hong Kong	92	3,000			6,855,000
India	850	48,000	US 3.80	300,000	1,065,070,000
Japan	1,100	220,000	US 170.00	2,000,000	127,333,000
Malaysia				500,000	23,522,000
Philippines (year 2003)	850	68,000		1,000,000	86,241,000
Singapore	380	3,000	US 2.00		4,353,000
PACIFIC					
Australia		720	US 62.00	600,000	19,913,000
New Zealand	350				3,993,000

AFRICA					
Egypt					76,117,000
South Africa	391	22,895	US 19.90	285,000	42,718,000

History of franchise regulation in Australia

5.6 The Current Regulatory Regime

The franchise sector in Australia is regulated by the Franchising Code of Conduct, which was introduced with effect from October 1 1998, as part of a range of Federal Government initiatives called the *New Deal: Fair Deal* reforms.

The Franchising Code of Conduct is a mandatory industry code prescribed by regulations under the Trade Practices Act (TPA) Pt IVB. The Franchising Code of Conduct was introduced by the Trade Practices Amendment (Fair Trading) Act 1998 in response to strong criticisms of business conduct in the franchising sector, in a report to the Federal Government known generally as the Fair Trading Report. At the same time the Federal government also introduced section 51AC of the TPA, which prohibits unconscionable conduct in small business transactions. Although not specifically targeted at franchising, section 51AC, in tandem with the broad and general prohibition of misleading or deceptive conduct under section 52 of the TPA, confers significant additional protection on franchisees.

The Franchising Code of Conduct is an important development for the Australian franchising sector. It imposes significant obligations on franchisors in relation to prior disclosure, substantive obligations and dispute resolution. The Code was modelled on the previous voluntary Franchising Code of Practice, but evolved considerably in scope and application during the exposure draft stage. During this stage the Franchising Policy Council, appointed to advise the government on its initial content and ongoing review, consulted widely with the sector. As a result some of the clauses in the draft Code which dealt with relationship or conduct issues, such as those which imposed obligations to pay compensation on termination of a franchise in certain circumstances, were removed.

The introduction of the Code does not limit the operation of the general law, which continues to govern the formation and general operation of franchising relationships. The main areas of law influencing franchising are contract, restrictive trade practices, intellectual property, consumer protection, fair trading, and revenue laws, in addition to retail leasing. Franchising is also subject to the TPA, which focuses upon competition and consumer protection. Of particular relevance to franchising is the prohibition on “misleading or deceptive conduct” contained in section 52.

5.7 The Origins of the Franchising Code of Conduct

The debate on the difficult issue of whether franchising should be subjected to a specific regulatory regime, commenced shortly after the introduction of business format franchising in Australia in the early 1970s.

Since 1981 the franchising sector in Australia has been subjected to a variety of regulatory regimes. Initially there was no regulation except under the general law (pre-1981). Then, in effect by accident, the sector was subject to quasi-regulation under the “prescribed interest” or “investment security” provisions of the Corporations Law (1981-87), to deregulation (1987-93), and to self-regulation pursuant to a voluntary Code of Practice (1993-96).

Until 1981 franchising was regulated only by the general laws governing all commercial relationships. The only exception was the regulation imposed on retail petroleum franchising through the *Petroleum Retail Marketing Franchise Act 1980* (Cth). However this changed when the Supreme Court of Western Australia held in *Commissioner for Corporate Affairs v Casnot Pty Ltd* (1981) ACLC 40-704, that an advertisement for a cleaning franchise was subject to regulation under the “prescribed interest” provisions of the then *Companies Act 1981*. These provisions dealt with the offering to the public of certain “investment schemes”.

This decision subjected franchising to an inappropriate regime more applicable to company securities and shares. This was compounded by the decision in *Commissioner for Corporate Affairs v Casnot Pty*

Ltd, which allowed the National Companies and Securities Commission (NCSC) to assume jurisdiction for franchising, requiring franchisors to comply with a number of statutory requirements.

The Corporations Law provisions prohibited a company from issuing a "prescribed interest" unless the company:
- was a public company;
- had issued a prospectus;
- had in place an approved trust deed; and
- had appointed an approved trustee.

The promoter and relevant employees were required to hold security dealers and dealers' representatives licences. The legislation went on to specify quite significant requirements to be inserted in the documentation. Compliance with these requirements imposed a substantial cost upon a franchisor. Significant civil and criminal sanctions applied to any breach of those requirements.

The problems created for the franchising sector were ameliorated by the governing body (then the NCSC, and now known as the Australian Securities and Investments Commission), which had the power to exempt a company from compliance. The NCSC accepted arguments that a franchisee was seeking a business opportunity rather than making a passive investment, and hence it was appropriate for there to be less protection. The acquisition of a franchise was known to carry certain risks, which a franchisee was better equipped to assume, and indeed influence, than a passive investor. Accordingly the NCSC issued a formal release (Policy Statement 118) which provided that franchisors would be exempt if they complied with certain less onerous requirements. The exemption was available if the franchisor was a company, whether private or public, and the franchise agreement contained certain provisions, relating inter alia to:
- the use of a trust fund;

the consent to assignment;
a cooling-off period; and
an obligation of disclosure.

The regime saw the first disclosure document requirement, which was conceptually a precursor to the disclosure document that is central plank of the Franchising Code of Conduct.

The NCSC was required to approve the franchise agreement and disclosure document before the exemption could apply.

Whatever the problems that resulted from the absence of regulation, they were not resolved by the arbitrary, complex, onerous and inappropriate regulation pursuant to the "prescribed interest provisions". Between 1981 and 1987 the interest provisions imposed a regime not specifically structured for franchising. By the mid-1980s the situation had become unworkable. National Companies and Securities Commission Policy Statement 118 requirements were less onerous, but nevertheless inappropriate for franchising. The requirements only applied when the prescribed interest was offered to the public, which led one commentator to advise that, "the sure way to avoid the Companies Act regime is to avoid advertising franchise opportunities to the public". Additionally, where it is considered necessary to advertise it was thought that it may be possible to structure the advertisement so that it merely provides a broad and vague outline of the proposal, and invites the reader to apply for information. However, a more basic problem was the emerging judicial divergence of opinion among State Supreme Courts as to whether the sale of franchises actually constituted prescribed interests.

The quasi-regulated era was brought to an end by the removal of franchising from the scope of the Companies Act by legislative amendment in 1987. Franchising then operated in a deregulated era, governed only by the general laws regulating all commercial activity until 1993.

A Franchising Task Force was established in 1990 to "examine impediments to the growth and efficiency of the franchising sector" and to "examine and report on the potential of self-regulatory codes for countering marketing failure in franchising, focussing on Business Format Franchising". The Task Force recommended a self regulatory Code of Practice administered and maintained by a council of representatives from all areas of the franchising sector. The recommendations were accepted by the Commonwealth, state and territory governments and the Code of Practice came into operation on 1

February 1993. The Code of Practice was authorised by the Trade Practices Commission on the basis of public benefit; it attempted to raise standards in the sector and to apply these nationally and uniformly across a diverse range of industries. Additionally, as an alternative to government legislation, the Code would avoid the attendant costs of implementation and enforcement. There were 5 editions of the Code during its short life, primarily in the nature of improvements and clarifications than changes of major significance.

Voluntary compliance with the Code was sought from franchisors, advisers and service providers. They were encouraged to register and thereby certify that they agreed to comply with those provisions of the Code that applied to them. The main Code provisions affected franchisors, and dealt with prior disclosure, cooling off periods, dispute resolution, certification and standards of conduct. Registration was voluntary. Non-compliance led to deregistration, but did not prevent that franchisor from operating as such .

The main features of the Code were:

Disclosure — Franchisors were required to provide a standard form of disclosure document to prospective franchisees at least 7 days prior to signing a franchise agreement. The disclosure document need to be updated annually and was available to existing franchisees upon request. A disclosure document also had to be provided by a vendor franchisee and its franchisor to a purchaser of that franchisee's business.

Cooling off — Franchisees were to be provided with a 7-day cooling-off period following execution of the franchise agreement. A franchisee who exercised the “cooling-off” option was to be refunded all fees paid less reasonable expenses specified in the franchise agreement.

- Dispute resolution — The Code laid down an alternative dispute resolution procedure with which the parties had to comply.
- Certification — Prior to the execution of the franchise agreement the franchisor had to require the franchisee to produce a certificate from a solicitor certifying that the solicitor had explained the franchise agreement to the franchisee, or have the franchisee sign a statement that the franchise agreement has been explained by a solicitor.

In line with the Task Force's recommendations, the Code imposed no specific requirements in relation to termination, intellectual property rights, tenure, assignment, approvals or other terms and conditions of the franchise agreement, including goodwill.

The Code nevertheless provided in paragraph 12 that franchisors and franchisees:

(0) will not participate in unconscionable conduct, in relation to franchise arrangements; and

(0) should act in an ethical, honest and lawful manner, and endeavour to pursue best franchise business practice on the time and place. They should in their dealings with one another at least avoid the following conduct, where such conduct would cause significant detriment to either party's business:

(a) substantial and unreasonable overvaluation of fees and prices;

(b) conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party; and

(c) conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

However, the body entrusted with the administration and enforcement of the Code, the Franchising Code Council (FCC), had no power to deregister any party who failed to comply with paragraph 12. The standards of conduct operated as ethical standards to which participants in the franchising sector should aspire, rather than mandatory provisions to which participants had to comply under threat of deregistration.

The Franchising Task Force which recommended the introduction of the voluntary Code acknowledged in its report that its conclusions would satisfy neither those who had called for strict mandatory legislative arrangements, nor those who believed that there was nothing wrong with the sector and that no form of regulation, even voluntary self-regulation, was necessary. Nevertheless, at the time of its introduction in 1993 there was a strong hope that it would be a sufficient response to the problems affecting the franchising sector. It was described by the then Minister for Small Business as:

> *the most progressive industry/government franchising initiative undertaken in the world [which has attracted] strong interest in its development from the franchising community overseas. This Code of Practice and the self-regulatory regime which will support it, provides an excellent model for how the business community and government can work in partnership to promote business development.*

However, the reality did not match the hyperbole. Fourteen months into its 2 year trial period, the government, prompted by increasing concerns as to the effectiveness of the Code, initiated an independent review of its operation and effectiveness. The Gardini Report was submitted in October 1994 and released in March 1995. It identified two major weaknesses in the Code: its lack of coverage across the franchise sector, and failure of the "standards of conduct" provisions to address serious franchise problems.

The Code eventually "died" with the demise of the FCC in December 1996 as a result of:

- funding pressures (the outgoing government's promise of government funding fell victim to cost-cutting measures of the new government elected in March 1996;
- concerns among members of the FCC regarding their vulnerability to defamation actions brought by franchisors whom the FCC threatened to deregister; and
- disputes among franchisor and franchisee members of the FCC as to the role, viability and integrity of the Code and the self-regulatory regime.

The Code lapsed with the demise of the FCC. Australia was again returned to a deregulated environment, where franchising was regulated only by the general laws that regulated all commercial activity. It was obvious that the unregulated environment would be a temporary stage which lasted only until the new government determined its policy for the franchising sector.

5.8 The *New Deal: Fair Deal* Reforms

In June 1996 the Government appointed the House of Representatives Standing Committee on Industry, Science and Technology with wide terms of reference to report on business conduct issues in fair trading in general, and franchising in particular. In May 1997 the Committee handed down its Report. This Report, *Finding a Balance — Towards Fair Trading in Australia* was highly critical of some practices within the franchising sector.

The Report found that the problems had considerable economic and social costs, in that they contributed significantly to business failure. The social costs identified by the Committee included stress, marriage breakdown, poor health and suicide. The economic costs of the business conduct issues raised with the Committee included an inability of small firms to gain a return on sunk costs, and market inefficiencies arising out of exploitative conduct.

Faced with an orchestrated media campaign highlighting unfair conduct issues, the accumulated experience of over 20 reports over the last two decades, and the harsh criticisms and unanimous recommendations of a backbench committee of both government and opposition members, the government was left with no option but to act quickly and decisively.

Its *New Deal: Fair Deal* reform package released in September 1997 contained initiatives of great significance to the franchising sector. These included the enactment of a "business unconscionability" provision modelled on the "consumer unconscionability" provision of section 51AB of the TPA, and the introduction of a mandatory Franchising Code of Conduct . These regulations were proscribed under the TPA pursuant to a new Pt IVB which provided the legislative infrastructure for Codes of Conduct.

Two Exposure Drafts of the Code were released for public comment — the first modelled closely on the voluntary Franchising Code of Practice, and the second a more comprehensive document moving significantly beyond prior disclosure obligations to regulation of the franchisor/franchisee relationship. The final form of the Code prescribed by regulations came into effect in stages on 1 July 1998 and 1 October 1998.

The package contained a number of measures including:

- new protection for small business in the TPA, through prohibiting unconscionable conduct in terms similar to the strong protection already provided for consumers;
- new protection for small business franchisees through a mandatory and stronger Franchising Code of Conduct underpinned by the TPA;
- a safety net of minimum legislative standards for protection of retail tenants to be negotiated through State and Territory legislation;
- stronger enforcement by the ACCC of small business' fair trading rights, including representative legal actions on behalf of small business, small business commissioners, a Codes of Conduct Enforcement Unit and funding for test cases;
- support for alternative dispute resolution to provide small business with quicker, less costly and more efficient remedies than traditional court litigation; and
- support for the development of information packages on fair trading.

A feature of the reforms was that they comprised of an integrated package, which the government argued was designed, "to induce behavioural change on the part of big business towards smaller business, and to provide to small businesses, that are unfairly treated, adequate means of redress". Additionally, the Government accepted the Committee's conclusions, and acted on each of the seven areas of reform identified - unfair conduct, retail tenancy, franchising, misuse of market power, small business finance, access to justice and education .

The Trade Practices Amendment (Fair Trading) Act 1998 which came into effect on 1 July 1998 enacted the "business unconscionability" provision (s51AC) and the legislative framework for the prescription, by regulations, of codes of conduct. The first mandatory industry code, the Franchising Code of Conduct, came fully into effect on 1 October 1998.

5.9 The Franchising Code of Conduct

The Franchising Code of Conduct is a mandatory industry code prescribed under section 51AE of the *Trade Practices Act 1974*. Section 51AD of the TPA makes it an offence to contravene a prescribed industry code. The Code became fully operational on 1 October 1998 and was amended by the *Trade Practices (Industry Code – Franchising Amendment) Regulations 2001*, which came into effect on 1 October 2001. The ACCC administers the Code.

The purpose of the Code is to regulate the conduct of participants in franchising, particularly the conduct of franchisors. A particular focus is on ensuring prospective franchisees are able to make an informed business decision about whether or not to enter into a franchise agreement. The Code also regulates the content of certain conditions to be included in franchise agreements, and dictates a procedure for dispute resolution.

The Code applies to franchise agreements entered into, renewed or extended after October 1998. Section 4(1) defines a "franchise agreement" as:

(1) a written, oral or implied agreement;

(2) involving the grant of a right to carry on business of offering, supplying or distributing goods or services;

(3) under a trade mark, advertising or commercial symbol;

(4) using a system or marketing plan substantially determined by the franchisor; and

(5) requiring the payment of an initial fee.

Motor vehicle dealership agreements are specifically declared to be franchise agreements and certain relationships such as co-operatives and partnerships are excluded. There are also some limited exceptions where a franchisor is resident outside Australia, or where the goods or services supplied under the agreement are likely to account for no more than 20% of the franchisee's gross turnover.

The definition of a franchise agreement is quite broad and has the potential to capture a wide range of licensing, distribution and agency arrangements not traditionally considered to be strictly franchise arrangements. Consequently, the definition has tended to be read down by the courts with a focus on ensuring that there is a system or marketing plan actually being imposed by the alleged franchisor before the Code will be applied.

There are comprehensive disclosure obligations on the part of a franchisor intending to enter into, extend or renew a franchise agreement covered by the Code. A franchisor must provide a detailed disclosure document to a prospective franchisee at least 14 days prior to signing a franchise agreement. The franchisor must also provide a copy of the Code and a copy of the franchise agreement to the franchisee. In the case of a sub-franchise situation, both the sub-franchisor (master franchisee) and the franchisor are required to prepare a disclosure document. This may be done either jointly or individually.

The disclosure document requires the franchisor to provide approximately 250 items of information listed under 23 categories. The disclosure document must be in the form, order and numbering prescribed by the Code. It must also use the prescribed headings and have an indexed table of contents. The information required to be disclosed includes details of the franchisor, the business experience of those involved in the franchise system, litigation history, existing franchisee contact particulars, intellectual property ownership, territorial or supply restrictions, marketing or other cooperative funds, and a range of costs and payments relevant to the franchise and the franchisor's financial position.

There is provision for a short form disclosure document where a franchised business has an expected annual turnover of less than $50,000. The benefit of this exemption is compromised by the fact that a franchisor is still required to provide all the information in the long form disclosure document if requested by the franchisee. As a consequence this form of disclosure document is virtually never used.

A disclosure document must be updated within three months of the end of each financial year, regardless of whether the franchisor is recruiting new franchisees or not. The content of a disclosure document must be carefully monitored to ensure that it contains no misleading or deceptive information. Similarly, a franchisor must be careful about the information regarding pricing and supply conduct, to ensure it does not fall foul of the anti-competitive conduct provisions of the TPA.

A franchisor must advise a prospective franchisee to obtain professional legal, business and accounting advice before entering into the franchise agreement. The franchisee must sign a statement to the effect that he or she has received such advice, or been told to receive such advice but elected not to.

The Code dictates how the following issues are regulated in a franchise agreement:

(7) Cooling Off Period - a franchisee is entitled to terminate the franchise agreement and recover all fees paid under the agreement if it does so within 7 days of entering the agreement;

(6) Marketing Funds - if a franchisee is required to contribute to a marketing fund, then the franchisor must prepare an annual financial statement in respect of the fund and have the statement audited;

(7) Transfer - a franchisor must not unreasonably withhold consent to the transfer of a franchised business to a new franchisee;

(8) Termination - if a franchisee has breached the franchise agreement, then the franchisee must be informed of the breach, and given a reasonable time to remedy it. If it cannot be, or is not remedied, then the franchisor can only terminate on reasonable notice. Similarly, if the franchisee is relying on a power of termination in the agreement (other than for breach), reasonable notice must be given. There is no definitive answer of what will constitute reasonable notice as it depends on individual circumstances;

(9) Liability disclaimer – a franchise agreement cannot require the franchisee to give a general release from liability.

The Code requires parties to give a notice of dispute in the event of disagreement. If the matter cannot be resolved between the parties according to the internal complaint handling procedure, then the dispute should proceed to mediation. The mediation must be conducted in Australia and attended by someone with the power to settle the dispute on behalf of each party.

A breach of the Code will allow for the application of the TPA remedies, including damages, injunctions, specific performance, termination, and variation of agreements entered into. Where there has been a serious breach of the Code, such as a failure to provide a disclosure document, the court may declare all the franchise agreements entered into by the franchisor void, and order the franchisor to refund all the money paid by the franchisees under these agreements. As a part of any remedy for a breach of the TPA, it is common for the court to order that a franchisor adopt a trade practices compliance program which can itself be an expensive exercise.

The Code is merely the starting point of a franchisor's legal obligations. Franchisors have specific obligations under an array of different laws. Other laws, such as the TPA itself, the Corporations Law, Occupational Health & Safety laws and retail tenancies legislation in each State apply to franchising in the same way as they apply to other businesses. The general law of contract also applies to franchising, as franchising is essentially a contractual relationship.

The role of the FCA in the past and future growth and development of franchising in Australia

5.10 Representation

The FCA has played a key role in the development of franchising in Australia. When it became obvious that some form of franchise regulation was necessary to curb some of the excesses of the free market dealings, and restore the reputation of franchising as a credible business method, the FCA embraced the need for regulation. The FCA worked collaboratively with the Federal Government to develop a regulatory framework that addressed the perceived weaknesses of a de-regulated environment, yet did not unnecessarily restrict the entrepreneurial flair of franchisors or important principles of freedom of contract. The outcome was a regulatory framework that enhanced the contractual process by providing a comprehensive disclosure document to assist prospective franchisees to make an informed decision, and introducing a requirement for franchisor's to encourage franchisees to seek independent legal and business advice prior to signing the franchise agreement.

The Franchising Code of Conduct addressed important issues such as transfer, termination and dispute resolution, providing additional certainty for franchisors and franchisees alike. In many ways the disclosure requirements have reduced the risk of application of the section 52 TPA prohibition on misleading or deceptive conduct.
The FCA then combined with the Australian Competition and Consumer Commission to educate the franchise sector on the Code and the new regulatory requirements via national seminar roadshow. The FCA also conducts regular training as part of its Diploma of Franchising program, and produces a variety of publications to assist franchisors with compliance.

The FCA has also represented the sector in discussions concerning the Goods and Services Tax, TPA, retail tenancies , and red tape reforms, industrial relations issues and a range of other small business matters. To date the focus has been fundamentally on matters that have a specific impact on franchising, but in more recent times that representation role has widened.

The primary focus of the FCA will continue to be political representation, as that is the area most important to its members. In 2003 as part of a deliberate strategy to enhance its capacity to effectively represent the franchising community, the FCA appointed former Federal politician Richard Evans as its Chief Executive Officer. The FCA is now an active member of various Governmental committees, including the ACCC Franchising Consultative Committee.

It is likely that the FCA's representative role will extend beyond franchising into the general small business sector. The FCA is deliberately positioning itself as being representative of successful small businesses, with the aim of helping to harness the political influence of the sector for constructive purposes. The FCA believes that small business is currently very poorly represented, with many so-called small business groups being very narrowly focused or unrepresentative of the genuine needs of the sector. The vast majority of franchisors and franchisees are small business people, and the success rates of franchising justifies the FCA taking a broader role in small business policy issues.

The FCA represents the whole franchising community – franchisors, franchisees, service providers and suppliers. The FCA sees this as an important role, as this collaborative approach is culturally consistent with the mutual interdependence of the franchisor and franchisee relationship. The FCA has vigorously opposed the formation of organisations purporting to represent franchisees, but in reality being self-interested organisations intent on fermenting discontent and litigation.
The FCA believes that by representing franchising, as opposed to franchisors or franchisees alone, the FCA is helping to create a truly a collaborative approach to franchising in Australia. As a business method franchising is a team game, and it is important for the FCA to foster teamwork and collaboration, not an adversarial framework.

To effectively represent the whole community the FCA realises that it will need to develop initiatives that appeal to the separate interests of its constituents. The representative efforts in relation to retail tenancies have been important for franchisees, as have the Franchisee of the Year Awards. In recent times franchisee specific seminars and events have been scheduled, and more are likely. It is also likely that the FCA will take some of its activities, particularly franchisee events, into regional locations.

5.11 Education

The FCA has been very active in franchise sector education, its activities including:

- educating the franchise sector upon introduction of the Franchising Code of Conduct and related reforms, including conducting with the ACCC a national roadshow, producing a range of compliance materials and generally assisting with sector education concerning the Code;

- educating the franchise sector upon introduction of the Goods and Services Tax, conducting a national roadshow, producing a compliance video, producing a Franchisors Guide and a Franchisees Guides and generally assisting with sector education concerning the GST;

- developing an Accredited Franchise Executive program, later superseded by the Diploma of Franchising, which is a portable qualification recognised under the Federal Government's educational competencies;

- conducting national and State conferences on franchise sector issues, together with a range of special interest seminars, workshops, training modules and educational events;

- running monthly breakfasts or similar events in each State as a forum for information exchange, practical continuing education and networking;

- sponsoring franchise exhibitions, and conducting public education forums to enhance the understanding of franchising by the general public; and

- producing general information, press releases, newsletters and other material and making the information available to journalists, Federal and State Parliamentarians and the public via a range of means including the FCA website (www.franchise.org.au).

Future educational initiatives are likely to include specific compliance oriented initiatives, including seminars and compliance measurement and training tools that will link directly in to insurance products and possibly banking accreditation.

5.12 Membership

The FCA currently represents the majority of major franchise systems. However the FCA intends to focus substantial energies and resources upon membership growth and development. Several initiatives are likely to drive membership growth, including:

- the FCA's *"Don't Sign Without This Sign"* campaign, aimed at educating the public about the values of FCA membership and the additional safeguards of dealing with FCA members as a result of the introduction of the FCA Member Standards;
- the FCA's Member Advantage program;
- new insurance products designed specifically for the franchise sector, including liability insurance available only to FCA members with additional benefits linked to the existence of strong compliance systems; and
- further educational and other events available only to FCA members, or available at substantial discounts to FCA members.

5.13 FCA Member Standards

The FCA has introduced Member Standards with effect from July 1 2005 to further enhance perceptions of the credibility of franchising, and ensure that ethical behaviour in the sector remains high. The FCA aims to ensure that people do not enter the sector attempting to trade off the goodwill and reputation of franchising without honouring the expected standards of conduct.

The FCA Member Standards supplement the TPA regulatory framework by providing further detail as to the forms of conduct unacceptable for those involved in franchising. Importantly the FCA Member Standards impose new obligations on consultants and service providers in areas such as disclosure, conflicts of interest and professional behaviour.

A copy of the FCA Member Standards is included in this report at Appendix 3.

Future trends in Australian franchising

The success of franchising in Australia is well chronicled, and the growth of franchising in Australia shows no signs of abating. However one of the key determinants of long-term success will be how well franchise systems cope with the franchising mega-trends. The FCA has identified some of the likely mega-trends in Australian franchising, and the challenges these trends pose for franchise networks.

<u>Internationalisation</u> is already a feature of Australian franchising, with over $220 million in export earnings derived in 2002. More and more Australian systems will expand internationally, buoyed by the success to date of systems as diverse as Cartridge World, Gloria Jeans Coffee, Aussie Pooch Mobile, Cash Converters, Expense Reduction Analysts, Pirtek, Dome, Boost Juice and numerous others. The Australian market, with its logistical and geographic challenges, highly competitive marketplace and strong and effective regulatory framework prepares Australian systems well for international expansion.

<u>Aggregation</u> is a feature of competition in all markets. In Australia we are likely to see either a reduction in the number of franchise systems, as smaller systems merge with others to achieve economies of scale, or a gap emerge between those franchise systems that can achieve superior economies and efficiencies, and those that cannot. Currently there are around 850 franchise systems, which means Australia has around 3 times as many franchise systems per head of population as the USA. However in the US the number of franchisees per franchise system is much higher than in Australia, with many systems having more than 1000 franchisees.

Concomitant with this aggregation is the development of the <u>super franchisee</u>. The single unit franchisee that has been a feature of Australian franchising will be progressively superseded by franchisees that are bigger, stronger, own multiple franchises and have their own resources. They may even have franchises from different non-competing co-branded outlets and raise their own venture capital. These franchisees will be totally focused on, and expert in, operational matters. The challenge for the franchisor is to deliver brand and systems value that justifies the royalty cheque from the super-franchisee. This has been the trend in the US, and there are in fact several publicly listed franchisees, and intense competition between franchise systems to attract the franchisee heavyweights.

<u>Corporate competition</u> has already increased substantially in recent years. Franchise systems have taken market share from the large corporations by developing specialty retail niches, but the corporations are fighting back. Franchise systems will experience even greater competition from department stores, supermarkets, international chains and even other beefed up franchise networks that

have added capital or other networks to their stable to achieve greater economies of scale. That said, franchise systems have proven in the past to be far too agile and innovative for large corporations. Provided franchise systems continue to adapt their product or service to the needs of consumers, use their franchisees to communicate those needs, and deliver exceptional customer service, franchise systems will continue to enjoy a competitive advantage over their corporate colleagues.

Greater sophistication is essential for franchise systems wishing to attract the best franchisees. Franchisors need to focus on brand and system development, and purchasing economies rather than just providing a range of operational services of minimal value to the discerning franchisee. Franchisors will also need to become more sophisticated in their brand promotion, communications, marketing, management, business methods, use of technology and systems. As super-franchisees deliver superior returns to the unit franchisee, franchisors will need to be sophisticated to be able compete for these franchisees.

The US trend that has seen the corporatisation of franchisors will be repeated in Australia. We will see more and more franchise companies move from private companies owned and operated by the founder, to corporations where management and ownership are separate. Corporatisation will raise capital to fund future expansion and facilitate exits for founders. Features of the new corporate franchisors will include management with specialist skills in brand building and systems development, and expert boards of directors appointed by shareholders.

Increased regulation is a feature of all western economies. There is likely to be new legislation in areas affecting franchising, such as employment law, occupational health and safety, consumer protection and taxation. In industries where rationalisation may occur, such as pharmacy, there may be a temptation to introduce franchise legislation to address industry issues. Although franchisee failure levels are very low, there is always a franchisor on hand to be blamed. In the face of circumstances of economic downturn or substantial occupancy cost increases, there may be calls for further regulation of the sector. The growth of franchising in the mobile or service field is likely to face threats from Government in the form of the extension of employee taxation regimes, although the Federal Liberal Government at present is proposing Commonwealth legislation to protect those areas from the encroachment by industrial relations legislation.

Appendix 1

List of Members of Franchise Council of Australia

http://www.franchise.org.au/index.cfm?fuseaction=list

FCA Membership List

123 Express Pty Ltd
1800 ONHOLD
1-800-GOT-JUNK? LLC
24seven
3D Paint Store Holdings Ltd
7 Eleven Stores Pty Ltd
A Balloon And Party Centre Pty Ltd
A.T.S Franchising
ABS - Auto Brake Service
Ace Body Corporate Management
Action International
Advanced Hair Studios
Advanced National Services
AGL Retail Energy Limited
AHL Investments Pty Ltd
Ali Baba Lebanese Cuisine Pty Ltd
All City Cleaning
All That And More
Allens Arthur Robinson
Amber Group Australia Ltd
AMC Commercial Cleaning
Andrew Benefield
ANZ Banking Group Ltd T/A ANZ Mortgage Solutions
ANZ Franchise Team
APCO Service Stations
Appetitos Franchise Systems Pty Ltd
Approveit Home Loans Pty Ltd
Aquatic Achievers (Douglas Family Trust T/A)
Aroma Café
Attache Sofware Australia P/L
Auset Pty Ltd
Aussie Pooch Mobile
Austrade
Australasian Pool Services Pty Ltd
Australia Pacific Computer Consultants Limited
Australia Post Head Office
Australian Exhibition Services
Australian Franchising Systems
Australian Independent Vendors Pty Ltd
Australian Money Exchange Pty Ltd
Australian Pharmaceutical Industries
Australian Private Realty Pty Ltd
Auto Leaders All Car Servicing
Auto Masters Australia Pty Ltd
Autobarn Pty Ltd
Avatar Consulting Pty Ltd
B Capital Pty Ltd
Just Cuts Canberra
Just Cuts Franchising
Just Fingerfoods pty ltd
Kelly & Co
Kelly Sports Franchising
Kemp Strang Lawyers
KenKleen Window Cleaners
Kick Juice Bars Pty Ltd
Kieran Liston & Co
Kings Swim Centre
Kiss Cafe Franchising Pty Ltd
Kleenmaid Pty Ltd
Kleins Franchising Pty Ltd
Knight Frank Licencing Pty Ltd
Kwik Fix International
Kwik Kopy
Kwik Kopy (T/A Errington Business Systems Pty Ltd)
La Porchetta Pizza & Pasta Restaurant
Lancione Partners Lawyers
Laser Group Management Pty Ltd
Lavis Melin Taylor
Le Cornu Furniture
Ledgers Franchising Pty Ltd
Lenard's Pty Ltd
Lifetime Franchise Pty Ltd (The Book People)
Link Business Australia Pty Ltd
Little Images Pty Ltd
LJ Hooker Swan Hill
Local Lenders
Logie-Smith Lanyon
Lotteries Commission of Western Australia
Macedone Christie Willis
Macpherson & Kelley Solicitors
MACT Franchise Pty Limited
Made Easy Financial Group pty ltd
Magnetite
Mannings AV Services
MapInfo Australia
Mars Venus Coaching Pty Ltd
Marshalls & Dent
Mason Sier Turnbull
Master Feng Institute Pty Ltd
Matchbox Franchising Pty Ltd
Matthews Folbigg
McInnes Wilson Lawyers
McLaughlins
McLean Delmo & Partners
McMahon Fearnley

Back in Motion Physiotherapy Pty Ltd
Baker & McKenzie
Bakers Delight Holdings Pty Ltd
Bamboozle
Bank of Queensland
Bank of Queensland Limited
BankWest
Barbeques Galore Ltd
Bargain Wheels Car Rentals (Australasia) Pty Ltd
Barry Plant Doherty
Barry's, The Home Improvers (PEACS Pty Ltd)
Bartercard Australia Pty Ltd
Bathroom Werx Australia Pty Ltd
Battery World Australia
Baybridge Lawyers
BBX Management Ltd
BCI Business Brokers
Beacon Lighting
Bean Bar Franchising Pty Ltd
Beaumont Tiles (R J Beaumont & Co Pty Ltd T/A)
BedShed Franchisors Pty Ltd
Beechworth Bakery
Belgravia Formalwear
Bennett & Philp Solicitors
Betta Stores Limited
Big Dad's Pies
Big Fun Franchises Pty Limited
Bill Buddy Pty Ltd
Bing Lee Pty Ltd
Bio-Lab Australia
BNI Australia Pty Ltd (T/A Business Network International)
Bob Jane Corporation Pty Ltd
Boost Juice Bars Pty Ltd
Boots Great Outdoors Pty Ltd
Boss Hogs Hot Dogs Pty Ltd.
Bowler Geotechnical
BP Australia
Brad's Test & Tag
Brady Australia Pty Ltd
Bramalco Group (T/A Modern Group of Companies)
Bright Eyes Pty Ltd
Bristol Banner Group Pty Ltd
Brown Wright Stein
Brumby's Bakeries Ltd
Buchanan Law
Business Growth Strategies Pty Ltd
Busy Bookkeeping Pty Ltd
Bywaters Timms
Cabot Square Pty Ltd
Cafe2U Pty Ltd
Calair Pipe Systems (Calair Systems Pty Ltd T/A)
Caltex Australia Ltd
Meerkin & Apel Lawyers
Megasealed Bathrooms Franchising Aust. Pty Ltd
Mercury Management Systems Services
Metro Modelling Academy Pty Ltd ATF The Metro Trust
Meyer & Associates
Michel's Patisserie Pty Ltd
Midas Asia Pacific Pty Ltd
Middletons Lawyers Melbourne
MINC Services
Mini Maestros Operations Pty Ltd
Mini-Tankers Australia
Minter Ellison Lawyers
Minuteman Press International Inc
Miss Maud
Mister Minit
Mister Plywood Management Pty Ltd (Mister Ply & Wood T/A)
Mobil Gosford Area Service Stations
Mobitow Geraldton
Modern Streamline Roller Shutters
Mokum International Trading Pty Ltd
Money Depot Franchising Pty Ltd
Mortgage Choice Group
Moss Financial Services
Mountain Designs/Kolumbin Retail (Wild Gear Pty Ltd T/A)
Mr Antenna Pty Ltd
Mr Carports Licensing Pty Ltd
Mr Colin McCosker
Mr Globologist Pty Ltd
Mr Meticulous Pty Limited
Mr Rentals Franchising Pty Ltd
Mrs Fields Bakehouse
Mrs Flannery's
My Virtual Home Pty Ltd
Nandos Australia Pty Ltd
Narellan Pools Pty Ltd
National Australia Bank
National Business Sales
National Recruitment Pty Ltd
Natra Pty Ltd
Nedai Pty Ltd
New Level Personal Training Studio's
New Price Retail
New Zealand Natural Pty Ltd
Nextra Australia Pty Ltd
Nicol Robinson Halletts
NightOwl Convenience Stores
NJF Electrics Pty Ltd
Nutshack Franchise Group Pty Ltd
O2V Austalasia PTY LTD T/A Open2view
Office Choice Pty Ltd
One Water Naturally Pty Ltd
OneSteel Ltd
Oporto Portuguese Style Chicken Pty Ltd
Opposite Lock

Card Connection
Cargroomers Pty Ltd
Cartridge World
Cash Converters International
Cash Loan Money Centres Pty Ltd
Catmax International
Cavalier Homes Australia Pty Ltd
Central Coast Business Lawyers
Central Park Limousines
Chakram Pty Limited
Charter Resources Group
Chemtura Australia Pty Ltd
Chick n Feed Group-Joemnik
Chicken Express Systems P/L
Chocolate Orange
Choice Hotels Australasia
Chooks Fresh & Tasty Pty Ltd
Cibo Espresso Australia Pty Ltd
City Farmers Franchising Pty Ltd
City Pacific Finance Pty Ltd
City Pacific Law Firm Pty Ltd
Clark Rubber Franchising Pty Ltd
CleanTastic Pty Ltd
Coffee Ezy (Patsa Pty Ltd T/A)
Cold Rock
Coldwell Banker NSW/ACT
Coleman & Greig
Commonwealth Bank of Australia
communikate et al pty ltd
Concrete Taxi Pty Ltd
Contours Express (Australasia Franchise Group Pty Ltd trading as)
Cookie Man Pty Ltd
Coolabah Tree Cafe
Cost Less Plants Pty Ltd
Coulton Isaac Barber
Coverall Queensland Pty Ltd
CPR Complete Property Rejuvenation
CRA Cost Reduction Analysts NSW
Creative Home Decor Pty Ltd
Creative Marketing and Design
Crown & Gleeson Business Finance Pty Ltd
Cullen Babington Hughes
Cummings Flavel McCormack
Curwoods Lawyers
Custom Car Care Australasia
Cutler Hughes & Harris
Dairy Farmers Pty Ltd Vendor Number 110842
Daly International
DANARU PTY LTD
Danlaid Contracting Brisbane (Stevenson Contracting Pty Ltd)
Danlaid Contracting Pty Ltd
Darriwill Farm Franchising Pty Ltd
David Reid Homes
Davies Knox Maynards Chartered Accountants
OPSM
Optus Administration
Ovenclean Enterprises Pty Ltd
Ovenu
OZ Bin Cleaning Pty Ltd
Oz Design Furniture
Oz-Cover Building Design Pty Ltd
Ozspy Pty Ltd
Ozzy Tyres
Pacific Internet
Pack & Send Systems Pty Ltd
Paddy Pallin
PaintRight Ltd
Paramount Franchise Services
Parasol Emt Pty Limited
Parker Enzed Australia Pty Ltd
Parmalat Australia Ltd
PARRAFINE
PBM Fitness Pty Ltd
PC Masters International Pty Ltd
Pedders Shock Absorber Services
Pet Mobile Pty Ltd
Petstock Pty Ltd
PFA Chartered Accountants
Phillips Fox
Phone Central Pty Ltd
Picton Printing
Pie Face Pty Ltd
Pilot Nexia Pty Ltd
Pirtek Fluid Systems Pty Ltd
Pizza Haven
PKF Australia
Plenty Trak Systems (Vimex Pty Ltd T/A)
PNF Management Pty Ltd T/A Pure & Natural
Poolwater Services
PoolWerx Corporation Pty Ltd
POS Displays Pty. Limited
Power Loan
Powertec Telecommunications Pty Ltd
PRD Nationwide Pty Ltd
PricewaterhouseCoopers
Priority Management Systems P/L
Pro Klean Systems
Professional Advantage
Prosell Franchising Pty Ltd
Protect-A-Window Australia Pty Ltd
Protex Australia
QB Securities
Quest Apartments
Quest Apartments WA Pty Ltd
Quick Fit Tyre Service
Quick Sign Shops Franchising Pty Ltd T/A Quick Colourprint.com.au
R.W Corrie & Co
Rams Finance Pty Ltd
Ranger Camping & Outdoors
Recruitment Vision Pty Ltd

DCM - Coffee & Donuts
Deacons
Deacons Consulting
Deloitte
Deloitte Growth Solutions Pty Ltd
Destiny Financial Solutions
DIA ORO JEWELLERY PTY LTD
Dibbs Abbott Stillman
Direct Pest Control Admin Pty Ltd
Dixon Systems
DMAW Lawyers
Doggy Wash (Flea Stoppers Pty Ltd T/A)
Dominion Printing
Domino's Pizza Australia New Zealand Limited
Donaldson Walsh
donbelinder pty ltd T/A healthy habits
Don't Fret Pet Franchising Pty Ltd
Downings Legal
Dymocks Group of Companies
Eagle Boy's Dial-A-Pizza Pty Ltd
Ecomist Australia Pty Ltd
Ecowash Mobile Pty Ltd
Edwards Global Services
Edworks Active Learning
Ekinci & Hardy Management P/L
Elite Fitness Equipment Pty Ltd
Elite Maintenance Services Pty Ltd
EmbroidMe
Endota Spa
Energie Fitness Clubs Ltd
Enzed (Parker Enzed Technology Pty Ltd)
Espresso Mobile Cafe
Ettamogah Franchising Systems
Eurolight
Executive Property Maintenance
Exhibitions & Promotions Pty Ltd
Expense Reduction Analysts
Express GST Accounting
Extragreen Travel Franchises Pty Ltd
Extrastaff Pty Ltd
Fastway Couriers (Aust) (Australian Couriers Pty Ltd t/as)
Ferguson Plarre Bakehouses Pty Ltd
Fernwood Fitness
Fernwood Womens Health Clubs Pty Ltd
Fibrecare Australia Group Pty Ltd
FiltaFry
Fire Hydrant Systems (Australia) P/L
First Class Accounts
First Class Accounts (Sydney) Pty Ltd
First Food Group Pty Ltd
Fisher & Paykel Appliances Australia P/L
Flight Centre Limited
Flippin' Fresh Seafood
FluidMasters International Pty Ltd
Foam Factory
Formalwear Express Franchising Pty Ltd
Red Rooster
Reed Business Information
Refund Home Loans
Resi Mortgage Corporation Ltd
Resumes For Results
Retail Brands Group Pty Ltd
Retail Food Group (Australia)
RetireInvest Pty Ltd
Riaz Jeena
Richard Solomon & Associates
Riordan Hume
Rivergum Furniture 1939 Pty Ltd
Roadside Auto Care
Robbins Watson
Robert James Lawyers
Ryco Hose
S2M2 Franchising Pty Ltd
Safetyquip (Australia) Pty Ltd
Save Time Services
Scoop News & Lotto Pty Ltd
Scott Alexander Pty Ltd
Sea Tow Services Australia Pty Ltd
Secretary.com.au Pty Ltd
Select Information Pty Ltd
Sensis Pty Ltd
Sign-A-Rama
Signwave Australia Pty Ltd
Sky Blue Coffees Pty Ltd
Sleepy's Pty Ltd
Slurp
Small Myers Hughes
Smart Saver
SmartCare (Franchising) Pty Ltd
Snap Franchising Ltd
Snap-on Tools (Australia) Pty Ltd
Snowgum
Software Quality Assurance Centre
South Coast Bakeries P/L
Spanline Weatherstrong Building
Spectrum Analysis Australia Pty Ltd
Spinners Holdings Pty Ltd
Sport For Life
Sportskeep Pty Ltd
Sportzing Court Care Pty Ltd
Spotless Services Ltd
ST Software Pty Ltd
Stacks of Snacks
Stain Busters Cleaning Systems ACT
Stephens Lawyers & Consultants
Stewart Germann Law Office
STORAGE KING PTY LTD
Strathfield Group Limited
Stretch-n-Grow Australia Pty Ltd
Stretch-N-Grow Upper North Shore & Northern Beaches
Subway Systems Australia P/L
Sumo Salad Franchising Pty Ltd
Supergeek.com.au Pty Ltd

FORTE fitout logistics Pty ltd
Forte School of Music
Forty Winks Franchising Pty Ltd
FRANCH-EYES Pty Ltd
Franchise Alliance Pty Ltd
Franchise Careers
Franchise Central
Franchise Control Systems
Franchise Council of Australia
Franchise Developments Management Consulting
Franchise Link
Franchise New Zealand Magazine (Franchise NZ Marketing Ltd T/A)
Franchise Point
Franchise Relationships Institute
Franchise Systems Group
Franchise Technology Solutions
Franchise Works Australia
Franchising Solutions Pty Ltd
Freedom Group Limited
Frenchams
Futureworld Drama Pty Ltd
Gadens Lawyers
Gallery 360
Gametraders Franchising Pty Ltd
Gauci Franchising Pty Ltd
Gaze Burt Solicitors
GE Commercial Corporation (Australia) Pty Ltd
Gelare International PtyLtd
Gelatissimo
Glass Art Australia
Glenwood Homes Pty Ltd
Global Art Australia Pty Ltd
Global Enterprises (t/as Salon Express Australia)
Global Living Furniture and Homewares Group Pty Ltd
Globepro's Australia Pty Ltd
Gloria Jean's Coffees
Go Gecko
Go Sushi Management
Golden Casket Lottery Corporation Ltd
Golden Circle Limited
goldenwest usa
Goodyear Auto Service Centre
Got One Pty Ltd
Grant Thornton Melbourne
Grey Army Management
Grill'd Pty Ltd
Grinners Catering (Australia) Pty Ltd
H&L Australia
Haarsmas Lawyers
Hairhouse Warehouse Pty Ltd
Hall & Wilcox
Hallas Trading (Ella Bache)
Handi Ghandi Franchising Pty Ltd
Superior Steel Lattice Pty Ltd
Sureslim Australia Pty Ltd
Survival First Response
Symbion Pharmacy Services
Synectico Pty Ltd
Synergy executive (south) pty limited
Tallahesse Pty Ltd
Taps 'n Toilets
Targett Retail Training Pty Ltd
Tasman Recruiting
Tasty Trucks Pty.Ltd.
Tattersalls Sweeps Pty Ltd
Tayco Petroleum
TCM Consulting and TCM Franchising
Teamwork Finance
Telco In A Box
Telefonix Technology Group Pty Ltd
Termi-Mesh Australia
Test Sponsor
Testel Australia Pty Ltd
Thai Express Australia
The Ad Company P/L
The Athlete's Foot Australia P/L
The Award Bookkeeping Company Pty Ltd
The Business Card Shop
The Cheesecake Shop (Hodmac Holdings t/a)
The Coaches Consortium Pty Ltd
The Coffee Club Franchising
The Computer Market Pty Ltd
The Concrete Cutter (Franchising) Pty Ltd
The Confectionery Party Shop
The Crêpe Cafe Development PTY LTD
The Duster Dollies Pty Ltd
The Edge Corporate Strategies
The Iceberg Corporation
THE KEBAB CO
The Loan Doctor Pty Ltd
The Lucky Charm
The Mortgage Bureau Pty Ltd
The Mortgage Gallery
The Natural Source
The Natural Way
The Outdoor Furniture Warehouse Pty Ltd
The Quantum Organization Pty Ltd
The Real Learning Experience
The Realise Group Pty Ltd
The Retail Doctor
The Safety Shop Pty Ltd
The Shed Company Franchising P/L
The Storage Space Company Pty Ltd
The Touch Up Guys Pty Ltd
The Tyre Factory
The Waterboys Pty Ltd
Thomson Playford
Thrifty Car Rental
Thymac Admin Pty Ltd
Tilecraft Ceramics
Timberland Furniture Franchise Systems

Han's Cafe PTY LTD
Harry's Cafe de Wheels (Holdings) Pty Ltd
Harvey World Travel Franchises Pty Ltd
Healthline Health Care Systems Australia Pty Ltd
Healthy Habits Australia Pty. Ltd.
Healthy Life Pty Ltd
Helen O'Grady International Pty Ltd
High Plains Trading (Rep. Action International)
Hill Mayoh
Hind Fort Pty Ltd
Hire A Hubby NSW Pty Ltd
Hire for Baby Pty Ltd
Hire Intelligence
Hire Intelligence North Sydney
Hobbysew
Hocking Stuart
Hog's Breath Cafe - Mackay
Holding Redlich
Holistic Group Pty Ltd
Holy Sheet! Homewares
Home Entertainment Express Pty Ltd
Home Wilkinson Lowry
Honda Australia MPE
Horizon Franchising Pty Ltd
Horizon Media Pty Ltd
Horseland Saddlery Pty Ltd
Horwath
Hosemasters International Pty Ltd
Hotkey Internet Services
Hotkey Internet Services Pty Ltd
Hotondo Building Pty Ltd
Howards Storage World
Hudsons Coffee
Hungry Jack's Gold Coast
Hungry Jack's Pty Ltd
Hunt & Hunt Lawyers
Hydrodog
I.L Wollermann
Icon Business Solutions
IFX International Inc.
Imagine Essential Services Limited
Ink On the Run
iNSIGHT Home Loans (GSR Corporation Pty Ltd T/A)
Insite Data Solutions
Insurance Australia Group
Intelink Franchise Services Pty Ltd
Inut Inut Pty Ltd
Investor Finance Pty Ltd
ISS Facility Services
Jackson McDonald
James Home Services
Jani-King (Aust) Pty Ltd
Jarima Holdings Pty Ltd
Jaymak Australia Pty Ltd
Jesters Jaffle Pie Company
Tint a Car
Tobacco Station Group
Tom's Trash Paks Pty Ltd
Toni & Guy Australia Pty Ltd
Toohey Reid Pty Ltd
Total Building Maintenance
Trampoline Franchising P/L
Travelworld
Trios Pty Ltd
True Choice Home Loans Pty Ltd
Ultra Tune (S A) Pty Ltd
Ultra Tune Australia Pty Ltd
Uncle Tony's Kebabs
University of New South Wales
Urban Burger (S2M PTY LTD t/as)
Vaby's Franchising Pty Ltd
Van Go Australia
Vatman Group
Vaughan Barnes
Versatile Buildings TA Totalspan Australia
Victory Curtains & Blinds
VIP Australia Pty Ltd (VIP Home Services)
Viva Life Photography
Walk on Wheels Franchise Systems Pty Ltd
Walker Wayland WA Pty Ltd
Waterco (Swimart)
Webresource Testing Company
Wengor Pty Ltd t/a City Pacific Finance - Business Solutions
Westpac Banking Corporation
Wet-seal Management Pty Limited
Whirlwind Print
WHK Greenwoods
WHK Greenwoods
William Buck
WISE Employment Ltd
WiseOnes Australia Pty Ltd
Wisewoulds Lawyers
Wok in a Box Pty Ltd
Wood Rot Doctor
WordWerx Pty Ltd t/a Franchise Advisory Centre
Workforce Services Pty Ltd
Worldwide Online Printing Aust/NZ Pty Ltd
Worldwide Refinishing Systems (Aust) Pty Ltd
Wozzie Trading Pty Ltd t/as Chooks Fresh & Tasty - Byford - Coolbellup - Maddington
Wrappings Pty Ltd
Xpresso Delight Pty Ltd
Xpresso Mobile Coffee Bar Pty Ltd
Yates Security
Yum Restaurants International
Zarraffa's Franchising Pty Ltd
Zebra Interactive Pty Ltd
ZUVELA LAWYERS

Jetset Travel World
Jim's Corp Limited
John Brennan Franchising
John Cully Pty Ltd
John Danks & Son Pty Ltd
Jones Condon
Jumping J-Jays Franchises Pty Ltd
Just Better Care Franchising Pty Ltd

Appendix 2

FCA Member Standards

http://www.franchise.org.au/content/?id=205

Franchise Council of Australia - Member Standards

To lodge a complaint please direct to:

The Complaints Officer
Franchise Council of Australia
PO Box 2195
Malvern East VIC 3145

Email: complaintsofficer@francise.org.au

(i) The new member standards promoting excellence in franchising

One of the hallmarks of a reputable industry sector is a commitment to high standards of personal and professional conduct. This enhances public perceptions of franchising, helps safeguard the investments of franchisors and the businesses of franchisees, protects franchise networks from unfair or unethical attack and provides guidance for those seeking to commence their franchising journey.

The Franchise Council of Australia (FCA) encourages its members to maintain standards of conduct worthy of franchise sector professionals. The Member Standards are designed to provide members of the FCA with an authoritative guide on acceptable standards of conduct.

The FCA believes the Australian franchise sector to be well regulated with the Franchise Code of Conduct (the Code) allowing for adequate dispute resolution procedures and disclosure provisions to assist and guide the sector. It also considers that the franchise relationship between the franchisor and franchisee can be developed even further with best practice guidelines in the form of Member Standards.

It is the FCA's view a member gains significant market benefit in identifying themselves with FCA membership and as such the business practice and activities of members should work towards franchise best practice.

The Member Standards and Best Practice are not intended to anticipate each and every occurrence of a franchise relationship, but rather, articulate the values upon which the members of the FCA can structure their franchise relationships and strive to conduct their businesses.

If a member does not comply with the requirements of the Member Standards then investigation and disciplinary procedures are in place to handle the matter. It is not intended that breach of the Member Standards have any legal consequences other than potentially in relation to membership of the FCA. Clause 2.10(1)(b) of the Constitution of the FCA empowers the FCA Board by three-quarter majority to censure, suspend or expel from the FCA a member who fails to comply with any Standards of Conduct applying to them.

The FCA will respond to any complaint alleging breach of the Member Standards by a member, but does not have sufficient resources to vet documentation, audit behaviour or generally police compliance. Use by a member of the FCA logo does not carry any endorsement or certify compliance, and the FCA accepts no liability to any person in relation to any breach of these Member Standards.

Franchising Activities
All Franchise Council of Australia members are expected to conduct their franchising activities professionally and in accordance with Australian law. They are expected to comply with agreed minimum standards of conduct.

The FCA considers the following standards to be relevant to Members:-

- Members of the FCA shall abide by all relevant State and Federal laws including in particular the Franchising Code of Conduct and the Trade Practices Act. A member shall within 14 days of written request by the FCA furnish to the FCA a copy of its current disclosure document, franchise agreement and any other documentation or advertising material used in connection with the appointment of a franchisee.
- No member shall imitate the trade mark, trade name, corporate name, slogan, or other mark of identification of another member of business in any manner or form that would have the tendency or capacity to mislead or deceive.
- Members will become familiar with the content of these Member Standards and draw them to the attention of clients as appropriate from time to time.
- A Member, be they franchisor, vendor franchisee, franchise broker, or representative of a franchise system should not sell a franchise if at the time the franchisor or vendor franchisee knew or ought to know that a reasonably competent franchisee would be unlikely to be able to successfully operate the franchise.
- Members are expected to behave professionally and refrain from illegal, unethical or improper dealings or otherwise act contrary to the image of franchising or the FCA.

Relating to a franchisor and franchisee

- A franchisor shall as part of its franchisee recruitment process make reasonable investigation to assess whether a prospective franchisee appears to possess the basic skills and resources to adequately perform and fulfil the needs and requirements of the franchise.
- The franchisor shall have training and support processes as applicable to the franchise system to help franchisees improve their abilities to conduct their franchises. Franchisees will endeavour to apply and adapt all learning to their operation
- A franchisor and franchisees should be reasonably accessible and responsive to communications, and provide a mechanism by which ideas may be exchanged and areas of concern discussed for the purpose of improving mutual understanding and reaffirming mutuality of interest.
- Franchisors and franchisees shall endeavour to resolve complaints, grievances and disputes through direct communications and negotiation. Failing this, consideration should be given to mediation or arbitration.
- Franchisors and franchisees should in their dealings with one another avoid the following conduct, where such conduct would cause significant detriment to either party's business:
  (a) substantial and unreasonable overvaluation of fees and prices; and
  (b) unnecessary and unreasonable conduct beyond that desirable for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

Relating to a Supplier Member

- A Member who is a lawyer, accountant, consultant or other supplier or service provider ("Supplier Member") should behave in a manner consistent with these guidelines.

- Respect the integrity of established franchise systems and not seek to inflame any dispute, incite litigation, generate media coverage or otherwise act in any way which is unprofessional or may create a misleading impression of the system.
- Provide a client or prospective client on request with a written resume or profile of any relevant qualifications of the supplier together with true representations of the supplier's franchising education and experience;
- Respect the confidentiality of all information received concerning a client's business which is not in the public domain and will not disclose or permit disclosure of any such information without the client's prior permission in writing;
- Not advise any franchisee or prospective franchisee in relation to any franchise opportunity offered by any franchisor for whom the adviser has acted, without full disclosure of relevant circumstances;
- Disclose to a client or prospective client any personal or financial interests or other material circumstances which may create a conflict of interest in respect of that client and in particular, without derogating from the generality of the foregoing:
  - any directorship or significant interest in any business which competes with the client;
  - any financial interest in goods or services recommended by the Adviser for use by the client;
  - any personal relationship with any individual in the client's employment;
- Not undertake work for which they are not appropriately licensed, qualified and experienced.

Inquiry into the Operation of Franchise Businesses in Western Australia

Submission from

FRANCHISE COUNCIL OF AUSTRALIA

January 21, 2008

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Introduction

As the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising the Franchise Council of Australia welcomes the opportunity to provide input to this Inquiry.

Industry statistics confirm that franchising continues to prosper throughout Australia, including in Western Australia. The FCA does not believe there are any endemic problems in franchising, a view confirmed by the recent Federal review of the Franchising Code of Conduct. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public.

All participants in the franchise sector acknowledge that the current Federal regulatory framework is working well. The *New Deal Fair Deal* Reforms were introduced in 1998 with bi-partisan support, and the Government's legislative response which takes effect March 1, 2008 also has bi-partisan approval. The Mathews Committee Report on the operation of the Franchising Code of Conduct noted as follows:-

> "*Strong support for the Code has been registered throughout the review process. It is widely seen as pivotal to the continued success of the franchising industry".*[21]

The FCA has been strongly supportive of the current Federal regulatory framework, including the recent reforms which will provide additional protection for prospective franchisees. The FCA believes the current regulatory environment creates a fair balance between the need for effective regulation supported by a strong and well resourced regulator, and the importance of minimising compliance costs for this entrepreneurial sector.

The FCA is aware of recent press articles in relation to certain aggrieved franchisees, and of the background to the significant commercial dispute between Yum Brands and the operator of a substantial number of KFC outlets. No doubt these matters have played a part in the Government's desire to examine the operation of the sector in Western Australia. It is not the role of the FCA to take sides in any matter. Rather the FCA represents and promotes the growth and development of franchising, as opposed to the interests of franchisors or franchisees alone. In preparing this submission the FCA has sought input from its franchisor, franchisee and supplier members including the FCA Legal Committee. The FCA strongly believes that franchising best practice requires collaboration between franchisors and franchisees, as opposed to the adversarial approach advocated by some with vested interest in promoting litigation.

The Background Paper prepared to assist those making submission to the Inquiry has been helpful in assisting the FCA to provide useful information to the Inquiry.[22] The following Executive Summary sets out the FCA's broad response to the specific terms of reference of the Inquiry. These matters are also discussed in more detail in section 7. Section 3 provides background on the policy position of the FCA and its attitude to franchise regulation, with sections 4, 5 and 6 providing a detailed analysis of the development and operation of the current regulatory regime. Section 8 contains some general remarks and observations on issues that from experience we find are raised in inquiries of this nature. The appendices contain the 2006 FCA Industry Report, which contains a broad collection of industry statistics and information and remains fundamentally current, and the FCA Member Standards.

[21] Foreword by Graeme Mathews, p4, Review of the Disclosure Provisions of the Franchising Code of Conduct.
[22] The FCA notes the intent of the background paper, being to provide very broad general guidance to those making submissions, and has therefore not commented specifically on any matters in the paper. There are some errors in the background paper which would warrant correction, and some comments with which the FCA would wish to take issue or comment upon, if the background paper had any broader purpose.

Executive Summary

The broad position of the FCA in relation to the specific terms of reference for this Inquiry can be summarised as follows:-

(2) The parties to a franchise agreement should be left free to negotiate the commercial terms to bind them in their business relationship. It would be totally inappropriate, and distort many existing commercial arrangements, to provide franchisees with specific rights of renewal or other statutory entitlements at the end of a franchise agreement;

(3) There is no demonstrable need for further disclosure of the respective rights of the parties to a franchise agreement either in relation to renewal or extension of a franchise agreement, or generally. It is (from March 1, 2008) a mandatory requirement that the franchise agreement be provided with the comprehensive disclosure document and in the form it is intended to be executed. Disclosure is supported by a process that ensure franchisees have ample time to make a considered decision and are strongly encouraged to obtain legal and business advice;

(4) It would be totally inappropriate, and distort many existing commercial relationships, to legislate in relation to the rights of the parties to goodwill at the end of a franchise agreement. The current legal position is clear, supported by High Court of Australia legal precedent and well understood by market participants. Further, it is consistent with principles applying to commercial leases and other non-franchise business relationships. The inclusion of a legislative right to goodwill under a franchise agreement would lead parties to avoid franchising, which would be damaging to franchisors, franchisees and the Australian economy;

(5) It would be totally inappropriate to require the parties to a franchise agreement to negotiate franchise agreements "in good faith". There are already substantial protections for franchisees entering into franchise agreements, including the Franchising Code of Conduct and s52 of the Trade Practices Act. There is also an existing implied duty of good faith and fair dealing implied into a franchise agreement in the context of the ongoing relationship.[23] The insertion of a good faith obligation in relation to franchise negotiations, or in relation to extending the agreement after termination, would create massive legal uncertainty and interfere with many existing commercial arrangements;

(6) The prohibitions on unconscionable conduct contained in the Trade Practices Act and the State Fair Trading legislation operate effectively in the context of the franchise relationship, and the ACCC has been active in enforcement. There are several precedents for the application of the unconscionable conduct provisions in a franchise context.[24] The arrangements work less effectively in the context of commercial leasing, but this is as a result of other factors more related to abuse of market power by landlords;

(7) There is no justification for legislating in relation to franchising matters on a State basis. The Code requirements and the Trade Practices Act prohibitions

[23] See Far Horizons Pty Ltd v McDonald's Australia Ltd, where Byrne J noted "there is to be implied in a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose. Such a term is a legal incident of such a contract."
[24] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

on misleading or deceptive conduct provide a comprehensive regulatory umbrella for the sector. There is already an implied duty of good faith and fair dealing implied into every franchise agreement. The purpose of State Fair Trading legislation in the business context is to essentially mirror the Federal Trade Practices Act and provide coverage to those few limited areas not covered by the jurisdiction of the TPA under the Corporations power of the Constitution. The FCA would strongly resist any attempt to introduce different State based remedies, whether they be in relation to goodwill or good faith or any other issue;

(8) The level of disputation in Australian franchising is statistically very low. It also compares very favourably with the levels of disputation in other jurisdictions including the USA. The mediation based dispute resolution procedure set out in the Code has been extremely successful, with the Office of Mediation Adviser reporting that over 80% of disputes it sees are successfully resolved via the mediation process. The cost of mediation is minimal, and far less than even the simplest court or tribunal procedure. The ACCC has been an active and efficient regulator. Any aggrieved franchisee can, at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act. The ACCC is well resourced, is duty bound to investigate all claims where there is a breach of the Code or the TPA, and has a strong track record of taking enforcement action where necessary. The FCA has supplemented these procedures with informal dispute resolution mechanisms pursuant to the FCA Member Standards. Although the FCA has seen media reports of alleged inappropriate conduct against franchisees, the FCA's experience (and indeed that of the ACCC according to its public statements) is that the allegations made in the media are often not substantiated by fact;

(9) In the opinion of the FCA, the Australian regulatory regime represents world's best practice. However the FCA is supportive of affirmative action to improve good practice in franchising. Indeed the FCA, through its various events and educational activities, actively promotes continuous improvement in franchising. From a regulatory perspective the FCA would like to see mediation made mandatory, and for all franchisees to be compelled to obtain legal advice prior to signing. In the FCA's experience there is a high correlation between franchisee failure or mismatched expectations, and failure to obtain expert advice. A constructive role for the State Government could be the funding of professional advice for prospective first time franchisees, and/or mandatory educational courses for prospective franchisees. More broadly, the FCA supports ongoing review of the regulatory regime at a Federal level, but does not consider any regulatory change is necessary at present. The Australian regulatory environment is already more prescriptive and comprehensive than most regimes overseas. Interestingly the UK, Singapore, Hong Kong and New Zealand – countries that are probably the closest to Australia in terms of legislative framework – in fact have no specific franchise legislation at all.

(10) It is inappropriate to seek to somehow enshrine "good practice" into legislation, as that is not the role of legislation. Legislation should establish mandatory standards, not attempt to codify "good practice". The Franchise Council of Australia endeavours, though its Member Standards and through educational and other initiatives, to provide guidance on best practice. However this is always done as guidance, not regulation. In franchising "good practice" is driven by the mutuality of interest of franchisor and franchisee. So, for example, many franchise systems have internal dispute resolution mechanisms that come into play well before mediation. In the context of the franchise term, it is not uncommon for franchisors to allow a franchisee to continue to extend the term of a franchise beyond the initial agreed term. However this is driven by mutuality of commercial interest, as

otherwise the franchisor has to find and train a new franchisee or operate the business itself, which many franchisors prefer not to do. However it would be totally inappropriate to legislate any of these common practices as a mandatory requirement.

(11) The FCA is strongly supportive of the current Federal regulatory environment. The FCA is opposed to State regulation of franchising, as this may create unnecessary administrative and compliance cost or become a barrier to cross-border or national franchise networking. It is difficult to envisage a franchising issue which would exist only in a single State or Territory. From a broader policy perspective, there are important initiatives State Governments could take to enhance the growth and development of franchising. The FCA considers the following issues to be important:-

(a) The FCA would be keen to receive a commitment by State Governments to fully harmonise legislation that has impact beyond State boundaries and avoid the duplication, inconsistency and cost of State based regulation not only in relation to franchising, but in relation to taxation, retail tenancies, workplace issues, occupational health and safety, business regulation and property law;

(b) The FCA believes there is a real opportunity presented by the Labor State and Federal incumbency for all Governments to move beyond lip service to genuine reform of red tape and business compliance costs. Typically this will require the simplification of legislation and the dismantling of State based public service bureaucracies which become self-justifying and act as an impediment to harmonisation in favour of more efficient nationally integrated infrastructure. The recent Productivity Commission report on the additional cost of the concurrent regulation of consumer affairs at Federal and State level discussed in section 5 is compelling evidence of the extent of possible savings.

As the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising, the Franchise Council of Australia welcomes the opportunity to provide input to this Inquiry. The FCA is concerned to ensure that the franchise sector operates efficiently and fairly, and there is a strong positive perception of franchising in Western Australia.

The FCA trusts the material included in this submission will assist the Inquiry. Although the FCA is not privy to the content of submissions made by other parties to the inquiry we have endeavoured in section 8 to anticipate and briefly respond to issues that have been raised in the past. If a matter is not sufficiently addressed in this submission or you require further comment or information the FCA would be pleased to provide it.

The Franchise Council of Australia

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers involved in franchising in Australia. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. Details of the activities of the FCA can be found at www.franchise.org.au Additional information on the FCA and a list of current members of the FCA are set out in the Report on the Current State of Australian Franchising in Appendix 1.

The FCA has as its core aim the promotion of the growth and development of franchising in Australia.

The FCA believes collaboration (as opposed to an adversarial relationship) between franchisors and franchisees has been one of the reasons for the success of the Australian franchise sector, and remains critical to its future success. The FCA represents franchising, and the joint and separate interests of all stakeholders, as opposed to the interests of one component of the sector over another component.

The Western Australian Small Business Minister has established this inquiry to consider existing laws in terms of whether they disadvantage franchisees or provide insufficient protection for franchisees. Press reports have quoted instances of alleged inappropriate behaviour by franchisors as the cause of failure of some franchisees, although no specific detail has been provided. These are important issues for the franchising community. The FCA would like to work with the State Government and the Inquiry to better understand the nature of the issues that have been raised with them, and provide input into the best manner of resolving any identified problems. The FCA can also play an important role in helping the Inquiry to verify the accuracy of representations made to the Inquiry, as in our experience there can often be a divergence between assertions and fact. Some of the franchising matters that have received extensive media publicity are being promoted by people with an often undisclosed self-interest in fermenting discontent and an adversarial approach to franchising. The FCA can help the Inquiry to sift through to the real facts.

The FCA has always been very concerned at any allegations of inappropriate conduct in franchising. As a result, in its submission to the recent Federal Government Inquiry into franchising, the FCA made several recommendations to improve the Franchising Code of Conduct and provide additional information and protection to franchisees. The FCA supported the legislative amendments to the Code made by the Federal Government (with bi-partisan support) and which take effect March 1, 2008. Further, the FCA has introduced its own Member Standards to provide additional guidance to FCA members on what is required of franchisors, franchisees and service providers to ensure responsible franchising. The Member Standards are supported by educational programs and a complaints process that enables the FCA to remain in touch with the issues causing concern in the franchising community.

The FCA is actively seeking information from its franchisee community as to the issues relevant to its franchisee stakeholders, including matters before this Inquiry. It has already conducted franchisee forums around the country, and this submission has drawn from that input. The members of the Western Australian Chapter of the FCA also met to discuss the terms of reference and provide input into this submission. In relation to the legal issues raised the FCA has sought input from its Legal

Committee, which comprises representatives of approximately 20 franchise law firms and includes representatives from all States including Western Australia. The feedback from the members of the Legal Committee was unanimous, and indeed quite stridently so, in support of the retention of the existing legal arrangements in relation to certainty of expiration of franchise agreements and goodwill on termination. The FCA Legal Committee, and indeed the FCA itself, strongly supports the legal position established by the High Court of Australia in this area.

More broadly the FCA board has identified franchisee inclusiveness as one of its top priorities for the ensuing year. To give effect to this priority franchisee representatives have been appointed in each State, and Gloria Jeans franchisee Tony Melhem has been appointed to the FCA board to specifically represent the franchisee interests in view of the recent retirement of long time franchisee director John Longmire.

The FCA remains committed to the promotion and development of franchising in Australia. In particular the FCA supports any improvements that can assist prospective franchisees to be better informed.

The FCA has always supported initiatives which acknowledge the need for entrepreneurial and contractual freedom but promote the two pillars upon which the current regulatory framework has been built - responsible franchisor behaviour and effective franchisee due diligence.

The FCA looks forward to working with the Inquiry and the Western Australian Government to assist them to meet the objectives of the Inquiry and more broadly to foster the growth and development of franchising in Western Australia.

The Development of Australian Franchising

The franchise sector in Australia makes a very substantial contribution to the Australian economy. The statistical information provided in the Background Paper produced to provide information to assist those making submissions to the inquiry provides statistics from 2006. More recent information shows that the sector has continued to grow and develop. Industry turnover is estimated by IBISWorld Research at $128 Billion, which equates to approximately 3.2% of Australian Gross Domestic Product[25]. The sector has around 1,000 franchise systems, 66,000 units and employs 600,000 people. The indirect impact of franchising is estimated at 1.5 times these figures based on research on franchising in the US conducted for the International Franchise Association by Price Waterhouse Coopers.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. Since 1998 the sector has not only grown, but matured and developed into one of the primary engines for economic growth in Australia. We have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practice.

The FCA is a strong supporter of the regulatory framework established by the Federal Government in 1998. It considers the *New Deal Fair Deal* reforms have made a very important contribution to the success of Australian franchising. The Background Paper makes reference to these reforms, but in the context of the discussion on "fairness" should be clarified in a number of respects:-

[25] The reference to 14% of GDP is in fact incorrect. 3.2% is the correct figure.

(12) Although important, the introduction of the Code was only one part of the New Deal Fair Deal reforms;

(13) The reforms included the introduction of a prohibition in s51AC on unconscionable conduct. The ACCC has successfully taken action in a franchising context on several occasions based on alleged unconscionable conduct by franchisors[26];

(14) The reforms established the ACCC as the designated regulator of the sector, and provided significant resources to the ACCC to take action where appropriate.

The FCA believes that Australia's regulatory framework represents world's best practice in terms of striking a balance between strong and effective regulation and the fundamental principles of free enterprise. It features the comprehensive Franchising Code of Conduct requirements, which are administered by the ACCC. In addition to the Code, the Commonwealth Trade Practices Act's prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions. It is beyond rational argument that the Australian regulatory environment for franchising is the most comprehensive of any nation including the US.

The FCA believes that franchisors that break the law must be strongly punished, as their conduct affects the general reputation of the sector and the value of the assets of reputable franchisors and franchisees. The FCA has been supportive of ACCC enforcement action. The ACCC has moved quickly, such that there has not often been a need for civil action by franchisees. Interestingly, in the vast majority of cases where either a franchisee or the ACCC have taken court action they have been successful. Importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA does not pretend that franchising is perfect, and indeed has been at pains to ensure that potential franchisees are not lured to the sector by a belief in the infallibility of a franchised business. The FCA, and more recently the ACCC, have emphasised that franchising not only requires responsible franchisor behaviour, but proper franchisee due diligence. Many of the problems the FCA sees in franchising would not have arisen had the potential franchisee sought appropriate specialist legal and business advice and undertaken proper due diligence prior to purchasing the franchise. This remains probably the biggest ongoing challenge for the sector.

[26] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

The Current Regulatory Environment

5.14 Balancing contractual freedom and regulation

The FCA is strongly supportive of the current regulatory environment. In our view it strikes an ideal balance between contractual freedom and flexibility that encourages growth and entrepreneurial behaviour, and regulatory intervention to support the contractual process and ensure informed and fair bargains are made.

The FCA believes that the two key principles that underlie effective franchising are responsible franchisor behaviour, and proper franchisee due diligence and risk awareness. The Code and the TPA prohibitions on misleading or deceptive conduct and unconscionable conduct support these principles, and do not undermine the important principle of freedom of contract. The Code requires responsible and lawful franchisor behaviour through a comprehensive disclosure regime, mandatory mediation based dispute resolution, constraints on restricting transfer and controls on termination. The Code facilitates proper franchisee due diligence and risk awareness by providing extensive information and franchisee contact details in the disclosure document, and creating a framework for franchisees to obtain independent advice and then sign (with the protection of the 14 day disclosure period and the 7 day cooling off period) without undue haste.

The FCA believes the Franchising Code of Conduct and the Trade Practices Act provide important protection for franchisees, and the ACCC has been a highly effective industry regulator. Australia's level of disputation, at just over 1%, is substantially lower than the US, which is estimated by the International Franchise Association at around 6%. Further, over 80% of disputes in Australia are successful resolved by mediation, whereas in the US arbitration and litigation are the more dispute resolution common methods. Another encouraging statistic is that the level of franchising complaints to the ACCC continue to fall, and is at historically low levels notwithstanding the substantially increased high profile of the ACCC. As a consequence the FCA considers Australian franchising is world's best practice.

The regulatory framework has only recently been comprehensively reviewed at a Federal level. The FCA supported the review of the Code conducted in 2006, and the Federal Government's response. These amendments take effect March 1, 2008. Obviously any review by this Inquiry needs to take into consideration the fact that these reforms, which include additional disclosure requirements in areas such as rebates and former franchisee information, have yet to take effect. Fundamentally the FCA believes the recently improved disclosure provisions in the Code are adequate and work well for the market.

The danger with any review is that regulatory change will be recommended without proper analysis of the nature and extent of any problem or assessment of the regulatory impact and cost. Given the objective evidence available as to the overall healthy state of the sector any recommendations should only be made after very careful analysis, properly tested evidence and having regard to the impact and cost of any proposed change.

5.15 State regulation of franchising

Although the FCA welcomes the interest shown by the Western Australian Government in franchising, and is appreciative of the opportunity to discuss franchising issues with the Inquiry, the FCA is strongly supportive of the regulation of franchising solely at a national level.

There would be no issues in franchising in Western Australia that would be unique to the Western Australian market. Over 95% of franchisors are small businesses, and they have limited capacity to absorb the costs of excessive regulation. Most franchise systems operate, or at the very least intend to operate, across State boundaries. State regulation of franchising would create unnecessary duplication and cost at a time when all Governments are championing a reduction in regulatory red tape.

On this point, and although only generally relevant, we note that the costs of regulatory duplication have been independently recognised quite recently. In early December the Productivity Commission released a report that estimated that the concurrent regulation of consumer affairs at Federal and State level cost an estimated $4.9 billion above the cost of a unified Federal scheme. The franchise sector cannot afford even a fraction of this additional cost, and the FCA and its members would strongly resist any attempt to regulate at a State level given the existence of the current Federal regime.

It is also useful to consider the US experience, where they do have concurrent Federal and State regulation. According to the International Franchise Association the consequence of inappropriate State legislation is not only substantial extra compliance cost, but often that franchise systems simply withdraw from business activities in that State. For example the damage to the State of Iowa due to the introduction of its franchise legislation has been significant, with 135 companies reducing or halting expansion in Iowa, with a consequent cost of $207 million in lost sales and 7,500 jobs. 27 US States have since rejected Iowa type laws, and the legislation has been broadly condemned.

5.16 Understanding the current regulatory environment

Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of that framework are:-

(1) the Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. In addition to typical requirements to disclose the franchisor's business background, relevant financial information, previous litigation and solvency history and other relevant matters the Code uniquely requires the franchisor to:

  (a) include a list and contact details of existing franchisees, which facilitates contact with those parties as part of due diligence. As of March 1, 2008 franchisors will also have to disclose details of former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence; and

  (b) requires a director to certify the solvency of the franchisor as at the end of the last financial year, which provides considerable additional comfort to prospective franchisees.

(2) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(3) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(4) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to prove it had reasonable grounds for making any representation as to a future event;

(5) the prohibition on unconscionable conduct in s51AC of the TPA; and

(6) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct.

The history of litigation in franchising shows that this protection is meaningful and effective. In the vast majority of cases where either a franchisee or the ACCC has taken court action they have been successful. More importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA contends that these statistics clearly demonstrate that franchisees are not disadvantaged by current laws, and that current laws provide strong protection against franchisors that act unlawfully. The dispute resolution mechanisms are world's best practice in terms of success and cost effectiveness, and franchisees have ready access to low cost remedies such as mediation. The ACCC is an active, expert and well-resourced regulator that is duty bound to investigate, at no cost to a franchisee, any allegation that a franchisor has breached the Code or the TPA.

The FCA has enacted its own Member Standards to supplement these statutory remedies, and provide some additional remedies. Again there is no cost to a complainant.

5.17 Disclosure as part of the contractual process

The Code not only facilitates the provision of extensive information through the disclosure document, but does so as part of a process that is designed to ensure as far as is reasonably possible that a prospective franchisee makes an informed decision to purchase the franchise. The information to be disclosed includes a list with contact details of existing franchisees, which enables a prospective franchisee to make contact with those actually involved in the business to verify any information provided by the franchisor. From March 1, 2008 this requirement is extended to include a list of former franchisees. The disclosure document must be provided at least 14 days prior to signing the franchise agreement, which allows ample time to obtain advice and avoids the risk of high pressure selling. Even then there is a mandatory 7 day cooling off period, so that a franchisee can essentially change its mind and exit the arrangement without penalty.

Importantly disclosure is intended only as part of the franchisee's due diligence process. The Code expressly notes in clause 6A the purpose of the disclosure document, being to give to a prospective franchisee "<u>information</u> from the franchisor to <u>help</u> the franchisee make a reasonably informed decision about the franchise". On the front page of every disclosure document as a mandatory requirement is a detailed statement advising that the disclosure document contains "<u>some</u> of the information you need in order to make an informed decision", and telling prospective franchisees "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

The advice process established by the Code is intended to reinforce the disclosure process by endeavouring to ensure the disclosure document and other information is not only read and understood by the franchisee, but considered by an independent legal, business and accounting adviser. A franchisor must receive from a prospective franchisee before signing the franchise agreement a certificate that the franchisee has either obtained advice, or been told that the advice should be sought but has decided not to seek it. It is hard to imagine a more comprehensive process. Indeed no other regulatory regime in Australia, and probably in the world, combines the concepts of disclosure, advice and pre-contractual certification so comprehensively. The concepts of cooling off, legal and business advice and disclosure of former franchisees are uniquely Australian.

5.18 Disclosure and compliance costs

There are currently over 250 separate pieces of information to be included in the disclosure document, which must be in a prescribed order and layout. No doubt there are other pieces of information that could be included. However any change to the current format will result in compliance costs not just in making changes to the document, but in accessing the necessary information and recording information for future documents. Depending on the nature of the information franchisors may not have kept records on the matter, so information may need to be accessed from archives or other records, at substantial cost. Any additional disclosure obligations must be considered in the context of the relevant compliance costs. This issue is particularly relevant given the stated purpose of the Code, being to provide "some" of the relevant information, as opposed to "all" relevant information.

5.19 Current complaints

Current research and anecdotal evidence from those associated with franchise complaints confirms that the level of complaints is low. Statistically franchisee non-compliance with the system has in fact been identified as the most significant cause of disputes. Anecdotally there also appears to be a strong correlation between complaints and a failure on the part of the franchisee to conduct due diligence and obtain independent legal, accounting and business advice.

As mentioned above, the FCA has itself received complaints from various parties involved in franchising since the launch of its Member Standards in 2005. On investigation many of the allegations of franchisor misconduct, including those that have achieved significant press coverage, have not in fact been substantiated. Further, where misconduct may have occurred, existing legal remedies were already available and appeared adequate. Interestingly, on a cursory analysis, few of the apparent root causes for the complaint appeared to relate to inadequate disclosure, but rather:-

- unwise investment decisions where a franchisee failed to undertake due diligence or seek independent legal, business and accounting advice prior to entering into the commercial arrangements;

- differences of commercial opinion as part of the ongoing franchise relationship;

- conduct by a franchisor that would appear to be illegal by virtue either of the Code or s52 of the Trade Practices Act;

- conduct of third parties such as landlords;

- mismatched expectations of business success or an underestimation of the amount of work required to achieve success;

- cost overruns in establishment costs or underestimation of start-up costs including working capital.

The FCA recognises that there have been in recent times a handful of quite public allegations of inappropriate business conduct in franchising. No doubt there are instances of inappropriate behaviour that have not come to our attention. However these complaints need to be considered in the context of the 66,000 franchised units and almost 1,000 franchise systems. Given the size of the market and the interdependent and long-term nature of the franchise relationship, often described as a business marriage, the divorce statistics in franchising are remarkably low.

5.20 Consultation and member input

The FCA submission was prepared after extensive consultation with its membership and is intended to compliment and provide background for the formal meetings with the Inquiry. It provides an overview of the sector and will identify many of the issues before the market at the moment and will also suggest some of the weaknesses in the current system.

The FCA has included with this submission some additional material providing background, or addressing specific issues. Although these documents have been prepared for other purposes it was felt that their inclusion was appropriate to assist the Inquiry in its deliberations and enable the Inquiry to gain a greater understanding of the issues before the sector. These important appendices include:

- An industry report on the current state of Australian franchising; and
- The FCA Member Standards and complaint process

We have also provided in section 5 below a commentary on the existing disclosure provisions to help the Inquiry in its deliberations.

We would welcome the opportunity to address any queries arising from our submission, or to respond to matters raised by any other submissions. We would also welcome the opportunity to provide input form the perspective of practising franchisors and franchisees to any proposed recommendations of the Inquiry to Government. Our position, and indeed our corporate objective as an organisation, is that we will support any initiative that is in the best interests of Australian franchising.

Disclosure Under the Franchising Code of Conduct

5.21 Introduction

The Franchising Code of Conduct provides a comprehensive regime of disclosure unparalleled in the Australian legal system.

Disclosure underpins the operation and effectiveness of the Code, and supports the fundamental legal principle that whilst freedom of contract should apply, contracts should be made between informed parties. The disclosure process is supplemented by a legal advice process to further ensure the parties have the opportunity to be fully informed.

This regime is even more effective when seen in the context of the general prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act and supporting provisions. Even without the disclosure obligation contained in the Code, the prohibition on misleading or deceptive conduct as interpreted by Australian courts of itself prevents a franchisor from providing information that is false, misleading or deceptive. It also probably prevents a franchisor from withholding information that is material and relevant to the decision, as in relationships such as a franchise relationship the courts have been prepared to find that silence of itself can be misleading. This would particularly be the case given the existence of the Code – if the franchisor is in possession of any material and relevant information that contradicts or renders misleading any information contained in the disclosure document the franchisor would be exposed to a misleading conduct claim if the franchisor did not disclose it.

5.22 The Effectiveness of Disclosure

The effectiveness of the Code's disclosure process should fairly be judged against the stated purpose contained in clause 6A of the Code, which provides (paraphrased, and with emphasis added):

The purposes of a disclosure document are:-

*1.1.1.3 to give to a prospective franchisee … **information** from the franchisor to **help** the franchisee make a **reasonably informed** decision about the franchise; and*

*1.1.1.4 to give a franchisee **current information** from the franchisor that is material to the running of the franchised business.*

It is clear from an analysis of this purpose, noting in particular words that have deliberately not been used, that:-

(8) the requirement is to provide "information", which can fairly be read as meaning "some" as opposed to "all" or even "current" information. [27]

(9) The disclosure document is intended to "help", not "ensure" the franchisee makes a reasonably informed decision; and

(10) The decision is to be "reasonably informed", as opposed to "fully" informed.

In other words the Code sees the disclosure document as an aid to the decision, and a starting point for the franchisee's own due diligence. Clause 11 supports this intention by establishing an advice process aimed at ensuring prospective franchisees understand that they should obtain legal, business and accounting advice.

[27] The requirement in (b) for "current" information relates only to information relevant to running the business, as opposed to the decision to purchase. The generally accepted interpretation of (b) is that it is intended to provide a purpose to renewal and extension of an existing franchise, as opposed to a grant of a new franchise where (a) is relevant, and to the obligation contained in clause 19 to provide a current disclosure document to any existing franchisee on request.

The disclosure document is clearly not intended to be exhaustive. Further the specific obligation to update the document annually, and for only limited continuous disclosure of materially relevant facts under clause 18 of the Code, shows it is only intended to be relatively current. The information is intended to relate to the franchise system and agreement generally and the business history and other details of the franchisor. Investment information is intended to show a range and relate to the overall nature of the business as opposed to the specific franchisee being purchased by an individual franchisee.

In evaluating the effectiveness of disclosure against the stated purposes, it is suggested that there should be two main criteria – the structure of the disclosure requirements, and the substance of disclosure. Each factor is considered below.

5.23 The Structure of Disclosure

The requirement to provide a disclosure document and make ongoing disclosure of certain materially relevant facts is similar to disclosure regimes applying under the Corporations Act in the fundraising and financial services arena. However the franchising disclosure regime is supplemented by a requirement for advice before entering into a franchise agreement that is unique in Australia, and indeed in the world. This system is further supplemented by a 7 day cooling off process that enables the franchisee to terminate the franchise agreement without cause.

Conceptually it is difficult to see how the structure of the disclosure arrangements could be improved:-

- The disclosure document is in writing, the format and layout of the document is prescribed and the document is indexed, thereby facilitating ease of review and comparison with other systems. (Interestingly no such requirements apply under corporate law disclosure.)

- The disclosure process allows a mandatory 14 day period between provision of disclosure and signing, which is ample time for consideration and to obtain advice. (Again no such requirement exists under corporate disclosure.)

- The disclosure process applies not just to grants of franchises, but renewals and extensions and to the making of any non-refundable payment. It is therefore comprehensive;

- The requirement for advice extends to legal, business and accounting advice, which is all that any prospective franchisee would fairly expect to require. (By way of comparison the advice certificate process instituted by many banks, which is generally considered to be an industry best practice benchmark, relates only to legal advice. No legal advice requirement exists under corporate law disclosure.)

- Although the franchisor is entitled to enter into a franchise agreement if advice is not obtained, it is only able to do so if the franchisee confirms in writing that the franchisee has been told that the particular kind of advice should be sought, "but has elected not to seek it." This places a strong obligation on the franchisor to "tell" the franchisee advice "should be sought", and is a clear warning to prospective franchisees. Arguably any prospective franchisee that proceeds without getting advice could legitimately be expected to accept responsibility for such a decision.

The only area for possible structural improvement would be to remove the discretion for a franchisee to elect not to seek advice. The proposal to make the obtaining of advice a mandatory requirement is supported by the FCA because the FCA believes that this would in fact actually reduce even further the opportunity for mismatched expectations. However the FCA considers that some due diligence responsibility must be accepted by prospective franchisees. Arguably this responsibility should apply to a franchisee that elects at the franchisee's peril not to seek advice despite being told to do so.

5.24 The Substance of Disclosure

The franchisor and franchisee are entering into a written contractual relationship. The fundamental rights and obligations of the parties will be set out in the contract, and the parties are free to include in the contract such provisions as they shall consider appropriate, subject to law and the specific requirements of the Code. The principle of freedom of contract underpins all business dealings, and is recognised by the nature of the disclosure obligations under the Code.

The Code also acknowledges that the principles of privity of contract are relevant to disclosure. For the most part disclosure needs to focus on the intended party to the franchise agreement, being the franchisor. Any departure from this principle needs to be justifiable in terms of relevance to the overall relationship or the decision to purchase the franchise.

5.25 The prescriptive nature of disclosure

Annexure 1 to the Code sets out the substantive disclosure requirements. The disclosure document must be in the form and order and using the headings set out in Annexure 1. The following comments are offered in the context of considering the substance of disclosure:

1. First page

The mandatory preamble reinforces the intent that the decision is "**a serious undertaking"** and "**legally binding"**, the disclosure document contains "**some"** of the information you need and the decision should be "**informed"**.

The preamble specifically advises franchisees to **"read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with the requirements of a franchised business."**

The franchisor contact detail, signature and preparation date requirements are non-controversial and sensible.

2. Franchisor details

These requirements are relatively standard internationally. They provide information on the franchisor and all associates. Further information could be obtained by company and other searches as part of due diligence if relevant.

3. Business experience

Again these requirements are relatively standard internationally. They provide information on the business experience of the people likely to be involved in the business. Further information could be obtained if desired as part of due diligence by seeking references, asking questions to the franchisor or via industry associations.

It may be useful to extend clause 3.2(b) beyond just the franchisor to at least associated companies if not associated individuals as well.

4. Litigation

These requirements are relatively standard internationally. They provide information on the franchisor. Further information could be obtained by company, court record and other searches as part of due diligence if relevant. The nature of proceedings to be disclosed is extensive and would appear to cover any claim likely to be relevant to a franchisor.

At the suggestion of the FCA the Federal Government has extended (with effect from March 1, 2008) the obligations in clause 4.1 beyond just the franchisor to franchisor directors, enhancing disclosure.

5. Payments to agents

The FCA suggested to the Mathews Committee that it may be appropriate to add the words “and the nature or purpose of the payment” at the end of the sentence concerning disclosure to agents. This is not known to be an area of great concern for prospective franchisees, and was not either recommended by the Mathews Committee or implemented by the Government.

6. Existing franchisees

This is a comprehensive and important provision that supports and facilitates the exhortation contained in clause 1 for the prospective franchisee to contact existing franchisees.

The FCA suggested to the Mathews Committee that clause 6.4 may be able to be improved, as the categories are somewhat ambiguous and overlapping. There is some argument that the substance of disclosure could be improved in this area. To assist franchisors complete this section accurately perhaps additional guidance could be provided, and franchisor’s encouraged to choose the primary category. However compliance costs need to be considered, as franchisor’s current recordkeeping systems will be structured around the existing categories and some adjustment time would be required should any changes be made.

The FCA supports the Government’s changes (effective March 1, 2008) to include a requirement for the franchisor to disclose contact details of former franchisees as well as existing franchisees.

7. Intellectual property

This section is comprehensive and important. We are not aware of any compliance issues.

8. Franchise site or territory

This section is comprehensive and important. We are not aware of any compliance issues.

9. Supply of goods or services to a franchisee

Disclosure in this section is comprehensive and important. It links in to other sections of the Trade Practices Act, in that admissions made in answer to what are very specific questions can immediately alert advisors or indeed any investigating regulator to any potential breaches of the law. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

The March 2008 Code changes will further tighten the requirements concerning disclosure of rebates to require disclosure of the name of the business providing the rebate.

The FCA’s view is that the Trade Practices Act has a comprehensive and powerful array of remedies relating to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct to address pricing and supply issues. Franchising is no different to other forms of commerce, and no further action is required in this area.

10. Supply of goods or services by a franchisee

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

11. Sites or territories

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

12. Marketing or other cooperative funds

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

13. Payments

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

It is not possible for the disclosure document to be customised for every transaction, it is an overarching document intended to apply to every franchise granted. It is not intended to provide exact or specific information on the particular franchise involved, as to do so would be impossible without imposing massive compliance costs on franchisors. The information provided is a “range”, and is intended only as a starting point for the franchisee’s further enquiries. Prospective franchisees and their advisors would secure more than enough initial information to make their own calculations and seek any additional information. It should also be noted that any potential for a prospective franchisee to be misled as to actual costs in relation to their particular investment is addressed by the s52 prohibition on misleading or deceptive conduct, which provides a more than adequate remedy. The Code provides an excellent starting point, and the categories are comprehensive.

14. Financing

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

15. Franchisor’s obligations

A copy of the franchise agreement must be provided with the disclosure document. The franchise agreement is normally already indexed, and it is a legitimate expectation of the franchisor that the prospective franchisee will read the agreement before signing.

16. Franchisee’s obligations

See 15 above.

17. Summary of other conditions of agreement

See 15 above.

18. Obligations to sign related agreements

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

19. Earnings information

This clause largely repeats existing law, and fundamentally serves as a reminder to franchisors in the context of potential claims under s52 and s51A of the Trade Practices Act. Any breach of this section of the Code would almost certainly be a breach of s52 or s51A. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

20. Financial details

20.1 This is an important and often overlooked additional protection provided to franchisees, as it is in effect an annual solvency warranty. It goes far beyond disclosure, and gives franchisees substantial additional legal rights.

20.2 Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

21. Updates

Disclosure is adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

22. Other relevant disclosure information

This clause is procedural and self-explanatory.

23. Receipt

This clause is procedural and self-explanatory.

WA Inquiry Discussion Points

5.26 **Should a franchisee be given rights at the end of a franchise agreement, and what should those rights be?**

No. The FCA believes that the parties to a franchise agreement should be left free to negotiate the commercial terms to bind them in their business relationship. It would be totally inappropriate, and distort many existing commercial arrangements, to provide franchisees with specific rights of renewal or other statutory entitlements at the end of a franchise agreement.

The FCA understands that other submissions to the Inquiry may suggest that a franchisee should have a definite right of renewal, or the franchisor should be somehow obliged to negotiate in good faith with the franchisee for renewal or to pay compensation. That is not the current law, and would represent a major commercial change that would impact many existing commercial arrangements. Such a right does not apply even in the highly prescriptive provisions of Oilcode that apply to the petroleum sector, and has recently been rejected in the context of commercial leasing by the Productivity Commission in its Draft Report.

The Productivity Commission comments are insightful in terms of broad policy in an area of law very relevant to, and to some extent conceptually similar to, franchising. Commenting upon the disparity in negotiating strength between landlords and tenants, especially in large shopping centres, the Commission took the view that "hard bargaining and varying business fortunes should not be confused with market failure warranting government intervention."[28] The Commission favoured a more laissez-faire approach to tenancy legislation and advocated against greater prescriptiveness. In accordance with this approach, certain key proposals were put forward by the Commission in relation to the retail tenancy market:

(1) maintain and, where practicable, improve features of the current system which seem to be working well, namely dispute resolution and information disclosure;

(2) progressively relax current provisions in retail tenancy legislation across all jurisdictions in areas that have sought to govern market behaviour, such as minimum lease terms;

(3) improve the alignment of regulations and practices governing retail tenancies with those regulating tenancies in the broader market for commercial tenancies; and

(4) move, where practicable, towards national consistency in legislation.

Although the FCA is satisfied with the current regulatory environment, it is worth noting that the application of these principles to the franchise sector would in fact lead to a relaxation of parts of the current legislation. The comments certainly are relevant in the context of any possible increase in regulation.

5.27 **In relation to renewing or extending a franchise agreement, is there a need for more up front disclosure about the respective rights of both parties?**

[28] Productivity Commission Draft Report *The Market for Retail Tenancy Leases in Australia*, XXIX.

Not as far as the FCA is aware. There is no demonstrable need for further disclosure of the respective rights of the parties to a franchise agreement either in relation to renewal or extension of a franchise agreement, or generally. It is (from March 1, 2008) a mandatory requirement that the franchise agreement be provided in the form it is intended to be executed, and the disclosure process is supported by a requirement for franchisees to obtain legal and business advice, or certify that they have elected not to do so. The legal rights of the parties are clear from reading the franchise agreement, and the disclosure document provides further clarity. Professional advice provides further support to the process. The only workable improvement, which in the view of the FCA would be unnecessary, would be to include a specific warning on the front of the disclosure document. However the FCA sees little likely benefit in such a warning particularly given that existing warnings as to obtaining advice, attending courses and generally conducting appropriate due diligence are often ignored by prospective franchisees.

A disclosure document prepared in accordance with the comprehensive requirements of the Franchising Code of Conduct provides sufficient information to assist a prospective franchisee to make an informed decision in relation to the franchise. The disclosure process has been further strengthened by the recent amendments to the Code which take effect March 1, 2008. The FCA supported the recent Code amendments, and believes they should be allowed to come into effect before any further regulation is contemplated;

5.28 **Is there a need to prescribe the respective parties' rights to goodwill at the end of the franchise agreement?**

No. It would be totally inappropriate, and distort many existing commercial relationships, to legislate in relation to the rights of the parties to goodwill at the end of a franchise agreement.

The current legal position is clear, supported by High Court of Australia legal precedent[29] and well understood. Further, it is consistent with principles applying to commercial leases and other non-franchise business relationships. The inclusion of a legislative right to goodwill under a franchise agreement would lead parties to avoid franchising. The accuracy of the information provided will depend on the level of compliance by franchisors. However the Code is highly prescriptive as to the information required, the format and layout and even the headings to be used, so any deficiencies in information are readily apparent. Strong sanctions apply in the event of non-compliance, and the ACCC is a vigilant and effective regulator;

5.29 **Is there a need to include a requirement for franchise agreements to be negotiated in good faith?**

No. It would be totally inappropriate to require the parties to a franchise agreement negotiate franchise agreements in good faith.

There are already substantial protections for franchisees entering into franchise agreements, including the Franchising Code of Conduct and s52 of the Trade Practices Act. There is also an existing implied duty of good faith and fair dealing implied into a franchise agreement in the context of the ongoing relationship. The insertion of a good faith obligation in relation to franchise negotiations, or in relation to extending the agreement after termination, would create massive legal uncertainty and interfere with many existing commercial arrangements.

Over 95% of franchisors are small businesses, and there is no demonstrable inequality of bargaining power. Quality franchisees are in short supply, and existing legislative protections apply to prevent misleading conduct, undue pressure etc.

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[29] Insert correct details of BP v Ranoa Oil case

The suggestion also misunderstands the concept of good faith. There is an existing implied duty of good faith and fair dealing already implied into a franchise agreement in the context of the ongoing relationship. The position was succinctly stated in Far Horizons Pty Ltd v McDonald's Australia Ltd, where Byrne J noted "there is to be implied in a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose. Such a term is a legal incident of such a contract."

The good faith concept supplements the contractual process by ensuring powers are exercised for the purpose intended. It is not appropriate to try and cloak the creation by statute of some new contractual right under the guise of good faith. It is indeed arguably legally impossible, or at best uncertain, to require parties to undertake activities such as negotiation in good faith. The FCA believes that the insertion of a good faith obligation in relation to franchise negotiations, or in relation to extending the agreement after termination, would create massive legal uncertainty and interfere with many existing commercial arrangements.

5.30 **In relation to the franchisor/franchisee relationship, do the current unconscionable conduct provisions contained within the Trade Practices Act 1974 provide adequate protection?**

Yes. The prohibitions on unconscionable conduct contained in the Trade Practices Act and the State Fair Trading legislation operate effectively in the context of the franchise relationship, and the ACCC has been active in enforcement. There are several precedents for the application of the unconscionable conduct provisions in a franchise context.[30] What is important to note in the context of franchising is the balance achieved not just by the unconscionable conduct provisions themselves, but by the intervention of the ACCC. These cases show that the ACCC will intervene, and can achieve an outcome, in franchising cases notwithstanding that the letter of the law may be somewhat more limited. This can be contrasted with other cases in which the ACCC has been involved in the unconscionable conduct area in retail leasing, where action taken against major landlords under unconscionable conduct has been less successful.

5.31 **Is there a case for including the principles of goodwill and good faith in the Fair Trading Act 1987(WA)?**

No. There is no justification for legislating in relation to franchising matters on a State basis. Further, it is totally inappropriate to legislate in relation to matters such as good faith and goodwill.

The FCA understands that some submissions to the Inquiry may seek to argue, based on US precedent, that it is possible for State and federal law to co-exist in relation to franchising. We have asked the International Franchise Association to comment directly on this issue, but understand from discussions with them that the vast majority of US State regulation in fact pre-dated the introduction of Federal legislation. Further we are advised that States such as Iowa that have sought to introduce relationship laws in franchising have suffered major adverse economic impact. In short national franchise systems have avoided those States.

5.32 **Is there a need to improve the regulatory and other avenues available for dispute resolution between franchisors and franchisees?**

The existing avenues are highly effective, and the FCA doubts that any suggested improvements would actually benefit franchising.

[30] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

The level of disputation in Australian franchising is statistically very low. It also compares very favourably with the levels of disputation in other jurisdictions including the USA. The mediation based dispute resolution procedure set out in the Code has been extremely successful, with over 80% of disputes being successfully resolved. The cost of mediation is minimal, and far less than even the simplest court or tribunal procedure.

The ACCC has been an active and efficient regulator. Any aggrieved franchisee can, at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act. The ACCC is well resourced, is duty bound to investigate all claims where there is a breach of the Code or the TPA, and has a strong track record of taking enforcement action where necessary.

The FCA has supplemented these procedures with informal dispute resolution mechanisms. The FCA Member Standards process is included in Appendix 2 to this submission. The FCA is able to bring into play informal initiatives such as peer counselling (where a franchisor or franchisee or supplier is counselled by a peer) and mandated education to supplement the legal remedies available under the Code

In any business relationship involving two independent parties there are likely to be disagreements, misunderstandings and arguments. Further, despite the higher than normal success rate of franchised businesses when compared to other small businesses, not all franchised businesses are successful. The media occasionally reports inappropriate conduct against franchisees, and there are instances of illegal or inappropriate conduct. However when we have looked into the facts behind many of the media stories our experience (and indeed that of the ACCC according to its public statements on the matter) is that the allegations made in the media are not substantiated by fact;

5.33 **Are there any requirements on either franchisors or franchisees – both legal and non-legal – that exist in other countries that should be adopted to improve the Australian franchising industry?**

No. In the opinion of the FCA, the Australian regulatory regime represents world's best practice.

Ideally the FCA would like to see mediation as mandatory, and for all franchisees to be compelled to obtain legal advice prior to signing. In the FCA's experience there is a high correlation between failure to obtain expert advice and franchisee failure, or mismatched expectations. However such requests have been rejected previously in the context of suggested amendments to the federal regulatory environment, and the FCA would not support the WA Government acting unilaterally on this issue. Perhaps the State Government could take the lead by providing funding towards professional advice for prospective first time franchisees, and/or mandatory educational courses for prospective franchisees.

More broadly, the FCA supports ongoing review of the regulatory regime at a Federal level, but does not consider there to be any significant regulatory change that should be made. The Australian regulatory environment is already more prescriptive and comprehensive than most countries. It should be noted that in the UK, Singapore, Hong Kong and New Zealand – countries that are probably the closest to Australia in terms of legislative framework.

In terms of any non-legal trends, the Australian franchise sector interacts with the franchising community on a global basis. The FCA is an active member of the World Franchise Council, and frequently sponsors or hosts trade missions to or from all over the world. The Australian franchise sector thereby has ready access to the latest trends and business practices from overseas.

5.34 **"Good practice" in franchising**

It is very dangerous to consider "good practice" in the context of legislation, as that is not the role of legislation. Legislation should establish mandatory standards, not attempt to codify "good practice".

The Franchise Council of Australia endeavours, through its Member Standards and through educational and other initiatives, to provide guidance on best practice. However this is always done as guidance, not regulation. In franchising "good practice" is driven by the mutuality of interest of franchisor and franchisee. However franchising techniques are used across all industry sectors, and the business issues facing those sectors can be very different

An example of "good practice" in relation to an issue identified by this Inquiry – behaviour at the expiration of a franchise agreement – might be that a franchisor allows a good performing franchisee to continue to extend the term of a franchise beyond the initial agreed term in many instances. This is usually driven by mutual commercial interest, as otherwise the franchisor has to find and train a new franchisee or operate the business itself, which many franchisors prefer not to do. However it would be totally inappropriate to legislate this as a mandatory requirement. Indeed there would be many circumstances (including possibly the current dispute between Yum and one of its large KFC franchisees) where it would provide one party with direct commercial value or advantage. Commercial value is to be achieved by agreement, not legislation.

As to good practice generally, the FCA would simply note that many franchise systems have processes in place that supplement the regulatory environment. For example many franchisors have their own internal dispute resolution processes that endeavour to identify and resolve issues before they escalate into a formal dispute. This may involve Franchise Advisory Councils, or internal dispute escalation processes that ensure that senior management become aware at an early stage of any problem. The regulatory framework is only one part of the structure of the franchise sector that has laid the foundations for the success of Australian franchising.

5.35 **Other matters relevant to the operation of franchise businesses in WA**

The FCA is strongly supportive of the current Federal regulatory environment. The FCA is opposed to State regulation of franchising, as franchising is essentially a national activity and there would be no issue in franchising in Western Australia that would not apply across State borders.

The FCA considers the following issues to be important:-

(a) The FCA seeks a genuine commitment by State Governments to fully harmonise legislation that has impact beyond State boundaries and avoid the duplication, inconsistency and cost of State based regulation not only in relation to franchising, but in relation to taxation, retail tenancies, workplace issues, occupational health and safety, business regulation and property law;

(b) A commitment from State Governments to move beyond lip service to genuine reform of red tape and business compliance costs. Typically this will require the simplification of legislation and the dismantling of State based public service bureaucracies which become self-justifying and act as an impediment to harmonisation in favour of more efficient nationally integrated infrastructure.

<u>Education</u>

The Code expressly recommends to franchisees in the mandatory preamble required to be included on the face of disclosure documents that they "consider educational courses, particularly if you have not operated a business before." However there are only a very limited range of courses available, and previous attempts by the FCA to obtain federal funding for such courses have been unsuccessful.

Education has been determined to be critically important for the future development of the sector, in particular education of pre-entry franchisees.
The FCA continues to focus on educating our franchisor members about best practice, and those initiatives are ongoing. We, the ACCC and others have also focused on providing extensive information to prospective franchisees via our participation at franchise exhibitions, our FCA website and our publications.

Although prospective franchisees these days are much better informed than has ever been the case, there remain substantial opportunities for improvement. Perhaps franchisee education could further emphasis the risk of failure, as sometimes the publicity of the success of franchising, and even the increased security provided by the regulatory environment, makes prospective franchisees too optimistic. However it is hard to imagine more strident warnings than currently appear on the front of all disclosure documents.

There is an argument that franchise advice and education should be mandatory prior to entry into a franchise system however this then becomes a philosophical question which raises issues of government control in the economic structure of the country. Education is vital but should it be mandatory?

As to other issues, the FCA is not privy to the detail of complaints or submissions received by the Inquiry, and would be pleased to provide further comment on specific issues. The FCA is concerned to ensure that the franchise sector operates efficiently and fairly, and there is a strong positive perception of franchising in Western Australia.

In summary, based on information collected by the FCA as part of its franchisee forums and in policing the FCA Member Standards, the FCA does not believe there are any endemic problems in franchising that are not addressed by current regulation. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public.

General remarks and observations

The FCA has learnt from past experience that a number of matters are consistently raised by people who make representation to franchising inquiries. We felt it may assist the Inquiry if we provided our comments on some of these issues in anticipation. We would of course be prepared to expand upon our comments at any time.

The substance of previous inquiries into franchising.

The Howard Government in 1998 introduced the New Deal Fair Deal reform package, which was focused on improving trading conditions for small business. This followed a comprehensive Parliamentary Inquiry into the franchise sector. This Inquiry took evidence from all major cities and recorded over two hundred submissions. The Mathews Committee review of the Franchising Code of Conduct commenced in late 2006, and the Government's legislative response will take effect March 1, 2008. The Code amendments have bi-partisan support, and are well accepted in the franchise sector.

Disputation in franchising

Disputation is low by world standards. Research indicates a significant drop in disputation and an increase in mediation services to resolve franchise disputes as forecasted by the Parliamentary Committee when it recommended such action. Griffith University research indicates that disputes are less than 1%, with 30% of that 1% being listed as action taken by the franchisor for lack of system compliance by the franchisee. This means that the majority of disputes happen when franchisees do not follow the prescribed system, the very essence of franchising.

Good faith should apply on termination of a franchise agreement

There is currently a dispute between a major franchisee of KFC restaurants and franchisor Yum brands that we understand from media reports has been a significant reason behind the establishment of the WA inquiry into franchising. In summary, the franchisee (which is a very substantial corporation) is arguing that Yum should have to negotiate with it at the end of a franchise term to either grant a further term, or pay compensation including goodwill if the franchisor wishes to take over the sites. It is being suggested that Government legislate to create a specific statutory good faith obligation to negotiate at the end of term for a renewal.

The High Court of Australia has ruled on this issue, and the law is clear – once a franchise term ends, it ends. This level of certainty enables all those involved in franchising to understand their legal rights, and negotiate accordingly. The FCA strongly opposes any move to create a statutory right that would thereby advantage one party to a contract over another.

The FCA would be pleased to expand upon its views on this issue.

Media coverage of alleged problems

In recent times, amongst the overwhelmingly positive coverage the franchise sector has received, some media commentators have reported alleged problems within the franchise sector. A number of major franchise systems have been named as having ongoing franchise disputes, but little has been provided by way of specifics. The FCA has seen little factual support for these claims. Indeed to date the FCA has been satisfied with all explanations provided when it contacted the franchise systems in question for their comment. It would appear that there has been a rather orchestrated and consistent email campaign from a small group of disgruntled former franchisees, and encouraged by journalists keen to publish unsubstantiated assertions rather than investigate the facts.

Some media commentators have questioned the Code, without conducting any real analysis of indeed demonstrating any real understanding of how the Code operates, and called in a very non-specific way for reform. Others have criticised the ACCC, and challenged the effectiveness of the mediation system.

This is legitimate media behaviour, and to some extent a consequence of the many success stories in franchising. Journalists feel the need to try and balance the ledger. However media reports should not be the basis of policy changes. The FCA accepts that media comment may have played a part in the convening of the Inquiry, but it should play no part in its recommendations or the action Government takes in response to the Inquiries recommendations.

Questions on the effectiveness of the ACCC

The ACCC has been active in taking action against franchisors that have breached the law, having undertaken around 20 effective prosecutions. Complainants who challenge the effectiveness of the ACCC seem to treat this number as proof of the ACCC's inaction, when in the FCA's opinion it is reflective of the generally excellent standards of behaviour within the sector. The ACCC has moved very quickly in all cases, and set clear precedent in the areas of Code compliance and unconscionable conduct that benefit all in the franchise sector.

The ACCC has recently instituted a process for providing a more transparent record of its enforcement activity. To some extent this was driven by a desire to correct misinformation being publicly circulated about the ACCC's activities, and the behaviour of franchisors entities under investigation. A review of this section of the ACCC website will show that the ACCC has been thorough and professional in its activities. The ACCC has also commented publicly that there have been significant differences between assertions of fact published in the media in relation to various companies, and the facts as established by ACCC investigations.

Since 2002 the ACCC has provided leadership on the management of the Code with regular meetings with the franchise sector with its Franchise Consultative Committee. This Committee meets twice a year to discuss issues pertaining to the sector. From these meetings there have been a number of initiatives have been instigated. The FCA Member Standards were introduced to endeavour to further improve industry behaviour and address matters that, whilst not breaches of the law, might benefit from some form of third party intervention. The ACCC has recently introduced its Franchisee Start Up Checklist, and there are various educational initiatives in progress.

Is there sufficient pre-entry education of franchisees?

No. Education has been determined to be critically important for the future development of the sector, in particular education of pre-entry franchisees. The FCA has proposed many initiatives, but funding has not been made available. The FCA focuses upon educating our franchisor members about best practice, and those initiatives are ongoing. We, the ACCC and others have also focused on providing extensive information to prospective franchisees via our participation at franchise exhibitions, our FCA website and our publications. Prospective franchisees these days are as a result much better informed than has ever been the case, a fact verified by our franchisor members in industry forums. With full employment, franchisee recruitment is a competitive business and standards are continually rising not to meet compliance obligations, but to secure the best franchisees by providing the best returns and security of investment.

Do existing laws prevent "churning" in franchising.

Yes they do. Prior to 1998 there were allegations of "churning" in franchising in Australia. What was happening, in a small number of franchise systems, was that franchisors were in essence selling franchises that were not viable. When the franchisee failed, the franchisor in essence resold the same franchise. This happened in particular in the service sector, where the costs of the franchise were relatively low and there were not premises or other complications. Although franchisees lost money, and would have had a pretty good legal claim under s52 of the Trade Practices Act, the cost of legal action to recover perhaps $20,000 - $30,000 was somewhat prohibitive, particularly as the franchisors themselves were often marginal in terms of asset backing.

The Government quite rightly addressed these issues in the New Deal Fair Deal reforms, which included the Franchising Code of Conduct but also featured a new prohibition on unconscionable conduct and provided increased funding for the ACCC to regulate the sector. The Franchise Council of Australia also acted, including a specific prohibition in their Member Standards on selling a franchise when there was no reasonable prospect of it being profitable.

The reforms in 1998 have strengthened the law and protected franchisees in the following specific areas:-

- the mere introduction of the Code, backed by the ACCC's careful supervisory eye, has introduced barriers to entry for franchise systems that keep out most of the marginal operators;

- any allegation of "churning" in Australia post 1998 would constitute a clear breach of not just the Code, but s52 of the TPA and probably s51AC (unconscionable conduct). The ACCC would therefore have to become involved on receipt of any complaint;

- the ACCC has done an excellent job of enforcement. As soon as the ACCC receives a complaint alleging breach of the law they act promptly and professionally.

- the Code requires specific disclosure of the history of a particular premises or site. This has been augmented by the most recent reforms;

- the franchisor has to provide substantial information concerning its financial history, in fact over 250 separate pieces of information;

- the Code requires specific disclosure of franchisee exits. This has been further augmented by the most recent reforms, which in effect enable a prospective franchisee to contact all recent previous franchisees including those who may have departed the system.

The commercial reality is that franchise systems get no financial or other joy from the business failure of a franchisee. Invariably the franchisors lose money as well, through unpaid royalties, the costs of operating the business while a solution is sought, the costs of recruiting and training a new franchisee, the cost of concessions given to any new franchisee to get the business back up and running etc.

Systematic failure, or unsolvable problems?

The Inquiry will no doubt receive submissions from various parties asserting that the current regulatory framework is inadequate. The real issue to determine is whether, in the context of the stated objectives of the Code, there is a systemic problem within the sector that requires change to a successful regulatory structure. The FCA is not privy to all submissions, so cannot provide a pre-determined response. However our own experiences with the FCA Member Standards provides some insight into the likely nature of submissions you will receive. To the extent that they are of commercial substance they are likely in the main to relate to matters already covered within the Code, to matters that would be a breach of existing law such as the Trade Practices Act, to conduct of third parties such as landlords, to matters that resulted from poor franchisee due diligence or to matters for which it would be almost impossible to provide any legislative protection.

Any change will create costs

It should be recognised the cost of compliance is already quite high, and any changes at all will add to the cost. The FCA and its members would strongly resist any proposal which increased compliance cost in a sector already burdened with comprehensive Federal Government compliance.

"Franchisor does not fully disclose"

The Code requires franchisors to disclose more than 250 items as a starting point to the franchisee's due diligence. The disclosure document is not intended to be an exhaustive source of all information – as stated on the front page it provide "<u>some</u>" of the information required to make an informed decision. Franchisees must accept responsibility for the investment decision. They cannot simply assert that the franchisor did not "fully disclose." Franchisees are clearly warned to "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

Further,s52 of the TPA applies to disclosure. Irrespective of the Code requirements, if a franchisor provides a compliance disclosure document but fails to disclosure a material fact that would have altered the franchisee's decision to proceed the franchisor is likely to have breached s52 of the TPA. The Code does not provide a defence to a s52 claim – that claim is judged on its separate merits.

The Code provides for the franchisee to seek legal, business and accounting advice. If advice is obtained any non-disclosure would be apparent to the relevant expert, and therefore the franchisee.

"Franchisor does not disclose trading figures"

Many franchise systems do provide historical trading figures as a matter of course, whilst others will provide them on request. There is no obligation on a franchisor to do so, and considerable risk in the context of a potential s52 claim should the franchisor provide any financial information. Such an obligation could not be mandated in the Code, as it would expose franchisors to unreasonable compliance costs and liability. A prospective franchisee has access to existing franchisees, and can thereby obtain much of this information other than via the franchisor. Ultimately this is a factor for the franchisee to consider when making an informed decision – if figures can not be substantiated, the franchisee should not proceed.

The franchisor is restricted in providing income projections by the Code and is restricted to historical information unless the franchisor wishes to take on the additional liability for projections contained in s51A of the TPA. Some franchisors provide a variety of trading actuals from franchisees within the system. Others provide full disclosure of all franchisees trading. Others provide nothing fearing the implications of Section 51A and 52 of the Trade Practices Act.

"Poor advice received"

Such an assertion should be treated with caution. It is true that the quality of understanding of franchising outside the franchise sector, and indeed possibly within it, is variable. However most advisers would have professional indemnity cover should poor advise be provided.

A far bigger problem is franchisees failing to seek advice.

There is an argument that franchise advice and education should be mandatory prior to entry into a franchise system however this then becomes a philosophical question which raises issues of government control in the economic structure of the country. Education is vital but should it be mandatory?

The FCA is currently establishing an accreditation system for those providing advice to franchisees, and is broadening its educational activities to legal and accounting professional bodies. The FCA considers no other action is necessary.

"the Franchisor has too much power"

The relationship between the franchisor and the franchisee is a contractual relationship akin to a commercial partnership. It is not a relationship of equals. The franchisor generally has more risk and money invested, has developed the brand and requires trading consistency within the market. Therefore the franchise business format model requires the franchisor to control aspects of the franchisee's behaviour that are relevant to the brand and the performance of the network. Decisions may need to be made that could affect the franchisee. This is the nature of franchising, and is clearly outlined within the franchise agreement. It should not be a surprise if a franchisee has undertaken appropriate due diligence.

Understanding the franchise relationship and the rights the franchisee has is a vital element within the relationship and this is why the Government advised franchisees to seek advice prior to entering the agreement. If a franchisee does not seek advice and then disputes the franchise agreement and the Disclosure document - is this the franchisor's responsibility of the franchisee's?

Retail Leasing Issues

As identified in the Fair Trading Inquiry in 1997, the practice of the landlords in major shopping centres continues to impact upon the relationship between the franchisor and the franchisee. The Landlord has monopolistic powers within standalone shopping centres and although most state legislation seems adequate the manipulative powers of the landlord prevails.

State legislation does not address the three major issues:

excessive rent reviews;

inadequate tenure and lease terms; and

- unequal information and bargaining power.

Issues of lease renewal and other tenancy matters can impact upon a franchisee and they can remain captive to a site because of the power the landlord has which therefore impacts upon the Franchising Code of Conduct provisions and the relationship between the franchisor and franchisee.

In its submission to the Mathews Committee the FCA recommended that the Federal Government review the retail leasing market and introduce a Code of Conduct for Shopping Centre management. This Code should provide that:

(11) landlords cannot increase rent beyond a specified multiple, say 15%, without providing clear written justification and being subject to an appeal process to ensure franchisors and franchisees are not held to ransom in their captive market;

(12) lease terms must be such as to ensure an adequate return or investment for a tenant;

(13) landlords must provide on request all available rental information in a shopping centre in the event of any rental dispute.

Appendices

3. FCA Industry Report

(Please note that the information, statistics and list of members in this Industry Report were accurate as at May 2006. Some aspects of the Report are no longer current. The FCA Chairman is now Mr John O'Brien, and some of the statistics have been superseded by the statistics contained in the body of this submission. However the essence of the Report remains relevant.)

4. FCA Member Standards

Appendix 1

FCA Industry Report

FRANCHISE COUNCIL OF AUSTRALIA REPORT ON THE CURRENT STATE OF AUSTRALIAN FRANCHISING

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The Franchise Council of Australia

The Franchise Council of Australia (FCA) was formed in 1983 and is the peak industry body in Australia, with responsibility for representing all sectors of the franchise community. It is a not-for-profit membership based association, and does not receive ongoing government funding.

As franchising is a global activity, the FCA is affiliated with franchise associations around the world and was a founding member of the Asia Pacific Franchise Confederation. It is also an active member of the World Franchise Council. This enables the FCA to have access to the latest global information on franchising, and to receive information on any franchising trends that may have relevance to the Australian market. The international links are also intended to assist Australian systems to enter foreign markets.

The FCA has excellent relations with the Australian Competition & Consumer Commission (ACCC), the Office of Small Business, Austrade and other industry bodies. The FCA meets regularly with the ACCC and is a key member of the ACCC Franchising Consultative Committee.

Membership of the FCA is open to individuals and organisations that are involved in franchising. There are several membership categories designed to accommodate franchisors, franchisees, advisors and service providers. A list of current members of the FCA is included at Appendix 1.

The FCA is structured to enable the organisation's professional management team to access the collective intellect of its members to supplement the skills and experience they bring to the FCA. Chief Executive Richard Evans, a former Federal parliamentarian with extensive franchising and small business experience, has day-to-day responsibility for the operations of the FCA, with his personal focus being the interface between the franchise sector and other stakeholders such as Government and the public. Other FCA employees have specific skills in education, event management and member services.

At a strategic level, a board of ten directors manages the FCA. Five directors are State Chapter Presidents, who each preside over a State Chapter Committee and are elected by the respective state chapter members. The other five directors are elected on a national basis at the Annual General Meeting. At least three of the five nationally elected directors must be either a franchisor or franchisee. There are State chapters in New South Wales, Queensland, South Australia, Victoria and Western Australia, with a National Secretariat based in Melbourne.

A list of current directors and senior executives of the FCA is set out in the table below. A brief summary of their franchising experience has been included to illustrate the skills and experience available to the FCA.

Chief Executive Officer	Richard Evans	A former franchisee who entered Federal politics as the Member for Cowan in 1993. Richard served on the House of Representatives Committee that handed down the landmark Fair Trading Report, which resulted in the introduction of the Franchising Code of Conduct and other reforms.
Chairman	Stephen Giles	Partner with Deacons and generally acknowledged as Australia's leading franchising lawyer. Author of numerous publications including Franchising Law & Practice, The Franchisor's Manual and Going International – A Guide for Australian Franchise Systems.
Deputy Chairman	John O'Brien	Managing Director and owner of Poolwerx Corporation, John O'Brien (PoolWerx Corporation) has the unique distinction of having been an Australian Franchise Council Franchisee of the Year (Queensland), inaugural Australian Master Franchisor of the Year, Franchisor of the Year (services category – twice), and current Australian Franchisor of the Year outright. His experience in the franchising sector spans more than 20 years.
Victorian President & Finance Director	George Yammouni	George Yammouni, B.Bus., Director, George Yammouni, B.Bus., Director, George is the CEO of the Bathroom Werx Group (which includes Mend-A-Bathroom) - a National Franchise System which specialises in bathroom restorations and renovations. Having started life as a Franchisee in 1986, he acquired the Australian Franchise in 1988 and then began franchising in 1990. Serving on Victorian Chapter Committee since 1993 and is currently Chair of the FCA Board Finance Committee.
NSW President	Ken Roseberry	Ken Roseberry is Chief Executive Office of Fastway Couriers, a position he has held since 2002. Fastway was established in Australia in 1993, boasts nearly 500 franchisees Australia-wide, and is a previous winner of the FCA's 'Franchise System of The Year'. Fastway now operates in 12 countries. Ken's other career highlights include being the CEO of; Australian Geographic, Qantas Holidays, Tourism Queensland, the Gold Coast Indycar Grand Prix, and promoter of the 1988 Bicentennial First Fleet Re-Enactment. Ken holds an MBA and has served on the FCA NSW Chapter for the past two years, being elected as Vice President in 2005.
Qld President	Philip Ciniglio	Philip has over 30 years of business, sales and marketing experience through his involvement with large global corporate organisations such as Bridgestone, Century Yuasa Batteries and Retail Food Group, having held senior positions in General Management, marketing, sales management and franchising. Philip has been associated for over 20 years with the Franchise Council of Australia and is currently a Director on the National Board and President for the Queensland Chapter.
WA President	Steve Hansen	Stephen is the Managing Director of the fast food chicken chain "Chooks Fresh & Tasty", formerly River Rooster. Steve started his career in banking, spending 4 years in PNG and many branches in the West. Steve started in franchising in 1983 as a franchisee, becoming a franchisor in 1991 with the River Rooster Brand. Steve has been involved with the FCA WA chapter for over 8 years and is passionate about franchising.
SA President	Steve Butler	Steve Butler is the National Franchise Manager for Beaumont Tiles, who are the largest distributor of ceramic wall and floor tiles in Australia. He has been in this position for 5 years. Prior to this he owned 3 South Australian Beaumont Tiles franchise outlets for a period of 15 years and has been in this industry for just under 30 years. He has served on the committee of the FCA in South Australia for 3 years, Vice President last year and recently taking on the role of President.
	Chris Malcolm	Chris Malcolm has been active in franchising for over 15 years. Initially with Solomon's carpets, he has more recently been involved with the Clark Rubber brand and has reinvented it as a vibrant modern retail network. Chris had a 2-year chairmanship of the Franchise Council of Australia during the mid 1990s and guided the Association through a restructuring process that resulted in a reinvigorated organisation with a national focus. Chris served for 5 years on the national board of the FCA, and is an active participant in the franchising debate.
	John Longmire	John owns five Just Cuts salons in the ACT and employs 80 staff. Prior to entering franchising John worked in government for 15 years. He started in franchising in June 1994 with the first Just Cuts salon outside of Sydney and is now part of an Australia-wide network of 120 salons. John was Highly Commended Franchisee of the Year in 1995 and 1996, the NSW/ACT Franchisee of the Year in 1998, and 1999 and the National Franchisee of the Year in 1999.
	Noel Carroll	Noel Carroll co-founded Michel's Patisserie, a multi-award winning franchise system he built to over 350 outlets. Michel's was Franchise System of the Year in 2003 and 2004. Noel has recently also taken an interest in two emerging franchise systems in the health and hairdressing field. Prior to Michel's, Noel's 15 year corporate career included senior management roles with S.A. Frozen Foods, R.M. Gow Frozen Food Division, McCain Foods, Sara Lee and Defiance Milling.

Executive Summary

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers to the franchise sector. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. A list of current members of the FCA is set out in Appendix 1.

The franchise sector in Australia makes a very substantial contribution to the Australian economy. Industry turnover is estimated at $111.5 Billion, or 3.2% of Australian Gross Domestic Product. The sector has around 900 franchise systems, 53,500 units and employs 550,000. The indirect impact of franchising is estimated at 1.5 times these figures.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has changed in recent years, with the sector maturing substantially since 1998 both in terms of size and conduct. Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished to some extent by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. The predecessor body to the FCA, the Franchisors Association of Australia, was fundamentally a franchisor networking group, and was described in Federal Parliament as unrepresentative and “controlled by a small cabal of franchisors”. This is a far cry from the multi-representative and highly professional industry body the FCA is today.

The regulatory framework established by the Federal Government in 1998 has made a very important contribution to the success of Australian franchising. It provides strong regulatory protection for franchisees through the Franchising Code of Conduct, which is administered by the Australian Competition and Consumer Commission. A copy of the Franchising Code of Conduct is in Appendix 2. In addition to the Code, the Commonwealth Trade Practices Act's prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions. As a consequence we have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practices.

The FCA worked closely with the Government in preparing the Franchising Code of Conduct. This work continues today to ensure there is ongoing review and amendment of the Code as required. There is also a strong ongoing collaborative relationship with the Australian Competition and Consumer Commission in regard to the Code, and the application of the Trade Practices Act within franchising.

The current regulatory environment finds the correct balance, providing a strong regulatory framework without unnecessarily impeding the flair of franchising entrepreneurs. Mr. Peter Reith, Federal Minister for Workplace Relations & Small Business, in his Foreword to the Franchising Code of Conduct commented as follows:

> *"Franchising is one of the fastest growing business sectors in Australia. Franchising is a unique way of doing business, built on mutual trust. The growth and development of franchise systems is dependent upon the relationship between the franchisor and its franchisees…. The Commonwealth Government is strongly committed to the growth and prosperity of the franchising sector."*

Although growth slowed for a very short period while the sector came to grips with the new compliance obligations, growth has continued since 1999 at similar rates to the pre-Code period. Importantly the regulatory framework has dramatically reduced the levels of disputation and enhanced the public perceptions of franchising. Largely as a result of the mediation based dispute resolution process contained in the Code, strong enforcement oversight by the ACCC and pro-active educational activities conducted by the FCA, disputation in Australian franchising is now extremely low. The Franchising Australia 2004 Survey estimates that around only 1% of franchisees are in "substantial dispute", with "substantial dispute" being very broadly defined beyond just litigation to include anything involving a solicitors letter or above. This compares extremely favourably with the United States, where the level of disputes is estimated at around 6% and many disputes are resolved in the courts. The Code's mediation based dispute resolution process has been an outstanding success, with around 75% of all franchise disputes in Australia resolved by mediation.

The FCA has further strengthened the franchise sector framework by introducing its Member Standards of Conduct. The Member Standards do not impose new legal obligations on franchisors, but they provide greater detail in terms of typical expectations of franchisors and service providers and introduce additional mechanisms for the FCA to be able to monitor behaviour and intervene pro-actively to ensure disputes are resolved quickly and cost effectively. A copy of the FCA Member Standards is in Appendix 3. Most franchise complaints today do not involve breaches of the law, but rather mismatched expectations. By taking control of the complaints process, the FCA aims to ensure such mismatched expectations do not escalate into court cases or media field days that harm the hard earned good reputation of Australian franchising.

With the prospect of an enhanced compliance process, and widespread adoption of comprehensive risk management systems, business risk for franchisees and franchisors is likely to further reduce. New developments in the area of specific franchise insurance products and further innovations in franchise sector lending are likely to drive further growth and development of the sector. Franchise systems are well placed to surf the wave of industry mega-trends, and meet the increasingly demanding needs of customers due to the unique relationship of the franchisor and franchisee. Franchisors can focus on branding, systems design and compliance management, while franchisees can concentrate on the customer relationship, delivering superior customer service and providing the coalface information needed to drive innovation and system improvements.

The Economic Impact of Franchising in Australia

5.36 Franchising Australia 2002

The FCA has commissioned regular independent surveys of the franchise sector. All paint a similar picture of growth, development and business success. One of the most relevant remains *Franchising Australia 2002, the Commonwealth Bank Franchising Survey*, released in August 2002. The survey was undertaken by Griffith University and sponsored by the Commonwealth Bank, and provided one of the most comprehensive reports on the status of the franchising sector in Australia. Much of the information remains relevant today.

The report confirmed the continued growth and increasing maturity of franchising in Australia. It also provided an insight into the economic contribution, development, trends and concerns of the sector. Speaking at the FCA national conference, FCA Chairman Stephen Giles welcomed the survey as further evidence of the value of the franchise sector to the Australia economy:
"It is now beyond rational argument that franchising delivers competitive advantage to the franchisors and franchisees that embrace best practice franchising principles in their business. The franchise sector delivers $80 billion in annual turnover, employs 500,000 people, has around 420,000 permanent employees, generates $292 million in annual export earnings, and has 90% of its business owners earning profits beyond wages. These are stunning figures."

The FCA Chairman went on to note that the survey confirmed, contrary to some perceptions, that there is a very low level of disputes in franchising.

"It is pleasing to see that less than 1% of franchisees were involved in a "substantial dispute" with their franchisor, meaning a dispute involving litigation, mediation or correspondence with a solicitor. 81% of franchisors recorded no substantial disputes at all in their system in the past 12 months. These are important statistics for those thinking of buying a franchise, and further signs of the increased maturity of the sector."

The key points of the Franchising Australia 2002 Survey, which was the first of its kind since 1999, were summarised as follows:

- There were approximately 700 franchise systems in Australia, or 3 times as many per head of population as in the USA. (This figure has now risen to around 900 according to Franchising Australia 2004 and the IBISWorld Report.) Over 90% of these systems were home grown. On average, Australian franchisors have been operating for 15 years, and franchising for 9 years.

- There were almost 50,000 franchised outlets. (This figure has now risen to around 60,000.) The number of franchised units had grown by 8.5% since 1999. An indicator of the success of franchising, and indeed the increasing maturity of the sector, was that the average number of franchised units per franchise units had grown by 100% since 1999.

- Franchising was big business in terms or export earnings, much bigger than had previously been appreciated. $292 million per annum was generated from overseas operations of Australian franchisors in 2001. 25% of Australian franchisors had expanded overseas, with 62% indicating an intention to do so in the next 3 years. This was up from 22% in 1999. New Zealand was the most popular destination (74%) followed by the UK (36%), USA (34%), Singapore (34%), South Africa (26%) and Europe (26%).

- The sector employed approximately 500,000 people, with permanent employment having risen dramatically to 83.5% of the workforce. This figure is now estimated at around 600,000.

- The level of disputation in franchising continued to fall, with less than 1% of franchisees in serious dispute with their franchisor. As with the 1999 survey, the top causes of substantial disputes were lack of compliance with the system (27%) and payment of fees (15%). Franchise re-sales provided further evidence of the strength of the sector, with 74% of franchisee exits resulting from sale of their business. Where the exit was due to franchisor or franchisee termination, lack of suitability to franchising and personal/family reasons were the main exit reasons identified.

- Franchised businesses remained affordable, with average start up costs being $62,500 for mobile and $208, 000 for fixed location franchisees (excluding GST).

- Although there is risk attaching to every business, 90% of franchisees were reported as earning profits beyond employee wages. This figure compared extremely favourably with the small business sector generally.

- Although the Franchising Code of Conduct had improved franchisor/franchisee relationships (53%), been beneficial to the sector (79%) and required franchisors to keep more detailed records (62%), there remained issues to be addressed to improve the effectiveness of the Code. The embryonic nature of the franchise mediation was demonstrated by the survey finding that, despite the requirements of the Code to attempt to resolve disputes through mediation, more disputes were in fact resolved through litigation (23%) than mediation (17%). It is important to note that this figure has now changed very dramatically, with most franchising disputes referred to mediation, and mediation achieving success in around 75% of cases.

- Cost of compliance, difficulty and uncertainty in compliance, excessive disclosure requirements and the ACCC influence over the sector rated highly as concerns in the regulatory area. These concerns have largely evaporated.

- Lack of suitable franchisees and insurance cover and cost were rated the most critical business issues by franchisors.

5.1 Franchising Australia 2004

The results of the Franchising Australia 2004 Survey conducted by Griffith University confirmed the continued growth in franchising in Australia and revealed that franchising techniques were in use in most industry sectors.

The research identified a total of 850 business format franchisors in Australia. The sector comprised 50,600 franchised outlets, together with around 3,400 company owned outlets. The growth from 1994 had been substantial, as the Australian Bureau of Statistics reported a total of only 24,500 franchised outlets in 1994. The growth in franchised outlets was 14 percent per annum from 1991 to 1994 (ABS) and 15.5 percent from 1989 to 1991, confirming a decade of strong performance.

Probably as a result of compliance responsibilities associated with the introduction of the Franchising Code of Conduct, the growth in 1999 reduced to around 6%. However, between 2002 and 2004 growth increased again to 14%.

The 1998 Survey revealed that the total turnover of business format franchised outlets was $22.4 billion, with $14.1 billion in turnover for company outlets, yielding a combined total of $36.5 billion. Motor vehicle and automotive fuel retailers were not included in these figures. If these groups are added, the estimated turnover is in excess of $80 billion. The total number of people employed in business format franchise systems (including motor vehicle retail franchises and automotive fuel retail franchises) at the time of the 2004 survey was around 600,000. 33% were permanent full-time employees, 50% permanent part-time and 17% casual employees.

5.2 Other relevant statistics

The various franchising surveys have provided the following additional information on franchising in Australia:-

- 10% of franchises are owned by couples, 74% are owned by men and 9% by women. A significant proportion (43%) of those owners are in the 41-50 years age group. Single unit franchise ownership is the norm in Australia, although the number of multi-unit franchise owners continues to grow. Master franchising and sub-franchising are common expansion methods, particularly for mobile or service franchise systems.

- Franchising continues to expand through all regions of Australia. New South Wales and Australian Capital Territory (31%) have the greatest concentration of outlets, similar to the population distribution. However, Queensland (22%) and Western Australia (13%) continue to exhibit a greater acceptance of franchise systems in that they host noticeably larger proportions than their populations.

- Of the total franchise systems in Australia, 95% were business format franchise systems, 0.4% were motor vehicle franchise systems and 0.1% were major auto fuel retail franchise systems.

- Australia is the most franchised nation per head of population in the world. That is, there are more franchise systems in Australia compared to our population than any other country, and Australia has at least three times as many franchise systems per head of population than the United States.

- The average length of time that current franchise systems have been franchising is 8 years.

- Franchising enjoys a small business success rate more than 2 and a ½ times greater than stand-alone small business. Each year, only 1% of franchisees leave their businesses.

- In 2002 24% of Australian franchise systems operated overseas, with a further 27% of systems planning to commence foreign operations within the next 3 years.

5.3 IBISWorld Report information

The IBISWorld Industry Report of 3 February 2006, which is the most recent industry report, confirmed the substantial contribution of franchising to the Australia economy. IBISWorld estimated that in 2004/05:

- the sector generated gross revenue of $111.5 billion;

- gross domestic product was $27.3 billion, or 3.2% of total Australian GDP;

- this turnover was an increase of 9.7% on 2003/04;

- there were 53,500 units;

- there were 900 franchise systems; and
- the sector employed 550,000 people, for a total wage bill of $15.9 billion.

Strong growth had been experienced in previous years, with turnover growth rates of 16.1%, 11.0% and 9.7% in the past 3 years. In the same period the number of franchise units had grown by 5.1%, 8.5% and 5.7% and the number of franchise systems by 10.7%, 9.7% and 5.9%. Employment had grown by 15.8%, 12.7% and 8.4%, and total wages by 18.3%, 12.4% and 8.1%.

The IBISWorld Industry Report determined food retailing to be the leading segment at 31.0%, with non-food retailing (furniture, books, whitegoods and clothing) at 30.0% and property and business services (real estate, finance, building) at 24.0% and other including education, training, domestic services, automotive and childcare) at 15.0%. It noted that financial services and retail food had experienced the strongest growth in recent years, but every area of commercial activity had been subject to some growth via franchising.

The distribution of franchise units amongst the States and Territories was generally consistent with population levels and availability of suitable premises. New South Wales had 31% of franchise units, followed by Queensland and Victoria at 22% each, Western Australia at 9%, South Australia at 8%, Tasmania at 4% and ACT and Northern Territory at 2% each.

In the 5 years to 2004/05:
- the sector experienced average revenue growth of 5.5%;
- gross domestic product grew by 4.0% per annum; and
- the number of systems grew by an average of 5.8%.

Turning to the future, IBIS World offered the following predictions:

	Revenue	**Growth**	**GDP**	**Growth**
2005	$111.5 Billion	9.7%	$27.3 Billion	8.3%
2006	119.3 Billion	7.8%	$29 Billion	6.0%
2007	$125.3 Billion	5.0%	$30.3 Billion	4.5%
2008	$132.8 Billion	6.0%	$31.9 Billion	5.5%
2009	$139.4 Billion	5.0%	$33.6 Billion	5.2%
2010	$145.7 Billion	4.5%	$35.2 Billion	4.8%

This yields an average annual growth of 5.5% in revenue, and 5.2% in GDP, which compares favourably to the predicted growth in Australian GDP of 3.5% over the same period.

IBISWorld concludes that the sector will transcend from the growth to mature stage of its lifecycle, but notes that "there is still room for the domestic growth in the franchising sector as low failure rates and low levels of disputation along with the relative security and stability of the sector attract small business investors. Investors are increasingly looking for new expansion opportunities internationally….as much future industry growth will come from offshore opportunities" (p39). BRW (June 23-29, 2005) predicts that the sector is set to continue experiencing strong growth, and IBIS World quotes PriceWaterhouseCoopers as predicting that the sector will double in the next 15 years and account for around 24.0% of Australian GDP.

5.4 Indirect impact of franchising

The International Franchise Association released a report on the direct and indirect impact of franchising in the United States by PriceWaterhouseCoopers. PWC determined that the direct and indirect impact of franchising in the US economy was approximately 1.5 times the direct impact. Although no similar report has been conducted in Australia, there are such strong similarities between US and Australian franchising that the indirect impact of franchising in Australia is likely to also be around 1.5 times the direct impact.

5.5 International statistics

The growth and development of franchising has been a global mega trend. The following information extracted from statistics provided by the World Franchise Council in 2004 indicate the penetration of franchising into many developed economies.

Country	**Franchise Brands**	**Total Outlets**	**Sector Turnover (Billions)**	**Sector Employment**	**Total Population**
EUROPE					
Austria	330	4,700	EU 3.00	60,000	8,174,000
Belgium	100	3,500	US 2.80	30,000	10,348,000
Czech Rep.	90	300			10,246,000
Denmark	128		US 0.07	22,316	5,413,000
Finland	177	3,666	EU 4.88	46,000	5,214,000
France	835	62,981	EU 94.78	400,000	60,424,000
Germany	845	45,200	EU 28.00	406,000	82,424,000
Great Britain	718	31,300	EU 13.30	327,000	60,270,000
Greece	430	6,540			10,647,000
Hungary	300				10,032,000
Italy	708	44,426	EU 16.90	117,783	58,057,000
Latvia	8				2,306,000
Netherlands	453	19,600	EU 18.80	187,000	16,318,000
Poland	210	13,500	EU 1.10		38,626,000
Portugal	489	8,500	US 3.40	53,000	10,524,000
Russia	95	1,850			143,782,000

Slovenia	106	980			2,011,000
Spain	650	42,554	EU 14.00	186,000	40,280,000
Sweden	300	9,600	EU 8.42	67,000	8,986,000
Switzerland	180				7,450,000
Canada	850	80,000	US 90.00	1,000,000	32,507,000
USA	1500	760,000	US 1,500.00	9,700,000	293,027,000
LATIN AMERICA					
Argentina	300	10,000	US 2.00	180,000	39,144,000
Brazil	814	59,028	US 1.00	531,000	184,101,000
Columbia	120	4,667		35,000	42,310,000
Mexico (year 2005)	720	462,000	US 50.00	500,000	104,959,000
ASIA					
PPR China	2,100	120,000	US 29.60	2,400,000	1,298,847,000
Hong Kong	92	3,000			6,855,000
India	850	48,000	US 3.80	300,000	1,065,070,000
Japan	1,100	220,000	US 170.00	2,000,000	127,333,000
Malaysia				500,000	23,522,000
Philippines (year 2003)	850	68,000		1,000,000	86,241,000
Singapore	380	3,000	US 2.00		4,353,000
PACIFIC					
Australia		720	US 62.00	600,000	19,913,000
New Zealand	350				3,993,000

AFRICA					
Egypt					76,117,000
South Africa	391	22,895	US 19.90	285,000	42,718,000

History of franchise regulation in Australia

5.6 The Current Regulatory Regime

The franchise sector in Australia is regulated by the Franchising Code of Conduct, which was introduced with effect from October 1 1998, as part of a range of Federal Government initiatives called the *New Deal: Fair Deal* reforms.

The Franchising Code of Conduct is a mandatory industry code prescribed by regulations under the Trade Practices Act (TPA) Pt IVB. The Franchising Code of Conduct was introduced by the Trade Practices Amendment (Fair Trading) Act 1998 in response to strong criticisms of business conduct in the franchising sector, in a report to the Federal Government known generally as the Fair Trading Report. At the same time the Federal government also introduced section 51AC of the TPA, which prohibits unconscionable conduct in small business transactions. Although not specifically targeted at franchising, section 51AC, in tandem with the broad and general prohibition of misleading or deceptive conduct under section 52 of the TPA, confers significant additional protection on franchisees.

The Franchising Code of Conduct is an important development for the Australian franchising sector. It imposes significant obligations on franchisors in relation to prior disclosure, substantive obligations and dispute resolution. The Code was modelled on the previous voluntary Franchising Code of Practice, but evolved considerably in scope and application during the exposure draft stage. During this stage the Franchising Policy Council, appointed to advise the government on its initial content and ongoing review, consulted widely with the sector. As a result some of the clauses in the draft Code which dealt with relationship or conduct issues, such as those which imposed obligations to pay compensation on termination of a franchise in certain circumstances, were removed.

The introduction of the Code does not limit the operation of the general law, which continues to govern the formation and general operation of franchising relationships. The main areas of law influencing franchising are contract, restrictive trade practices, intellectual property, consumer protection, fair trading, and revenue laws, in addition to retail leasing. Franchising is also subject to the TPA, which focuses upon competition and consumer protection. Of particular relevance to franchising is the prohibition on “misleading or deceptive conduct” contained in section 52.

5.7 The Origins of the Franchising Code of Conduct

The debate on the difficult issue of whether franchising should be subjected to a specific regulatory regime, commenced shortly after the introduction of business format franchising in Australia in the early 1970s.

Since 1981 the franchising sector in Australia has been subjected to a variety of regulatory regimes. Initially there was no regulation except under the general law (pre-1981). Then, in effect by accident, the sector was subject to quasi-regulation under the “prescribed interest” or “investment security” provisions of the Corporations Law (1981-87), to deregulation (1987-93), and to self-regulation pursuant to a voluntary Code of Practice (1993-96).

Until 1981 franchising was regulated only by the general laws governing all commercial relationships. The only exception was the regulation imposed on retail petroleum franchising through the *Petroleum Retail Marketing Franchise Act 1980* (Cth). However this changed when the Supreme Court of Western Australia held in *Commissioner for Corporate Affairs v Casnot Pty Ltd* (1981) ACLC 40-704, that an advertisement for a cleaning franchise was subject to regulation under the “prescribed interest” provisions of the then *Companies Act 1981*. These provisions dealt with the offering to the public of certain “investment schemes”.

This decision subjected franchising to an inappropriate regime more applicable to company securities and shares. This was compounded by the decision in *Commissioner for Corporate Affairs v Casnot Pty*

Ltd, which allowed the National Companies and Securities Commission (NCSC) to assume jurisdiction for franchising, requiring franchisors to comply with a number of statutory requirements.

The Corporations Law provisions prohibited a company from issuing a "prescribed interest" unless the company:
- was a public company;
- had issued a prospectus;
- had in place an approved trust deed; and
- had appointed an approved trustee.

The promoter and relevant employees were required to hold security dealers and dealers' representatives licences. The legislation went on to specify quite significant requirements to be inserted in the documentation. Compliance with these requirements imposed a substantial cost upon a franchisor. Significant civil and criminal sanctions applied to any breach of those requirements.

The problems created for the franchising sector were ameliorated by the governing body (then the NCSC, and now known as the Australian Securities and Investments Commission), which had the power to exempt a company from compliance. The NCSC accepted arguments that a franchisee was seeking a business opportunity rather than making a passive investment, and hence it was appropriate for there to be less protection. The acquisition of a franchise was known to carry certain risks, which a franchisee was better equipped to assume, and indeed influence, than a passive investor. Accordingly the NCSC issued a formal release (Policy Statement 118) which provided that franchisors would be exempt if they complied with certain less onerous requirements. The exemption was available if the franchisor was a company, whether private or public, and the franchise agreement contained certain provisions, relating inter alia to:
- the use of a trust fund;

the consent to assignment;
a cooling-off period; and
an obligation of disclosure.

The regime saw the first disclosure document requirement, which was conceptually a precursor to the disclosure document that is central plank of the Franchising Code of Conduct.

The NCSC was required to approve the franchise agreement and disclosure document before the exemption could apply.

Whatever the problems that resulted from the absence of regulation, they were not resolved by the arbitrary, complex, onerous and inappropriate regulation pursuant to the "prescribed interest provisions". Between 1981 and 1987 the interest provisions imposed a regime not specifically structured for franchising. By the mid-1980s the situation had become unworkable. National Companies and Securities Commission Policy Statement 118 requirements were less onerous, but nevertheless inappropriate for franchising. The requirements only applied when the prescribed interest was offered to the public, which led one commentator to advise that, "the sure way to avoid the Companies Act regime is to avoid advertising franchise opportunities to the public". Additionally, where it is considered necessary to advertise it was thought that it may be possible to structure the advertisement so that it merely provides a broad and vague outline of the proposal, and invites the reader to apply for information. However, a more basic problem was the emerging judicial divergence of opinion among State Supreme Courts as to whether the sale of franchises actually constituted prescribed interests.

The quasi-regulated era was brought to an end by the removal of franchising from the scope of the Companies Act by legislative amendment in 1987. Franchising then operated in a deregulated era, governed only by the general laws regulating all commercial activity until 1993.

A Franchising Task Force was established in 1990 to "examine impediments to the growth and efficiency of the franchising sector" and to "examine and report on the potential of self-regulatory codes for countering marketing failure in franchising, focussing on Business Format Franchising". The Task Force recommended a self regulatory Code of Practice administered and maintained by a council of representatives from all areas of the franchising sector. The recommendations were accepted by the Commonwealth, state and territory governments and the Code of Practice came into operation on 1

February 1993. The Code of Practice was authorised by the Trade Practices Commission on the basis of public benefit; it attempted to raise standards in the sector and to apply these nationally and uniformly across a diverse range of industries. Additionally, as an alternative to government legislation, the Code would avoid the attendant costs of implementation and enforcement. There were 5 editions of the Code during its short life, primarily in the nature of improvements and clarifications than changes of major significance.

Voluntary compliance with the Code was sought from franchisors, advisers and service providers. They were encouraged to register and thereby certify that they agreed to comply with those provisions of the Code that applied to them. The main Code provisions affected franchisors, and dealt with prior disclosure, cooling off periods, dispute resolution, certification and standards of conduct. Registration was voluntary. Non-compliance led to deregistration, but did not prevent that franchisor from operating as such .

The main features of the Code were:

Disclosure — Franchisors were required to provide a standard form of disclosure document to prospective franchisees at least 7 days prior to signing a franchise agreement. The disclosure document need to be updated annually and was available to existing franchisees upon request. A disclosure document also had to be provided by a vendor franchisee and its franchisor to a purchaser of that franchisee's business.

Cooling off — Franchisees were to be provided with a 7-day cooling-off period following execution of the franchise agreement. A franchisee who exercised the “cooling-off” option was to be refunded all fees paid less reasonable expenses specified in the franchise agreement.

- Dispute resolution — The Code laid down an alternative dispute resolution procedure with which the parties had to comply.
- Certification — Prior to the execution of the franchise agreement the franchisor had to require the franchisee to produce a certificate from a solicitor certifying that the solicitor had explained the franchise agreement to the franchisee, or have the franchisee sign a statement that the franchise agreement has been explained by a solicitor.

In line with the Task Force's recommendations, the Code imposed no specific requirements in relation to termination, intellectual property rights, tenure, assignment, approvals or other terms and conditions of the franchise agreement, including goodwill.

The Code nevertheless provided in paragraph 12 that franchisors and franchisees:

(3) will not participate in unconscionable conduct, in relation to franchise arrangements; and

(4) should act in an ethical, honest and lawful manner, and endeavour to pursue best franchise business practice on the time and place. They should in their dealings with one another at least avoid the following conduct, where such conduct would cause significant detriment to either party's business:

> (a) substantial and unreasonable overvaluation of fees and prices;
>
> (b) conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party; and
>
> (c) conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

However, the body entrusted with the administration and enforcement of the Code, the Franchising Code Council (FCC), had no power to deregister any party who failed to comply with paragraph 12. The standards of conduct operated as ethical standards to which participants in the franchising sector should aspire, rather than mandatory provisions to which participants had to comply under threat of deregistration.

The Franchising Task Force which recommended the introduction of the voluntary Code acknowledged in its report that its conclusions would satisfy neither those who had called for strict mandatory legislative arrangements, nor those who believed that there was nothing wrong with the sector and that no form of regulation, even voluntary self-regulation, was necessary. Nevertheless, at the time of its introduction in 1993 there was a strong hope that it would be a sufficient response to the problems affecting the franchising sector. It was described by the then Minister for Small Business as:

> *the most progressive industry/government franchising initiative undertaken in the world [which has attracted] strong interest in its development from the franchising community overseas. This Code of Practice and the self-regulatory regime which will support it, provides an excellent model for how the business community and government can work in partnership to promote business development.*

However, the reality did not match the hyperbole. Fourteen months into its 2 year trial period, the government, prompted by increasing concerns as to the effectiveness of the Code, initiated an independent review of its operation and effectiveness. The Gardini Report was submitted in October 1994 and released in March 1995. It identified two major weaknesses in the Code: its lack of coverage across the franchise sector, and failure of the "standards of conduct" provisions to address serious franchise problems.

The Code eventually "died" with the demise of the FCC in December 1996 as a result of:

- funding pressures (the outgoing government's promise of government funding fell victim to cost-cutting measures of the new government elected in March 1996;
- concerns among members of the FCC regarding their vulnerability to defamation actions brought by franchisors whom the FCC threatened to deregister; and
- disputes among franchisor and franchisee members of the FCC as to the role, viability and integrity of the Code and the self-regulatory regime.

The Code lapsed with the demise of the FCC. Australia was again returned to a deregulated environment, where franchising was regulated only by the general laws that regulated all commercial activity. It was obvious that the unregulated environment would be a temporary stage which lasted only until the new government determined its policy for the franchising sector.

5.8 The *New Deal: Fair Deal* Reforms

In June 1996 the Government appointed the House of Representatives Standing Committee on Industry, Science and Technology with wide terms of reference to report on business conduct issues in fair trading in general, and franchising in particular. In May 1997 the Committee handed down its Report. This Report, *Finding a Balance — Towards Fair Trading in Australia* was highly critical of some practices within the franchising sector.

The Report found that the problems had considerable economic and social costs, in that they contributed significantly to business failure. The social costs identified by the Committee included stress, marriage breakdown, poor health and suicide. The economic costs of the business conduct issues raised with the Committee included an inability of small firms to gain a return on sunk costs, and market inefficiencies arising out of exploitative conduct.

Faced with an orchestrated media campaign highlighting unfair conduct issues, the accumulated experience of over 20 reports over the last two decades, and the harsh criticisms and unanimous recommendations of a backbench committee of both government and opposition members, the government was left with no option but to act quickly and decisively.

Its *New Deal: Fair Deal* reform package released in September 1997 contained initiatives of great significance to the franchising sector. These included the enactment of a "business unconscionability" provision modelled on the "consumer unconscionability" provision of section 51AB of the TPA, and the introduction of a mandatory Franchising Code of Conduct . These regulations were proscribed under the TPA pursuant to a new Pt IVB which provided the legislative infrastructure for Codes of Conduct.

Two Exposure Drafts of the Code were released for public comment — the first modelled closely on the voluntary Franchising Code of Practice, and the second a more comprehensive document moving significantly beyond prior disclosure obligations to regulation of the franchisor/franchisee relationship. The final form of the Code prescribed by regulations came into effect in stages on 1 July 1998 and 1 October 1998.

The package contained a number of measures including:

- new protection for small business in the TPA, through prohibiting unconscionable conduct in terms similar to the strong protection already provided for consumers;
- new protection for small business franchisees through a mandatory and stronger Franchising Code of Conduct underpinned by the TPA;
- a safety net of minimum legislative standards for protection of retail tenants to be negotiated through State and Territory legislation;
- stronger enforcement by the ACCC of small business' fair trading rights, including representative legal actions on behalf of small business, small business commissioners, a Codes of Conduct Enforcement Unit and funding for test cases;
- support for alternative dispute resolution to provide small business with quicker, less costly and more efficient remedies than traditional court litigation; and
- support for the development of information packages on fair trading.

A feature of the reforms was that they comprised of an integrated package, which the government argued was designed, "to induce behavioural change on the part of big business towards smaller business, and to provide to small businesses, that are unfairly treated, adequate means of redress". Additionally, the Government accepted the Committee's conclusions, and acted on each of the seven areas of reform identified - unfair conduct, retail tenancy, franchising, misuse of market power, small business finance, access to justice and education .

The Trade Practices Amendment (Fair Trading) Act 1998 which came into effect on 1 July 1998 enacted the "business unconscionability" provision (s51AC) and the legislative framework for the prescription, by regulations, of codes of conduct. The first mandatory industry code, the Franchising Code of Conduct, came fully into effect on 1 October 1998.

5.9 The Franchising Code of Conduct

The Franchising Code of Conduct is a mandatory industry code prescribed under section 51AE of the *Trade Practices Act 1974*. Section 51AD of the TPA makes it an offence to contravene a prescribed industry code. The Code became fully operational on 1 October 1998 and was amended by the *Trade Practices (Industry Code – Franchising Amendment) Regulations 2001*, which came into effect on 1 October 2001. The ACCC administers the Code.

The purpose of the Code is to regulate the conduct of participants in franchising, particularly the conduct of franchisors. A particular focus is on ensuring prospective franchisees are able to make an informed business decision about whether or not to enter into a franchise agreement. The Code also regulates the content of certain conditions to be included in franchise agreements, and dictates a procedure for dispute resolution.

The Code applies to franchise agreements entered into, renewed or extended after October 1998. Section 4(1) defines a "franchise agreement" as:

(1) a written, oral or implied agreement;

(2) involving the grant of a right to carry on business of offering, supplying or distributing goods or services;

(3) under a trade mark, advertising or commercial symbol;

(4) using a system or marketing plan substantially determined by the franchisor; and

(5) requiring the payment of an initial fee.

Motor vehicle dealership agreements are specifically declared to be franchise agreements and certain relationships such as co-operatives and partnerships are excluded. There are also some limited exceptions where a franchisor is resident outside Australia, or where the goods or services supplied under the agreement are likely to account for no more than 20% of the franchisee's gross turnover.

The definition of a franchise agreement is quite broad and has the potential to capture a wide range of licensing, distribution and agency arrangements not traditionally considered to be strictly franchise arrangements. Consequently, the definition has tended to be read down by the courts with a focus on ensuring that there is a system or marketing plan actually being imposed by the alleged franchisor before the Code will be applied.

There are comprehensive disclosure obligations on the part of a franchisor intending to enter into, extend or renew a franchise agreement covered by the Code. A franchisor must provide a detailed disclosure document to a prospective franchisee at least 14 days prior to signing a franchise agreement. The franchisor must also provide a copy of the Code and a copy of the franchise agreement to the franchisee. In the case of a sub-franchise situation, both the sub-franchisor (master franchisee) and the franchisor are required to prepare a disclosure document. This may be done either jointly or individually.

The disclosure document requires the franchisor to provide approximately 250 items of information listed under 23 categories. The disclosure document must be in the form, order and numbering prescribed by the Code. It must also use the prescribed headings and have an indexed table of contents. The information required to be disclosed includes details of the franchisor, the business experience of those involved in the franchise system, litigation history, existing franchisee contact particulars, intellectual property ownership, territorial or supply restrictions, marketing or other cooperative funds, and a range of costs and payments relevant to the franchise and the franchisor's financial position.

There is provision for a short form disclosure document where a franchised business has an expected annual turnover of less than $50,000. The benefit of this exemption is compromised by the fact that a franchisor is still required to provide all the information in the long form disclosure document if requested by the franchisee. As a consequence this form of disclosure document is virtually never used.

A disclosure document must be updated within three months of the end of each financial year, regardless of whether the franchisor is recruiting new franchisees or not. The content of a disclosure document must be carefully monitored to ensure that it contains no misleading or deceptive information. Similarly, a franchisor must be careful about the information regarding pricing and supply conduct, to ensure it does not fall foul of the anti-competitive conduct provisions of the TPA.

A franchisor must advise a prospective franchisee to obtain professional legal, business and accounting advice before entering into the franchise agreement. The franchisee must sign a statement to the effect that he or she has received such advice, or been told to receive such advice but elected not to.

The Code dictates how the following issues are regulated in a franchise agreement:

(14) Cooling Off Period - a franchisee is entitled to terminate the franchise agreement and recover all fees paid under the agreement if it does so within 7 days of entering the agreement;

(6) Marketing Funds - if a franchisee is required to contribute to a marketing fund, then the franchisor must prepare an annual financial statement in respect of the fund and have the statement audited;

(7) Transfer - a franchisor must not unreasonably withhold consent to the transfer of a franchised business to a new franchisee;

(8) Termination - if a franchisee has breached the franchise agreement, then the franchisee must be informed of the breach, and given a reasonable time to remedy it. If it cannot be, or is not remedied, then the franchisor can only terminate on reasonable notice. Similarly, if the franchisee is relying on a power of termination in the agreement (other than for breach), reasonable notice must be given. There is no definitive answer of what will constitute reasonable notice as it depends on individual circumstances;

(9) Liability disclaimer – a franchise agreement cannot require the franchisee to give a general release from liability.

The Code requires parties to give a notice of dispute in the event of disagreement. If the matter cannot be resolved between the parties according to the internal complaint handling procedure, then the dispute should proceed to mediation. The mediation must be conducted in Australia and attended by someone with the power to settle the dispute on behalf of each party.

A breach of the Code will allow for the application of the TPA remedies, including damages, injunctions, specific performance, termination, and variation of agreements entered into. Where there has been a serious breach of the Code, such as a failure to provide a disclosure document, the court may declare all the franchise agreements entered into by the franchisor void, and order the franchisor to refund all the money paid by the franchisees under these agreements. As a part of any remedy for a breach of the TPA, it is common for the court to order that a franchisor adopt a trade practices compliance program which can itself be an expensive exercise.

The Code is merely the starting point of a franchisor's legal obligations. Franchisors have specific obligations under an array of different laws. Other laws, such as the TPA itself, the Corporations Law, Occupational Health & Safety laws and retail tenancies legislation in each State apply to franchising in the same way as they apply to other businesses. The general law of contract also applies to franchising, as franchising is essentially a contractual relationship.

The role of the FCA in the past and future growth and development of franchising in Australia

5.10 Representation

The FCA has played a key role in the development of franchising in Australia. When it became obvious that some form of franchise regulation was necessary to curb some of the excesses of the free market dealings, and restore the reputation of franchising as a credible business method, the FCA embraced the need for regulation. The FCA worked collaboratively with the Federal Government to develop a regulatory framework that addressed the perceived weaknesses of a de-regulated environment, yet did not unnecessarily restrict the entrepreneurial flair of franchisors or important principles of freedom of contract. The outcome was a regulatory framework that enhanced the contractual process by providing a comprehensive disclosure document to assist prospective franchisees to make an informed decision, and introducing a requirement for franchisor's to encourage franchisees to seek independent legal and business advice prior to signing the franchise agreement.

The Franchising Code of Conduct addressed important issues such as transfer, termination and dispute resolution, providing additional certainty for franchisors and franchisees alike. In many ways the disclosure requirements have reduced the risk of application of the section 52 TPA prohibition on misleading or deceptive conduct.
The FCA then combined with the Australian Competition and Consumer Commission to educate the franchise sector on the Code and the new regulatory requirements via national seminar roadshow. The FCA also conducts regular training as part of its Diploma of Franchising program, and produces a variety of publications to assist franchisors with compliance.

The FCA has also represented the sector in discussions concerning the Goods and Services Tax, TPA, retail tenancies , and red tape reforms, industrial relations issues and a range of other small business matters. To date the focus has been fundamentally on matters that have a specific impact on franchising, but in more recent times that representation role has widened.

The primary focus of the FCA will continue to be political representation, as that is the area most important to its members. In 2003 as part of a deliberate strategy to enhance its capacity to effectively represent the franchising community, the FCA appointed former Federal politician Richard Evans as its Chief Executive Officer. The FCA is now an active member of various Governmental committees, including the ACCC Franchising Consultative Committee.

It is likely that the FCA's representative role will extend beyond franchising into the general small business sector. The FCA is deliberately positioning itself as being representative of successful small businesses, with the aim of helping to harness the political influence of the sector for constructive purposes. The FCA believes that small business is currently very poorly represented, with many so-called small business groups being very narrowly focused or unrepresentative of the genuine needs of the sector. The vast majority of franchisors and franchisees are small business people, and the success rates of franchising justifies the FCA taking a broader role in small business policy issues.

The FCA represents the whole franchising community – franchisors, franchisees, service providers and suppliers. The FCA sees this as an important role, as this collaborative approach is culturally consistent with the mutual interdependence of the franchisor and franchisee relationship. The FCA has vigorously opposed the formation of organisations purporting to represent franchisees, but in reality being self-interested organisations intent on fermenting discontent and litigation.
The FCA believes that by representing franchising, as opposed to franchisors or franchisees alone, the FCA is helping to create a truly a collaborative approach to franchising in Australia. As a business method franchising is a team game, and it is important for the FCA to foster teamwork and collaboration, not an adversarial framework.

To effectively represent the whole community the FCA realises that it will need to develop initiatives that appeal to the separate interests of its constituents. The representative efforts in relation to retail tenancies have been important for franchisees, as have the Franchisee of the Year Awards. In recent times franchisee specific seminars and events have been scheduled, and more are likely. It is also likely that the FCA will take some of its activities, particularly franchisee events, into regional locations.

5.11 Education

The FCA has been very active in franchise sector education, its activities including:

- educating the franchise sector upon introduction of the Franchising Code of Conduct and related reforms, including conducting with the ACCC a national roadshow, producing a range of compliance materials and generally assisting with sector education concerning the Code;

- educating the franchise sector upon introduction of the Goods and Services Tax, conducting a national roadshow, producing a compliance video, producing a Franchisors Guide and a Franchisees Guides and generally assisting with sector education concerning the GST;

- developing an Accredited Franchise Executive program, later superseded by the Diploma of Franchising, which is a portable qualification recognised under the Federal Government's educational competencies;

- conducting national and State conferences on franchise sector issues, together with a range of special interest seminars, workshops, training modules and educational events;

- running monthly breakfasts or similar events in each State as a forum for information exchange, practical continuing education and networking;

- sponsoring franchise exhibitions, and conducting public education forums to enhance the understanding of franchising by the general public; and

- producing general information, press releases, newsletters and other material and making the information available to journalists, Federal and State Parliamentarians and the public via a range of means including the FCA website (www.franchise.org.au).

Future educational initiatives are likely to include specific compliance oriented initiatives, including seminars and compliance measurement and training tools that will link directly in to insurance products and possibly banking accreditation.

5.12 Membership

The FCA currently represents the majority of major franchise systems. However the FCA intends to focus substantial energies and resources upon membership growth and development. Several initiatives are likely to drive membership growth, including:

- the FCA's *"Don't Sign Without This Sign"* campaign, aimed at educating the public about the values of FCA membership and the additional safeguards of dealing with FCA members as a result of the introduction of the FCA Member Standards;
- the FCA's Member Advantage program;
- new insurance products designed specifically for the franchise sector, including liability insurance available only to FCA members with additional benefits linked to the existence of strong compliance systems; and
- further educational and other events available only to FCA members, or available at substantial discounts to FCA members.

5.13 FCA Member Standards

The FCA has introduced Member Standards with effect from July 1 2005 to further enhance perceptions of the credibility of franchising, and ensure that ethical behaviour in the sector remains high. The FCA aims to ensure that people do not enter the sector attempting to trade off the goodwill and reputation of franchising without honouring the expected standards of conduct.

The FCA Member Standards supplement the TPA regulatory framework by providing further detail as to the forms of conduct unacceptable for those involved in franchising. Importantly the FCA Member Standards impose new obligations on consultants and service providers in areas such as disclosure, conflicts of interest and professional behaviour.

A copy of the FCA Member Standards is included in this report at Appendix 3.

Future trends in Australian franchising

The success of franchising in Australia is well chronicled, and the growth of franchising in Australia shows no signs of abating. However one of the key determinants of long-term success will be how well franchise systems cope with the franchising mega-trends. The FCA has identified some of the likely mega-trends in Australian franchising, and the challenges these trends pose for franchise networks.

<u>Internationalisation</u> is already a feature of Australian franchising, with over $220 million in export earnings derived in 2002. More and more Australian systems will expand internationally, buoyed by the success to date of systems as diverse as Cartridge World, Gloria Jeans Coffee, Aussie Pooch Mobile, Cash Converters, Expense Reduction Analysts, Pirtek, Dome, Boost Juice and numerous others. The Australian market, with its logistical and geographic challenges, highly competitive marketplace and strong and effective regulatory framework prepares Australian systems well for international expansion.

<u>Aggregation</u> is a feature of competition in all markets. In Australia we are likely to see either a reduction in the number of franchise systems, as smaller systems merge with others to achieve economies of scale, or a gap emerge between those franchise systems that can achieve superior economies and efficiencies, and those that cannot. Currently there are around 850 franchise systems, which means Australia has around 3 times as many franchise systems per head of population as the USA. However in the US the number of franchisees per franchise system is much higher than in Australia, with many systems having more than 1000 franchisees.

Concomitant with this aggregation is the development of the <u>super franchisee</u>. The single unit franchisee that has been a feature of Australian franchising will be progressively superseded by franchisees that are bigger, stronger, own multiple franchises and have their own resources. They may even have franchises from different non-competing co-branded outlets and raise their own venture capital. These franchisees will be totally focused on, and expert in, operational matters. The challenge for the franchisor is to deliver brand and systems value that justifies the royalty cheque from the super-franchisee. This has been the trend in the US, and there are in fact several publicly listed franchisees, and intense competition between franchise systems to attract the franchisee heavyweights.

<u>Corporate competition</u> has already increased substantially in recent years. Franchise systems have taken market share from the large corporations by developing specialty retail niches, but the corporations are fighting back. Franchise systems will experience even greater competition from department stores, supermarkets, international chains and even other beefed up franchise networks that

have added capital or other networks to their stable to achieve greater economies of scale. That said, franchise systems have proven in the past to be far too agile and innovative for large corporations. Provided franchise systems continue to adapt their product or service to the needs of consumers, use their franchisees to communicate those needs, and deliver exceptional customer service, franchise systems will continue to enjoy a competitive advantage over their corporate colleagues.

Greater sophistication is essential for franchise systems wishing to attract the best franchisees. Franchisors need to focus on brand and system development, and purchasing economies rather than just providing a range of operational services of minimal value to the discerning franchisee. Franchisors will also need to become more sophisticated in their brand promotion, communications, marketing, management, business methods, use of technology and systems. As super-franchisees deliver superior returns to the unit franchisee, franchisors will need to be sophisticated to be able compete for these franchisees.

The US trend that has seen the corporatisation of franchisors will be repeated in Australia. We will see more and more franchise companies move from private companies owned and operated by the founder, to corporations where management and ownership are separate. Corporatisation will raise capital to fund future expansion and facilitate exits for founders. Features of the new corporate franchisors will include management with specialist skills in brand building and systems development, and expert boards of directors appointed by shareholders.

Increased regulation is a feature of all western economies. There is likely to be new legislation in areas affecting franchising, such as employment law, occupational health and safety, consumer protection and taxation. In industries where rationalisation may occur, such as pharmacy, there may be a temptation to introduce franchise legislation to address industry issues. Although franchisee failure levels are very low, there is always a franchisor on hand to be blamed. In the face of circumstances of economic downturn or substantial occupancy cost increases, there may be calls for further regulation of the sector. The growth of franchising in the mobile or service field is likely to face threats from Government in the form of the extension of employee taxation regimes, although the Federal Liberal Government at present is proposing Commonwealth legislation to protect those areas from the encroachment by industrial relations legislation.

Appendix 1

List of Members of Franchise Council of Australia

http://www.franchise.org.au/index.cfm?fuseaction=list

FCA Membership List

123 Express Pty Ltd
1800 ONHOLD
1-800-GOT-JUNK? LLC
24seven
3D Paint Store Holdings Ltd
7 Eleven Stores Pty Ltd
A Balloon And Party Centre Pty Ltd
A.T.S Franchising
ABS - Auto Brake Service
Ace Body Corporate Management
Action International
Advanced Hair Studios
Advanced National Services
AGL Retail Energy Limited
AHL Investments Pty Ltd
Ali Baba Lebanese Cuisine Pty Ltd
All City Cleaning
All That And More
Allens Arthur Robinson
Amber Group Australia Ltd
AMC Commercial Cleaning
Andrew Benefield
ANZ Banking Group Ltd T/A ANZ Mortgage Solutions
ANZ Franchise Team
APCO Service Stations
Appetitos Franchise Systems Pty Ltd
Approveit Home Loans Pty Ltd
Aquatic Achievers (Douglas Family Trust T/A)
Aroma Café
Attache Sofware Australia P/L
Auset Pty Ltd
Aussie Pooch Mobile
Austrade
Australasian Pool Services Pty Ltd
Australia Pacific Computer Consultants Limited
Australia Post Head Office
Australian Exhibition Services
Australian Franchising Systems
Australian Independent Vendors Pty Ltd
Australian Money Exchange Pty Ltd
Australian Pharmaceutical Industries
Australian Private Realty Pty Ltd
Auto Leaders All Car Servicing
Auto Masters Australia Pty Ltd
Autobarn Pty Ltd
Avatar Consulting Pty Ltd
B Capital Pty Ltd
Just Cuts Canberra
Just Cuts Franchising
Just Fingerfoods pty ltd
Kelly & Co
Kelly Sports Franchising
Kemp Strang Lawyers
KenKleen Window Cleaners
Kick Juice Bars Pty Ltd
Kieran Liston & Co
Kings Swim Centre
Kiss Cafe Franchising Pty Ltd
Kleenmaid Pty Ltd
Kleins Franchising Pty Ltd
Knight Frank Licencing Pty Ltd
Kwik Fix International
Kwik Kopy
Kwik Kopy (T/A Errington Business Systems Pty Ltd)
La Porchetta Pizza & Pasta Restaurant
Lancione Partners Lawyers
Laser Group Management Pty Ltd
Lavis Melin Taylor
Le Cornu Furniture
Ledgers Franchising Pty Ltd
Lenard's Pty Ltd
Lifetime Franchise Pty Ltd (The Book People)
Link Business Australia Pty Ltd
Little Images Pty Ltd
LJ Hooker Swan Hill
Local Lenders
Logie-Smith Lanyon
Lotteries Commission of Western Australia
Macedone Christie Willis
Macpherson & Kelley Solicitors
MACT Franchise Pty Limited
Made Easy Financial Group pty ltd
Magnetite
Mannings AV Services
MapInfo Australia
Mars Venus Coaching Pty Ltd
Marshalls & Dent
Mason Sier Turnbull
Master Feng Institute Pty Ltd
Matchbox Franchising Pty Ltd
Matthews Folbigg
McInnes Wilson Lawyers
McLaughlins
McLean Delmo & Partners
McMahon Fearnley

Back in Motion Physiotherapy Pty Ltd
Baker & McKenzie
Bakers Delight Holdings Pty Ltd
Bamboozle
Bank of Queensland
Bank of Queensland Limited
BankWest
Barbeques Galore Ltd
Bargain Wheels Car Rentals (Australasia) Pty Ltd
Barry Plant Doherty
Barry's, The Home Improvers (PEACS Pty Ltd)
Bartercard Australia Pty Ltd
Bathroom Werx Australia Pty Ltd
Battery World Australia
Baybridge Lawyers
BBX Management Ltd
BCI Business Brokers
Beacon Lighting
Bean Bar Franchising Pty Ltd
Beaumont Tiles (R J Beaumont & Co Pty Ltd T/A)
BedShed Franchisors Pty Ltd
Beechworth Bakery
Belgravia Formalwear
Bennett & Philp Solicitors
Betta Stores Limited
Big Dad's Pies
Big Fun Franchises Pty Limited
Bill Buddy Pty Ltd
Bing Lee Pty Ltd
Bio-Lab Australia
BNI Australia Pty Ltd (T/A Business Network International)
Bob Jane Corporation Pty Ltd
Boost Juice Bars Pty Ltd
Boots Great Outdoors Pty Ltd
Boss Hogs Hot Dogs Pty Ltd.
Bowler Geotechnical
BP Australia
Brad's Test & Tag
Brady Australia Pty Ltd
Bramalco Group (T/A Modern Group of Companies)
Bright Eyes Pty Ltd
Bristol Banner Group Pty Ltd
Brown Wright Stein
Brumby's Bakeries Ltd
Buchanan Law
Business Growth Strategies Pty Ltd
Busy Bookkeeping Pty Ltd
Bywaters Timms
Cabot Square Pty Ltd
Cafe2U Pty Ltd
Calair Pipe Systems (Calair Systems Pty Ltd T/A)
Caltex Australia Ltd
Meerkin & Apel Lawyers
Megasealed Bathrooms Franchising Aust. Pty Ltd
Mercury Management Systems Services
Metro Modelling Academy Pty Ltd ATF The Metro Trust
Meyer & Associates
Michel's Patisserie Pty Ltd
Midas Asia Pacific Pty Ltd
Middletons Lawyers Melbourne
MINC Services
Mini Maestros Operations Pty Ltd
Mini-Tankers Australia
Minter Ellison Lawyers
Minuteman Press International Inc
Miss Maud
Mister Minit
Mister Plywood Management Pty Ltd (Mister Ply & Wood T/A)
Mobil Gosford Area Service Stations
Mobitow Geraldton
Modern Streamline Roller Shutters
Mokum International Trading Pty Ltd
Money Depot Franchising Pty Ltd
Mortgage Choice Group
Moss Financial Services
Mountain Designs/Kolumbin Retail (Wild Gear Pty Ltd T/A)
Mr Antenna Pty Ltd
Mr Carports Licensing Pty Ltd
Mr Colin McCosker
Mr Globologist Pty Ltd
Mr Meticulous Pty Limited
Mr Rentals Franchising Pty Ltd
Mrs Fields Bakehouse
Mrs Flannery's
My Virtual Home Pty Ltd
Nandos Australia Pty Ltd
Narellan Pools Pty Ltd
National Australia Bank
National Business Sales
National Recruitment Pty Ltd
Natra Pty Ltd
Nedai Pty Ltd
New Level Personal Training Studio's
New Price Retail
New Zealand Natural Pty Ltd
Nextra Australia Pty Ltd
Nicol Robinson Halletts
NightOwl Convenience Stores
NJF Electrics Pty Ltd
Nutshack Franchise Group Pty Ltd
O2V Austalasia PTY LTD T/A Open2view
Office Choice Pty Ltd
One Water Naturally Pty Ltd
OneSteel Ltd
Oporto Portuguese Style Chicken Pty Ltd
Opposite Lock

Card Connection
Cargroomers Pty Ltd
Cartridge World
Cash Converters International
Cash Loan Money Centres Pty Ltd
Catmax International
Cavalier Homes Australia Pty Ltd
Central Coast Business Lawyers
Central Park Limousines
Chakram Pty Limited
Charter Resources Group
Chemtura Australia Pty Ltd
Chick n Feed Group-Joemnik
Chicken Express Systems P/L
Chocolate Orange
Choice Hotels Australasia
Chooks Fresh & Tasty Pty Ltd
Cibo Espresso Australia Pty Ltd
City Farmers Franchising Pty Ltd
City Pacific Finance Pty Ltd
City Pacific Law Firm Pty Ltd
Clark Rubber Franchising Pty Ltd
CleanTastic Pty Ltd
Coffee Ezy (Patsa Pty Ltd T/A)
Cold Rock
Coldwell Banker NSW/ACT
Coleman & Greig
Commonwealth Bank of Australia
communikate et al pty ltd
Concrete Taxi Pty Ltd
Contours Express (Australasia Franchise Group Pty Ltd trading as)
Cookie Man Pty Ltd
Coolabah Tree Cafe
Cost Less Plants Pty Ltd
Coulton Isaac Barber
Coverall Queensland Pty Ltd
CPR Complete Property Rejuvenation
CRA Cost Reduction Analysts NSW
Creative Home Decor Pty Ltd
Creative Marketing and Design
Crown & Gleeson Business Finance Pty Ltd
Cullen Babington Hughes
Cummings Flavel McCormack
Curwoods Lawyers
Custom Car Care Australasia
Cutler Hughes & Harris
Dairy Farmers Pty Ltd Vendor Number 110842
Daly International
DANARU PTY LTD
Danlaid Contracting Brisbane (Stevenson Contracting Pty Ltd)
Danlaid Contracting Pty Ltd
Darriwill Farm Franchising Pty Ltd
David Reid Homes
Davies Knox Maynards Chartered Accountants
OPSM
Optus Administration
Ovenclean Enterprises Pty Ltd
Ovenu
OZ Bin Cleaning Pty Ltd
Oz Design Furniture
Oz-Cover Building Design Pty Ltd
Ozspy Pty Ltd
Ozzy Tyres
Pacific Internet
Pack & Send Systems Pty Ltd
Paddy Pallin
PaintRight Ltd
Paramount Franchise Services
Parasol Emt Pty Limited
Parker Enzed Australia Pty Ltd
Parmalat Australia Ltd
PARRAFINE
PBM Fitness Pty Ltd
PC Masters International Pty Ltd
Pedders Shock Absorber Services
Pet Mobile Pty Ltd
Petstock Pty Ltd
PFA Chartered Accountants
Phillips Fox
Phone Central Pty Ltd
Picton Printing
Pie Face Pty Ltd
Pilot Nexia Pty Ltd
Pirtek Fluid Systems Pty Ltd
Pizza Haven
PKF Australia
Plenty Trak Systems (Vimex Pty Ltd T/A)
PNF Management Pty Ltd T/A Pure & Natural
Poolwater Services
PoolWerx Corporation Pty Ltd
POS Displays Pty. Limited
Power Loan
Powertec Telecommunications Pty Ltd
PRD Nationwide Pty Ltd
PricewaterhouseCoopers
Priority Management Systems P/L
Pro Klean Systems
Professional Advantage
Prosell Franchising Pty Ltd
Protect-A-Window Australia Pty Ltd
Protex Australia
QB Securities
Quest Apartments
Quest Apartments WA Pty Ltd
Quick Fit Tyre Service
Quick Sign Shops Franchising Pty Ltd T/A Quick Colourprint.com.au
R.W Corrie & Co
Rams Finance Pty Ltd
Ranger Camping & Outdoors
Recruitment Vision Pty Ltd

DCM - Coffee & Donuts
Deacons
Deacons Consulting
Deloitte
Deloitte Growth Solutions Pty Ltd
Destiny Financial Solutions
DIA ORO JEWELLERY PTY LTD
Dibbs Abbott Stillman
Direct Pest Control Admin Pty Ltd
Dixon Systems
DMAW Lawyers
Doggy Wash (Flea Stoppers Pty Ltd T/A)
Dominion Printing
Domino's Pizza Australia New Zealand Limited
Donaldson Walsh
donbelinder pty ltd T/A healthy habits
Don't Fret Pet Franchising Pty Ltd
Downings Legal
Dymocks Group of Companies
Eagle Boy's Dial-A-Pizza Pty Ltd
Ecomist Australia Pty Ltd
Ecowash Mobile Pty Ltd
Edwards Global Services
Edworks Active Learning
Ekinci & Hardy Management P/L
Elite Fitness Equipment Pty Ltd
Elite Maintenance Services Pty Ltd
EmbroidMe
Endota Spa
Energie Fitness Clubs Ltd
Enzed (Parker Enzed Technology Pty Ltd)
Espresso Mobile Cafe
Ettamogah Franchising Systems
Eurolight
Executive Property Maintenance
Exhibitions & Promotions Pty Ltd
Expense Reduction Analysts
Express GST Accounting
Extragreen Travel Franchises Pty Ltd
Extrastaff Pty Ltd
Fastway Couriers (Aust) (Australian Couriers Pty Ltd t/as)
Ferguson Plarre Bakehouses Pty Ltd
Fernwood Fitness
Fernwood Womens Health Clubs Pty Ltd
Fibrecare Australia Group Pty Ltd
FiltaFry
Fire Hydrant Systems (Australia) P/L
First Class Accounts
First Class Accounts (Sydney) Pty Ltd
First Food Group Pty Ltd
Fisher & Paykel Appliances Australia P/L
Flight Centre Limited
Flippin' Fresh Seafood
FluidMasters International Pty Ltd
Foam Factory
Formalwear Express Franchising Pty Ltd
Red Rooster
Reed Business Information
Refund Home Loans
Resi Mortgage Corporation Ltd
Resumes For Results
Retail Brands Group Pty Ltd
Retail Food Group (Australia)
RetireInvest Pty Ltd
Riaz Jeena
Richard Solomon & Associates
Riordan Hume
Rivergum Furniture 1939 Pty Ltd
Roadside Auto Care
Robbins Watson
Robert James Lawyers
Ryco Hose
S2M2 Franchising Pty Ltd
Safetyquip (Australia) Pty Ltd
Save Time Services
Scoop News & Lotto Pty Ltd
Scott Alexander Pty Ltd
Sea Tow Services Australia Pty Ltd
Secretary.com.au Pty Ltd
Select Information Pty Ltd
Sensis Pty Ltd
Sign-A-Rama
Signwave Australia Pty Ltd
Sky Blue Coffees Pty Ltd
Sleepy's Pty Ltd
Slurp
Small Myers Hughes
Smart Saver
SmartCare (Franchising) Pty Ltd
Snap Franchising Ltd
Snap-on Tools (Australia) Pty Ltd
Snowgum
Software Quality Assurance Centre
South Coast Bakeries P/L
Spanline Weatherstrong Building
Spectrum Analysis Australia Pty Ltd
Spinners Holdings Pty Ltd
Sport For Life
Sportskeep Pty Ltd
Sportzing Court Care Pty Ltd
Spotless Services Ltd
ST Software Pty Ltd
Stacks of Snacks
Stain Busters Cleaning Systems ACT
Stephens Lawyers & Consultants
Stewart Germann Law Office
STORAGE KING PTY LTD
Strathfield Group Limited
Stretch-n-Grow Australia Pty Ltd
Stretch-N-Grow Upper North Shore & Northern Beaches
Subway Systems Australia P/L
Sumo Salad Franchising Pty Ltd
Supergeek.com.au Pty Ltd

FORTE fitout logistics Pty ltd
Forte School of Music
Forty Winks Franchising Pty Ltd
FRANCH-EYES Pty Ltd
Franchise Alliance Pty Ltd
Franchise Careers
Franchise Central
Franchise Control Systems
Franchise Council of Australia
Franchise Developments Management Consulting
Franchise Link
Franchise New Zealand Magazine (Franchise NZ Marketing Ltd T/A)
Franchise Point
Franchise Relationships Institute
Franchise Systems Group
Franchise Technology Solutions
Franchise Works Australia
Franchising Solutions Pty Ltd
Freedom Group Limited
Frenchams
Futureworld Drama Pty Ltd
Gadens Lawyers
Gallery 360
Gametraders Franchising Pty Ltd
Gauci Franchising Pty Ltd
Gaze Burt Solicitors
GE Commercial Corporation (Australia) Pty Ltd
Gelare International PtyLtd
Gelatissimo
Glass Art Australia
Glenwood Homes Pty Ltd
Global Art Australia Pty Ltd
Global Enterprises (t/as Salon Express Australia)
Global Living Furniture and Homewares Group Pty Ltd
Globepro's Australia Pty Ltd
Gloria Jean's Coffees
Go Gecko
Go Sushi Management
Golden Casket Lottery Corporation Ltd
Golden Circle Limited
goldenwest usa
Goodyear Auto Service Centre
Got One Pty Ltd
Grant Thornton Melbourne
Grey Army Management
Grill'd Pty Ltd
Grinners Catering (Australia) Pty Ltd
H&L Australia
Haarsmas Lawyers
Hairhouse Warehouse Pty Ltd
Hall & Wilcox
Hallas Trading (Ella Bache)
Handi Ghandi Franchising Pty Ltd
Superior Steel Lattice Pty Ltd
Sureslim Australia Pty Ltd
Survival First Response
Symbion Pharmacy Services
Synectico Pty Ltd
Synergy executive (south) pty limited
Tallahesse Pty Ltd
Taps 'n Toilets
Targett Retail Training Pty Ltd
Tasman Recruiting
Tasty Trucks Pty.Ltd.
Tattersalls Sweeps Pty Ltd
Tayco Petroleum
TCM Consulting and TCM Franchising
Teamwork Finance
Telco In A Box
Telefonix Technology Group Pty Ltd
Termi-Mesh Australia
Test Sponsor
Testel Australia Pty Ltd
Thai Express Australia
The Ad Company P/L
The Athlete's Foot Australia P/L
The Award Bookkeeping Company Pty Ltd
The Business Card Shop
The Cheesecake Shop (Hodmac Holdings t/a)
The Coaches Consortium Pty Ltd
The Coffee Club Franchising
The Computer Market Pty Ltd
The Concrete Cutter (Franchising) Pty Ltd
The Confectionery Party Shop
The Crêpe Cafe Development PTY LTD
The Duster Dollies Pty Ltd
The Edge Corporate Strategies
The Iceberg Corporation
THE KEBAB CO
The Loan Doctor Pty Ltd
The Lucky Charm
The Mortgage Bureau Pty Ltd
The Mortgage Gallery
The Natural Source
The Natural Way
The Outdoor Furniture Warehouse Pty Ltd
The Quantum Organization Pty Ltd
The Real Learning Experience
The Realise Group Pty Ltd
The Retail Doctor
The Safety Shop Pty Ltd
The Shed Company Franchising P/L
The Storage Space Company Pty Ltd
The Touch Up Guys Pty Ltd
The Tyre Factory
The Waterboys Pty Ltd
Thomson Playford
Thrifty Car Rental
Thymac Admin Pty Ltd
Tilecraft Ceramics
Timberland Furniture Franchise Systems

Han's Cafe PTY LTD
Harry's Cafe de Wheels (Holdings) Pty Ltd
Harvey World Travel Franchises Pty Ltd
Healthline Health Care Systems Australia Pty Ltd
Healthy Habits Australia Pty. Ltd.
Healthy Life Pty Ltd
Helen O'Grady International Pty Ltd
High Plains Trading (Rep. Action International)
Hill Mayoh
Hind Fort Pty Ltd
Hire A Hubby NSW Pty Ltd
Hire for Baby Pty Ltd
Hire Intelligence
Hire Intelligence North Sydney
Hobbysew
Hocking Stuart
Hog's Breath Cafe - Mackay
Holding Redlich
Holistic Group Pty Ltd
Holy Sheet! Homewares
Home Entertainment Express Pty Ltd
Home Wilkinson Lowry
Honda Australia MPE
Horizon Franchising Pty Ltd
Horizon Media Pty Ltd
Horseland Saddlery Pty Ltd
Horwath
Hosemasters International Pty Ltd
Hotkey Internet Services
Hotkey Internet Services Pty Ltd
Hotondo Building Pty Ltd
Howards Storage World
Hudsons Coffee
Hungry Jack's Gold Coast
Hungry Jack's Pty Ltd
Hunt & Hunt Lawyers
Hydrodog
I.L Wollermann
Icon Business Solutions
IFX International Inc.
Imagine Essential Services Limited
Ink On the Run
iNSIGHT Home Loans (GSR Corporation Pty Ltd T/A)
Insite Data Solutions
Insurance Australia Group
Intelink Franchise Services Pty Ltd
Inut Inut Pty Ltd
Investor Finance Pty Ltd
ISS Facility Services
Jackson McDonald
James Home Services
Jani-King (Aust) Pty Ltd
Jarima Holdings Pty Ltd
Jaymak Australia Pty Ltd
Jesters Jaffle Pie Company
Tint a Car
Tobacco Station Group
Tom's Trash Paks Pty Ltd
Toni & Guy Australia Pty Ltd
Toohey Reid Pty Ltd
Total Building Maintenance
Trampoline Franchising P/L
Travelworld
Trios Pty Ltd
True Choice Home Loans Pty Ltd
Ultra Tune (S A) Pty Ltd
Ultra Tune Australia Pty Ltd
Uncle Tony's Kebabs
University of New South Wales
Urban Burger (S2M PTY LTD t/as)
Vaby's Franchising Pty Ltd
Van Go Australia
Vatman Group
Vaughan Barnes
Versatile Buildings TA Totalspan Australia
Victory Curtains & Blinds
VIP Australia Pty Ltd (VIP Home Services)
Viva Life Photography
Walk on Wheels Franchise Systems Pty Ltd
Walker Wayland WA Pty Ltd
Waterco (Swimart)
Webresource Testing Company
Wengor Pty Ltd t/a City Pacific Finance - Business Solutions
Westpac Banking Corporation
Wet-seal Management Pty Limited
Whirlwind Print
WHK Greenwoods
WHK Greenwoods
William Buck
WISE Employment Ltd
WiseOnes Australia Pty Ltd
Wisewoulds Lawyers
Wok in a Box Pty Ltd
Wood Rot Doctor
WordWerx Pty Ltd t/a Franchise Advisory Centre
Workforce Services Pty Ltd
Worldwide Online Printing Aust/NZ Pty Ltd
Worldwide Refinishing Systems (Aust) Pty Ltd
Wozzie Trading Pty Ltd t/as Chooks Fresh & Tasty - Byford - Coolbellup - Maddington
Wrappings Pty Ltd
Xpresso Delight Pty Ltd
Xpresso Mobile Coffee Bar Pty Ltd
Yates Security
Yum Restaurants International
Zarraffa's Franchising Pty Ltd
Zebra Interactive Pty Ltd
ZUVELA LAWYERS

Jetset Travel World
Jim's Corp Limited
John Brennan Franchising
John Cully Pty Ltd
John Danks & Son Pty Ltd
Jones Condon
Jumping J-Jays Franchises Pty Ltd
Just Better Care Franchising Pty Ltd

Appendix 2

FCA Member Standards

http://www.franchise.org.au/content/?id=205

Franchise Council of Australia - Member Standards

To lodge a complaint please direct to:

The Complaints Officer
Franchise Council of Australia
PO Box 2195
Malvern East VIC 3145

Email: complaintsofficer@francise.org.au

(i) The new member standards promoting excellence in franchising

One of the hallmarks of a reputable industry sector is a commitment to high standards of personal and professional conduct. This enhances public perceptions of franchising, helps safeguard the investments of franchisors and the businesses of franchisees, protects franchise networks from unfair or unethical attack and provides guidance for those seeking to commence their franchising journey.

The Franchise Council of Australia (FCA) encourages its members to maintain standards of conduct worthy of franchise sector professionals. The Member Standards are designed to provide members of the FCA with an authoritative guide on acceptable standards of conduct.

The FCA believes the Australian franchise sector to be well regulated with the Franchise Code of Conduct (the Code) allowing for adequate dispute resolution procedures and disclosure provisions to assist and guide the sector. It also considers that the franchise relationship between the franchisor and franchisee can be developed even further with best practice guidelines in the form of Member Standards.

It is the FCA's view a member gains significant market benefit in identifying themselves with FCA membership and as such the business practice and activities of members should work towards franchise best practice.

The Member Standards and Best Practice are not intended to anticipate each and every occurrence of a franchise relationship, but rather, articulate the values upon which the members of the FCA can structure their franchise relationships and strive to conduct their businesses.

If a member does not comply with the requirements of the Member Standards then investigation and disciplinary procedures are in place to handle the matter. It is not intended that breach of the Member Standards have any legal consequences other than potentially in relation to membership of the FCA. Clause 2.10(1)(b) of the Constitution of the FCA empowers the FCA Board by three-quarter majority to censure, suspend or expel from the FCA a member who fails to comply with any Standards of Conduct applying to them.

The FCA will respond to any complaint alleging breach of the Member Standards by a member, but does not have sufficient resources to vet documentation, audit behaviour or generally police compliance. Use by a member of the FCA logo does not carry any endorsement or certify compliance, and the FCA accepts no liability to any person in relation to any breach of these Member Standards.

Franchising Activities
All Franchise Council of Australia members are expected to conduct their franchising activities professionally and in accordance with Australian law. They are expected to comply with agreed minimum standards of conduct.

The FCA considers the following standards to be relevant to Members:-

- Members of the FCA shall abide by all relevant State and Federal laws including in particular the Franchising Code of Conduct and the Trade Practices Act. A member shall within 14 days of written request by the FCA furnish to the FCA a copy of its current disclosure document, franchise agreement and any other documentation or advertising material used in connection with the appointment of a franchisee.
- No member shall imitate the trade mark, trade name, corporate name, slogan, or other mark of identification of another member of business in any manner or form that would have the tendency or capacity to mislead or deceive.
- Members will become familiar with the content of these Member Standards and draw them to the attention of clients as appropriate from time to time.
- A Member, be they franchisor, vendor franchisee, franchise broker, or representative of a franchise system should not sell a franchise if at the time the franchisor or vendor franchisee knew or ought to know that a reasonably competent franchisee would be unlikely to be able to successfully operate the franchise.
- Members are expected to behave professionally and refrain from illegal, unethical or improper dealings or otherwise act contrary to the image of franchising or the FCA.

Relating to a franchisor and franchisee

- A franchisor shall as part of its franchisee recruitment process make reasonable investigation to assess whether a prospective franchisee appears to possess the basic skills and resources to adequately perform and fulfil the needs and requirements of the franchise.
- The franchisor shall have training and support processes as applicable to the franchise system to help franchisees improve their abilities to conduct their franchises. Franchisees will endeavour to apply and adapt all learning to their operation
- A franchisor and franchisees should be reasonably accessible and responsive to communications, and provide a mechanism by which ideas may be exchanged and areas of concern discussed for the purpose of improving mutual understanding and reaffirming mutuality of interest.
- Franchisors and franchisees shall endeavour to resolve complaints, grievances and disputes through direct communications and negotiation. Failing this, consideration should be given to mediation or arbitration.
- Franchisors and franchisees should in their dealings with one another avoid the following conduct, where such conduct would cause significant detriment to either party's business:
  (a) substantial and unreasonable overvaluation of fees and prices; and
  (b) unnecessary and unreasonable conduct beyond that desirable for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

Relating to a Supplier Member

- A Member who is a lawyer, accountant, consultant or other supplier or service provider ("Supplier Member") should behave in a manner consistent with these guidelines.

- Respect the integrity of established franchise systems and not seek to inflame any dispute, incite litigation, generate media coverage or otherwise act in any way which is unprofessional or may create a misleading impression of the system.
- Provide a client or prospective client on request with a written resume or profile of any relevant qualifications of the supplier together with true representations of the supplier's franchising education and experience;
- Respect the confidentiality of all information received concerning a client's business which is not in the public domain and will not disclose or permit disclosure of any such information without the client's prior permission in writing;
- Not advise any franchisee or prospective franchisee in relation to any franchise opportunity offered by any franchisor for whom the adviser has acted, without full disclosure of relevant circumstances;
- Disclose to a client or prospective client any personal or financial interests or other material circumstances which may create a conflict of interest in respect of that client and in particular, without derogating from the generality of the foregoing:
  - any directorship or significant interest in any business which competes with the client;
  - any financial interest in goods or services recommended by the Adviser for use by the client;
  - any personal relationship with any individual in the client's employment;
- Not undertake work for which they are not appropriately licensed, qualified and experienced.

Appendix 3

FCA Formal Response to the SA and WA Inquiries

Response by the Franchise Council of Australia to:-

(1) The Inquiry into the Operation of Franchise Business in Western Australia; and

(2) The Parliament of South Australia Economic and Finance Committee Inquiry into Franchises

FRANCHISE COUNCIL OF AUSTRALIA

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1. Executive Summary

1.1 Background

The Franchise Council of Australia ("the FCA") is the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising.

Recent State Government inquiries in Western Australia ("the WA Inquiry") and South Australia ("the SA Inquiry") have considered the operation of franchised businesses in those States, and published reports of their deliberations ("the WA Report" and "the SA Report" respectively). The FCA provided detailed written submissions to these inquiries which are attached as Appendices 1 and 2 to this Response, and attended in person to respond to questioning and provide further input. This document ("this Response") is a formal response to the two State inquiries. It notes those areas where the FCA supports the reports and those areas where the FCA considers the reports are deficient or the recommendations inappropriate.

Industry statistics confirm that franchising continues to prosper throughout Australia, including in Western Australia and South Australia. The FCA does not believe there are any endemic problems in franchising, a view confirmed by the recent Federal review of the Franchising Code of Conduct, the WA Report and even for the most part by the SA Report. Both reports make some useful recommendations which the FCA can comfortably support, particularly in relation to pre-entry education and assisting prospective franchisees to undertake more effective due diligence. The FCA considers some of the suggestions to improve the Code have merit, and remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public.

1.2 Operation of the current regulatory framework

All participants in the franchise sector acknowledge that the current Federal regulatory framework is working well. The *New Deal Fair Deal* Reforms were introduced in 1998 with bi-partisan support, and the Government's legislative response which took effect March 1, 2008 also had bi-partisan approval. The Mathews Committee Report on the operation of the Franchising Code of Conduct noted as follows:-

> "*Strong support for the Code has been registered throughout the review process. It is widely seen as pivotal to the continued success of the franchising industry".*[1]

The FCA has been strongly supportive of the current Federal regulatory framework, including the recent March 1, 2008 reforms which provide additional protection for prospective franchisees. The FCA believes the current regulatory environment creates a fair balance between the need for effective regulation supported by a strong and well resourced regulator, and the importance of minimising compliance costs for this entrepreneurial sector.

Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of this framework are:

(1) the Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. Typical requirements include disclosure of the franchisor's business background, relevant financial information, previous litigation and solvency history. Other relevant matters the Code uniquely requires of the franchisor include:

   (a) a list and contact details of existing and former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence; and

[1] Foreword by Graeme Mathews, p4, Review of the Disclosure Provisions of the Franchising Code of Conduct.

(b) a certification of solvency signed by the director of the franchisor, as at the end of the last financial year, which provides considerable additional comfort to prospective franchisees.

(2) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(3) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(4) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to provide it had reasonable grounds for making any representation as to a future event;

(5) the prohibition on unconscionable conduct in s51AC of the TPA; and

(6) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct.

1.2 General observations on the WA Report and the SA Report

The WA Report is consistent with the conclusions of previous Federal inquiries, is more balanced, and its recommendations more thoughtful. The WA Inquiry notes that "the Code serves the industry well", and "most franchise systems operate within the spirit and intent of the Franchising Code of Conduct." [2] The main focus of the recommendations contained in the WA Report is pre-entry education to improve overall understanding of the Code and franchising, and improvements to the disclosure provisions of the Code.

The SA Inquiry does not comment specifically on the effectiveness of the overall regulatory framework, although by implication the SA Inquiry would appear to think more drastic change is required. The SA Report is more emotive, less rigorous in its analysis of issues and some of its recommendations are more ill-considered. The SA Inquiry would appear to have commenced the process with a degree of bias. Mr Tony Piccolo, one of the Committee members, had commented extensively on the likely conclusions of the SA Inquiry before the Committee had actually commenced taking evidence.[3] This is to be contrasted with the WA Inquiry, which was conducted by a former franchisee who has a sound understanding of franchising and of small business generally.

1.3 Evidence to the inquiries

The WA Inquiry and the SA Inquiry both addressed essentially the same issues, and many individuals and organisations presented to both inquiries. The WA Inquiry was conducted by Mr Chris Bothams, a former franchisee with considerable industry experience and a strong background in business. The SA Inquiry was conducted by a group of South Australian parliamentarians who serve on the House of Assembly Economic & Finance Committee.

The FCA represents and promotes the growth and development of franchising, as opposed to the interests of franchisors or franchisees alone. In preparing its submissions to the two inquiries the FCA sought input from its franchisor, franchisee and supplier members including the FCA Legal Committee.

[2] Chairman's letter to the Minister included page 1 of the WA Report.

[3] See for example the article in The Bunyip (Gawler SAA) page 20 where Mr Piccolo comments on his alleged experience with "horror stories" of "franchisees sent to the wall". He is quoted as saying that "the inquiry will focus on franchisors who break the law with apparent impunity, not people who make bad business decisions", and "the committee is interested in hearing from current or ex-franchisees who have been treated badly by their franchisors".

There was significant technical rigour to the FCA submission, including a detailed analysis of the regulatory framework[4]. Similarly in representations before the inquiries the FCA articulated how existing legislation already provided remedies for many of the allegations of misconduct.

The FCA strongly believes that franchising best practice requires collaboration between franchisors and franchisees, as opposed to the adversarial or litigious approach advocated by some vested interests. Similarly the regulatory framework needs to provide protection to franchisees and support the capacity of franchisees to make informed business decisions, but should not unduly impinge on the ability of the parties to a business transaction to freely contract. The current framework, based essentially on two dual pillars - responsible franchisor behaviour and franchisee due diligence – not only strikes the right balance, but is the correct structure for business regulation. Franchising is a business relationship based on contract, not a consumer transaction.

Several of those making submissions to the inquiries provided instances of franchisee failure as if the failure of an individual franchisee was in itself proof of the failure of the regulatory framework. In a free market economy many franchisees are successful, but some also fail. Similarly not all franchise systems will succeed. It is impossible to legislate for business success. Just as the franchisor does not receive a bonus if a franchisee makes a higher than expected profit, or enjoys a substantial capital gain on sale of the business, so a franchisor cannot fairly be held responsible for every business failure within a network. The franchisor should rightly be held responsible in the event of fraud, misleading or deceptive conduct, misrepresentation, materially inaccurate information, failure to substantially comply with the Code, negligence, unconscionable conduct, breach of contractual obligation or fundamental system failure. That protection is already provided by the current regulatory framework. The FCA supports any further improvements to the Code disclosure process, but does not consider there to be a need for any additional legislative remedy.

In the context of this Response the FCA notes that many of those making submissions (including unfortunately some of the academics) brought to the inquiries significant personal prejudice or bias that should not cloud the debate on the effectiveness of industry regulation. Many would dismantle the current highly successful regulatory structure in favour of one based on almost strict franchisor liability for any franchisee failure. This of course is not franchising, it is employment, and would sound the death knell of franchising in Australia. The franchise sector makes a very substantial contribution to the Australian economy, with $128 Billion in annual turnover, 1,000 franchise systems, 66,000 units and 600,000 people employed.[5] Franchising enables small business to compete effectively against large business. This advantage would be lost if an employer/employee mentality were allowed to pervade this vital small business sector.

The noise created by interest groups must be seen in the context of industry statistics. Official industry surveys have repeatedly shown a level of disputation in the sector of around 2%,[6] which is incredibly low. There is very little franchise litigation notwithstanding the extensive legal remedies available to franchisees, and the mediation based dispute resolution framework has been phenomenally successful, with the Office of Mediation Adviser consistently reporting over 80% of disputes being successfully resolved at very low cost through mediation.

There has been significant publicity, representations and media generated by a small group of disaffected former franchisees. The evidence of many of these people has been largely discredited in the past, and in relation to others whose claims appear genuine the FCA has found that there are often discrepancies between the allegations and the facts. In this respect our experience is similar to that of the Australian Competition & Consumer Commission, which recently publicly commented in relation to an investigation into allegations by former Bakers Delight franchisees that:-

> *"although there is no suggestion that the allegations made by the franchisees were made with any improper intent, in many cases, it was difficult to substantiate claims and in some cases information given was directly contradicted by documents and other evidence."*[7]

The WA Inquiry prudently noted that *"the Inquiry was not an investigation and was unable to verify allegations made in many submissions."*[8] In contrast the SA Inquiry appears to have taken all evidence of alleged franchisor misconduct as fact.

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[4] See Appendices 1 and 2 to this Response.
[5] See IBISWorld Franchising Survey 2008
[6] See for example Franchising Australia 2004 and 2006
[7] ACCC News Release 104/08, April 22, 2008

Industry policy must consider industry issues, and not intervene in commercial disputes between corporations. On this issue we note that one apparent contributing factor to the establishment of the WA Inquiry and the SA Inquiry, and indeed some of the recommendations, appears to have been lobbying from interests associated with Competitive Foods Pty Ltd, which is involved in a substantial commercial dispute with Yum Brands in relation to the decision by Yum Brands not to renew its franchise agreements for the operation of a substantial number of KFC outlets. It is not the role of the FCA to take sides in any matter, and indeed both organisations are FCA members. However industry policy needs to be based on industry issues, and the FCA strongly opposes any regulatory change which is designed to remedy private issues or which delivers competitive advantage to one party in a commercial dispute.

None of these comments is intended to be dismissive of the issues. It is simply intended to put the extent of any alleged problems into context, and to reinforce the importance of making any legislative change based on fact not anecdote. In an industry sector of around 1,000 franchise systems and over 65,000 franchisees there will always be cases of inappropriate behaviour. However the FCA firmly believes that the existing regulatory framework works well and strikes the correct balance, and there is no endemic problem. Evidence and assertions by some parties at first glance contradicts this fundamental position. However the FCA's experience is that on closer examination such evidence tends to be either unreliable, lack objectivity or have been inaccurately represented as an industry issue rather than a problem with a particular franchise or franchise system. In many cases calls for legislative action ignore existing laws which already cover the alleged problem. The FCA's experience in questioning by the SA Inquiry where we were asked to comment on what the inquiry saw as issues requiring redress which in fact appeared to be clearly covered by existing legislative protection.

1.4 WA Recommendations:

More detailed reasoning is contained in section 5 of this Response, but the broad position of the FCA in relation to the specific recommendations put forward by the WA Inquiry is as follows:

(1) The FCA does not believe that current laws disadvantage franchisees. Indeed the laws provide strong protection for franchisees. The regulatory framework in Australia is the most comprehensive regulatory framework in the world, and features:-

  (a) A comprehensive prior disclosure process set out in the Franchising Code of Conduct;

  (b) A general prohibition on misleading or deceptive conduct contained in s52 and 51A of the Trade Practices Act;

  (c) A general prohibition on unconscionable conduct;

  (d) A well resourced and effective regulator in the Australian Competition and Consumer Commission.

(2) The FCA believes pre-entry education of prospective franchisees is the most important improvement that could be made to the regulatory framework, and is very supportive of all recommendations of the WA Inquiry in relation to franchise education.

(3) The FCA believes that franchisees may benefit from receiving more information on the possible risks of a franchised business, but that this information is best provided by the ACCC rather than by individual franchisors.

(4) The FCA would be prepared to consider any further improvements to the quality of information provided to franchisees as part of the disclosure process.

(5) The FCA objects to the proposal for mandatory disclosure of rebate amounts. Rebate rates and amounts are highly sensitive information. Mandatory disclosure would put franchises at a disadvantage against non-franchised competitors, and would create substantial additional compliance cost.

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[8] WA Report Chairman's letter to the Minister, page 1

(6) The FCA is supportive of the proposal for periodic review of the Franchising Code of Conduct. We have no objections with the 2010 date proposed.

(7) The FCA is concerned that any process which required that all franchisors register their franchise systems and lodge their disclosure document annually with the ACCC would be a costly burden that would add little to the current regulatory regime. Registration with the ACCC could also be seen as an endorsement of the franchise that gives undue credibility to any claims made. This could in fact have a detrimental affect on the due diligence undertaken by a potential franchisee. Although the FCA would not rule out supporting such an initiative it could only be introduced with substantial industry consultation as to the process and framework.[9]

(8) The FCA has no concern with the recommendation to provide specific information in the disclosure document in relation to end of agreement arrangements. The FCA does not support the amendment of franchise legislation to provide guaranteed rights of renewal to existing franchisees, or impose an obligation on a franchisor to negotiate "in good faith" to give an existing franchisee a renewal or compensation when no such right is conferred by laws applying to non-franchised businesses such as licences, agencies, dealerships and distribution agreements.

(9) The FCA supports measures to augment and further streamline dispute resolution.

(10) The FCA provides in principle support to the recommendations on enforcement of the Franchising Code. Greater detail is needed to allow us to comment more fully.

The FCA has offered to work with the WA Government and other bodies to fine tune any recommendations to ensure they add value without undue additional compliance cost.

1.5 SA Inquiry Recommendations

As a general comment the FCA considers that the SA Inquiry has raised a number of valid issues, but the recommendations made are typically either unlikely to improve the situation or will have broader or unintended consequences that have not been thought through.

More detailed reasoning is contained in section 6 of this Response. The broad position of the FCA in relation to the specific recommendations put forward by the SA Inquiry can be summarised as follows:

(1) The FCA is supportive of enhanced information to franchisees concerning retail tenancies. However the recommendation to amend the definition of "lessee" to include "licensee", purportedly to improve the position of franchisees, is unlikely to have that effect and is more likely to increase compliance costs on franchisors.

(2) The FCA is supportive of the recommendation to amend the SA Retail and Commercial Leases Act 1995 (SA) to prohibit unconscionable conduct in retail leasing, including enforcement and dispute resolution processes to facilitate that prohibition.

(3) The FCA sees no real value in the recommendation that the SA Minister for Consumer Affairs require prospective franchisees and franchisors to identify their proposed business as a franchise when they register their business name with the Office of Consumer and Business Affairs. This is likely simply to add additional compliance cost for no real benefit. The same can be said of the recommendation to create a SA State database for regulators and researchers.

(4) The FCA strongly endorses the recommendation that the Minister for Consumer Affairs provide educational information (including access to seminars) relating to franchising to all business registered as franchises (both franchisees and franchisors).

(5) The FCA is concerned that any process which required that all franchisors register their franchise systems and lodge their disclosure document annually with the ACCC

[9] The FCA has explored this option in the past, and has thoughts on a low-cost industry sponsored process that could work with the support of Government and the ACCC. The International Franchise Association considers registration in the USA to have been effectively superseded by a comprehensive Federal disclosure regime.

would be a costly burden that would add little to the current regulatory regime. Registration with the ACCC could also be seen as an endorsement of the franchise that gives undue credibility to any claims made. This could in fact have a detrimental affect on the due diligence undertaken by a potential franchisee. Although the FCA would not rule out supporting such an initiative it could only be introduced with substantial industry consultation as to the process and framework.[10]

(6) The FCA rejects the recommendation that the Code be amended to require the franchisor to provide further continuous disclosure. (The recommendation appears to overlook the fact that a continuous disclosure requirement already exists in the Code, together with a provision that allows an existing franchisee to call for a current disclosure document at any time).

(7) The FCA supports the recommendation that item 11 of Annexures 1 and 2 of the Franchising Code of Conduct be amended to require the franchisor to disclose a summary of its particular experience operating a franchise business.

(8) The FCA has seen no evidence of franchisors preventing or obstructing communication between prospective and existing franchises. The FCA does not consider any amendment to the Code is required in this area.

(9) The FCA supports the provision by the ACCC or other bodies of information which describes the risks and consequences of franchisor failure, and indeed the operation of businesses generally. However the FCA does not support any requirement that a franchisor must produce a risk statement for every franchisee.

(10) The FCA does not support the recommendation that the Code be amended to remove the exception in item 20.3, as the exemption does not diminish (and indeed arguably enhances) the quality of information available to franchisees and provides a reasonable alternative for private companies not wishing to make public their actual financial statements.

(11) The FCA does not support the recommendation the Code be amended to include a requirement to disclose not just that rebates are paid and to whom, but the amount or the methods of calculation of any rebates and/or other financial or commercial benefits received by franchisors or master franchises in relation to goods or services supplied to franchises. This recommendation has previously been rejected correctly by Government as it breaches commercial confidentiality and places franchised businesses at a disadvantage when compared to others.

(12) The FCA prefers the current position, where a court has very broad discretion to determine the sanctions that ought to apply to breaches of the Code, to the recommendation that the Code be amended to introduce specific penalties for breaches of the disclosure requirements under the Code.

(13) The FCA rejects the recommendation that section 51AC of the Trade Practices Act 1974 (Cth) be amended by the inclusion of a statutory definition of unconscionability or alternatively by the insertion in the Act of a prescribed list of examples of the types of conduct that would ordinarily be considered to be unconscionable. The FCA considers that the law currently works well in this area and no further changes is required.

(14) The FCA supports any sensible mechanism to further improve the alternative dispute resolution measures available under the Code, but considers the existing system operates very well and very cost-effectively. The Office of Mediation Advisor consistently reports that over 80% of mediations successfully resolve the disputes. This occurs at a fraction of the cost of any court case, and in a manner that is prompt and if appropriate can even allow the business relationship to continue.

[10] The FCA has explored this option in the past, and has thoughts on a low-cost industry sponsored process that could work with the support of Government and the ACCC. The International Franchise Association considers registration in the USA to have been effectively superseded by a comprehensive Federal disclosure regime.

(15) The FCA does not at this point support the creation of a Franchise Ombudsman, or a Franchise Tribunal, or a specific Franchise Arbitration Unit within the ACCC or other relevant entity to administer the enhanced dispute resolution system. The FCA considers any new tribunal or process will simply add cost, and invite an adversarial approach to disputes.

(16) The FCA does not support the amendment of the Code by inserting a provision imposing a duty to act in accordance with good faith and fair dealing by each party of the franchise relationship. There is already a duty implied at law, and any new definition will simply add cost and create uncertainty where none currently exists. The FCA is also concerned that such a proposal may be used to create a de facto automatic right of renewal of franchise agreements.

(17) The FCA rejects the recommendation that the Code be amended to include a provision mandating that franchise agreements must include the basis on which termination payments or goodwill or other such exit payments will be paid at the end of the agreement. This is unnecessary interference with the freedom of the parties to contract. The FCA would support the inclusion of a requirement for more specific disclosure on this issue in the disclosure document.

(18) The FCA rejects the recommendation that the exclusion or inadequate determination of goodwill or other such exit payments by a franchisor during negotiations with a franchisee regarding a franchise agreement constitute "unconscionable conduct". The FCA sees no need to amend section 51AC of the *Trade Practices Act*.

(19) The FCA has no objection to the recommendation that the ACCC publishes the outcomes of any investigations in which franchisors are found to be acting unlawfully or persistently in breach of the Franchising Code of Conduct, or that such findings should further be kept on a publicly accessible register. The FCA also supports the current practice of the ACCC of publishing the outcomes of investigations which have found franchisors had no case to answer.

(20) The FCA notes that the Code already contains provisions which address the recommendation that the Code be amended to include a requirement to disclose a copy of the franchisor's, or associate's, head lease over a premises; and any sub-leases over the premises occupied by the franchisee for the purpose of conducting the franchise business.

(21) The FCA supports the recommendation that the ACCC considers providing further resources for the explicit purpose of providing educational support to the franchise industry.

(22) The FCA believes the ACCC has been a vigilant and effective regulator of the franchise sector, and does not consider it necessary (although would not object to) the ACCC strengthening its involvement in the development of case law in the area of unconscionable conduct by supporting actions brought under section 51AC of the *TPA* and review its enforcement and funding strategies to support such an aim.

(23) The FCA does not consider it will be necessary to make any consequential amendments to the ACCC's jurisdiction with regard to franchising to accommodate and complement the operation of additional dispute resolution measures.

2. The Franchise Council of Australia

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers involved in franchising in Australia. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. Details of the activities of the FCA can be found at www.franchise.org.au.

The FCA has as its core aim the promotion of the growth and development of franchising in Australia. The FCA believes collaboration (as opposed to an adversarial relationship) between franchisors and franchisees has been one of the reasons for the success of the Australian franchise sector, and remains critical to its future success. The FCA represents franchising, and the joint and separate interest of all stakeholders, as opposed to the interests of one component of the sector over another component.

The FCA is strongly committed to working collaboratively with Government at all levels to promote the growth and development of Australian franchising. We enjoy a productive relationship with the ACCC and the Office of Small Business, as well as other organisations such as Austrade, the Australian Taxation Office and various Government departments.

The FCA has always been very concerned at any allegations of inappropriate conduct in franchising. As a result, in its submission to the 2006 Federal Government Inquiry into franchising, the FCA made several recommendations to improve the Franchising Code of Conduct and provide additional information and protection to franchisees. The FCA supported the legislative amendments to the Code made by the previous Federal Government (with bi-partisan support) and which took effect March 1, 2008. Further, the FCA has introduced its own Member Standards to provide additional guidance to FCA members on what is required of franchisors, franchisees and service providers to ensure responsible franchising. The Member Standards are supported by educational programs and a complaints process that enables the FCA to remain in touch with the issues causing concern in the franchising community.

The FCA has always supported initiatives which acknowledge the need for entrepreneurial and contractual freedom but promote the two pillars upon which the current regulatory framework has been built – responsible franchisor behaviour and effective franchisee due diligence. The FCA remains committed to the promotion and development of franchising in Australia. In particular the FCA supports any improvements that can assist prospective franchisees to be better informed.

The FCA has long recognised that the success of the franchise sector is fundamentally dependent on both the entrepreneurial spirit of franchisors and the operational success of the vast majority of franchisees. It is critical that the regulatory environment give potential franchisees the confidence and security to invest without burdening franchisors, as small businesses themselves, with excessive regulatory cost or rules which stifle their entrepreneurial activities. The FCA board has identified franchisee inclusiveness as one of its top priorities. To give effect to this priority franchisee representatives have been appointed in each State, and Gloria Jeans franchisee Tony Melhem has been appointed to the FCA board to specifically represent the franchisee interests in view of the recent retirement of long time franchisee director John Longmire.

The FCA looks forward to working with Government at all levels to assist them to understand the dynamics of franchising, improve the profitability of franchisors and franchisees, continually review the effectiveness of the regulatory framework and foster the growth and development of franchising in Australia.

3. The Development of Australian Franchising

The franchise sector in Australia makes a very substantial contribution to the Australian economy. Industry turnover is estimated by IBISWorld Research at $128 Billion, which equates to approximately 3.2% of Australian Gross Domestic Product.[11] The sector has around 1,000 franchise systems, 66,000 units and employs 600,000 people. The indirect impact of franchising is estimated at 1.5 times these figures based on research on franchising in the US conducted for the International Franchise Association by Price Waterhouse Coopers.

Once seen predominately as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the preferred business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; speciality retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. Since 1998 the sector has not only grown, but matured and developed into one of the primary engines for economic growth in Australia. We have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practice.

The FCA is a strong supporter of the regulatory framework established by the Federal Government in 1998. It considers the *New Deal Fair Deal* reforms have made a very important contribution to the success of Australian franchising. This included the introduction of a prohibition in s51AC of the Trade Practices Act on unconscionable conduct, and the establishment of the ACCC as the designated regulator of the sector.

The FCA believes that Australia's regulatory framework represents world's best practice in terms of striking a balance between strong and effective regulation and the fundamental principles of free enterprise. It features the comprehensive Franchising Code of Conduct requirements, which are administered by the ACCC. In addition to the Code, the Commonwealth Trade Practices Act's prohibitions on misdealing or deceptive conduct and unconscionable conduct also apply to franchising transactions. The Australian regulatory environment for franchising is the most comprehensive of any nation, including the USA.

The FCA does not pretend that franchising is perfect, and indeed has been at pains to ensure that potential franchisees are not lured to the sector by a belief in the infallibility of a franchised business. The FCA, and more recently the ACCC have emphasised that franchising not only requires responsible franchisor behaviour, but proper franchisee due diligence. Many of the problems the FCA sees in franchising would not have arisen had the potential franchisee sought appropriate specialist legal and business advice and undertaken proper due diligence prior to purchasing the franchise. This remains probably the biggest ongoing challenge for the sector.

[11] The reference to 14% of GDP is in fact incorrect. 3.2% is the correct figure.

4. The Current Regulatory Environment

4.1 Understanding the current regulatory framework

Australian franchising is regulated by the *Trade Practices Act* and the *Franchising Code of Conduct,* as well as the contractual relationship between the parties. The Matthews Committee comprehensively reviewed the regulatory framework of Australian franchising in late 2006. The effect was a series of amendments to the *Trade Practices (Industry Codes – Franchising) Regulations 1998*. These changes took affect on March 1, 2008. The Code amendments have bi-partisan support, and are well accepted in the franchise sector.

As a result, Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of this framework are:

(1) the Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. Typical requirements include disclosure of the franchisor's business background, relevant financial information, previous litigation and solvency history. Other relevant matters the Code uniquely requires of the franchisor include:

   (a) a list and contact details of existing and former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence; and

   (b) a certification of solvency signed by the director of the franchisor, as at the end of the last financial year, which provides considerable additional comfort to prospective franchisees.

(2) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(3) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(4) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to provide it had reasonable grounds for making any representation as to a future event;

(5) the prohibition on unconscionable conduct in s51AC of the TPA; and

(6) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct.

4.2 Balancing contractual freedom and regulation

The FCA is strongly supportive of the current regulatory environment. In our view it strikes an ideal balance between contractual freedom and flexibility that encourages growth and entrepreneurial behaviour, and regulatory intervention to support the contractual process and ensure informed and fair bargains are made.

The FCA believes that the two key principles that underlie effective franchising are responsible franchisor behaviour, and proper franchisee due diligence and risk awareness. The Code and the TPA prohibitions on misleading or deceptive conduct and unconscionable conduct support these principles, and do not undermine the important principle of freedom of contract. The Code requires responsible and lawful franchisor behaviour through a comprehensive disclosure regime, mandatory mediation based dispute resolution, constraints on restricting transfer and controls on termination. The Code facilitates proper franchisee due diligence and risk awareness by providing extensive information and franchisee contact details in the disclosure document, and creating a framework for franchisees to obtain independent advice and then sign (with the protection of the 14 day disclosure period and the 7 day cooling off period) without undue haste.

The FCA believes the Franchising Code of Conduct and the Trade Practices Act provide important protection for franchisees, and the ACCC has been a highly effective industry regulator. Australia's level of disputation, at just over 1% is substantially lower than the US, which is estimated by the International Franchise Association at around 6%. Further, over 80% of disputes in Australia are successfully resolved by mediation, whereas in the US arbitration and litigation are the more common dispute resolution methods. Another encouraging statistic is that the level of franchising complaints to the ACCC continues to fall, and is at historically low levels notwithstanding the substantially increased profile of the ACCC. As a consequence the FCA considers Australian franchising is world's best practice.

4.3 State regulation of franchising

The FCA strongly believes franchising should be regulated at the Federal level only. To introduce State specific legislation would create confusion and uncertainty, and increase business costs. It could potentially act as a disincentive for businesses in that State, on account of additional obligations and/or compliance costs. It could also act as a barrier to cross-border or national franchise networking. The purpose of State Fair Trading legislation in the business context is to essentially mirror the Federal Trade Practices Act and provide coverage to those few limited areas not covered by the jurisdiction of the TPA under the Corporations power of the Constitution. The FCA would strongly resist any attempt to introduce different State based remedies.

We are pleased to note the WA and SA Inquiries recommended a co-ordinated approach, working with the Commonwealth and State and Territory governments.

The FCA believes there is a real opportunity presented by the Labour State and Federal incumbency to produce genuine reform of business compliance costs. The FCA would be keen to receive a commitment by State Governments to fully harmonise legislation that has impact beyond State boundaries and avoid the duplication, inconsistency and cost of State based regulation. This is not limited to franchising, but also covers taxation, retail tenancies, workplace issues, occupational health and safety, business regulation and property law. Other issues include the simplification of legislation and dismantling of State based public service bureaucracies which become self-justifying and act as an impediment to harmonisation, in favour of a more efficient nationally integrated infrastructure. The recent Productivity Commission report of December 2007 put the additional cost of the concurrent regulation of consumer affairs at Federal and State level at an estimated $4.9 billion above the cost of a unified Federal scheme. This is compelling evidence of the extent of possible savings.

4.4 Disclosure as part of the contractual process

The Code facilitates the provision of extensive information through the disclosure document, as part of a process that is designed to ensure as far as is reasonably possible that a prospective franchisee makes an informed decision to purchase the franchise. Importantly, the disclosure document is intended only as part of the franchisee's due diligence process.

Potential franchisees are clearly warned to get independent legal, accounting and business advice before signing a franchise agreement, and to make their own enquiries about the franchise and the business of the franchise. To place all obligations on the part of the franchisor would be unprecedented, and massively distort the commercial relationship. This has not been suggested by the Inquiry. However it is worth reiterating that the disclosure document is not intended to be an exhaustive document. Nor is it intended to replace thorough due diligence.

The FCA is highly supportive of the recent amendments to the Code, including the expansion of the disclosure requirements. However it is the franchising agreement that is the basis of the legal relationship between the parties. As such, the FCA is wary of recommendations that seek to expand the disclosure document beyond the recent amendments to the Code. There is no demonstrable need for further disclosure of the respective rights of the parties to a franchise agreement either in relation to renewal or extension of a franchise agreement, or generally. Much of the information the WA and SA recommendations call for is already outlined in the agreement. While the disclosure document is an important starting point to allow a potential franchisee to make an informed decision, it is no substitute for education and training, professional advice, and reading and understanding the franchise agreement before signing it.

4.5 Disclosure and compliance costs

There are currently over 250 separate pieces of information to be included in the disclosure document, which must be in a prescribed order and layout. No doubt there are other pieces of information that could be included. However any change to the current format will result in further compliance costs not just in making changes to the document, but in accessing the necessary information and recording information for future documents. Depending on the nature of the information franchisors may not have kept records on the matter, so information may need to be accessed from archives or other records, at substantial cost. Additional disclosure obligations must be considered in the context of the relevant compliance costs.

4.6 Questioning the need for an overhaul of the Code

The Federal Government Inquiry into the Franchising Code of Conduct will be the fourth inquiry into franchising in two years. It follows:

- The Mathews Committee;
- The Inquiry into the Operation of Franchise Businesses in Western Australia; and
- Parliament of South Australian Economic and Finance Committee Inquiry into Franchises.

The regulatory framework has only recently been comprehensively reviewed at a Federal level, with the amendments taking effect on 1 March 2008. The Western Australian and South Australian Inquiries were initiated before the new amendments came into force. It is the FCA's view that many of the areas identified as needing reform in these recommendations are now sufficiently covered by the newly amended code.

Fundamentally the FCA believes the recently improved disclosure provisions in the code are adequate and work well for the market. In any event, insufficient time has passed since the amendments took effect to allow for critical appraisal. Absent of this, there is no case for further amendments to the Code, particularly where these changes would represent replications or minor amendments.

It should also be recognised that the cost of compliance is already quite high. Franchisors have very recently been required to review their disclosure documents, access the necessary information and record information for future documents to ensure adherence to the new amendments. This process involved significant time and money. We would question the value of requiring franchisors to incur further costs to revisit this area, so shortly after the changes were implemented, without compelling evidence to the contrary. This is even more important in the context of a slowing global economy. The Government should be extremely wary of introducing untested measures that may have an unintended affect of harming the industry.

4.7 Current complaints

In recent times, amongst the overwhelmingly positive coverage the franchise sector has received, some media commentators have reported alleged problems within the franchise sector. The FCA is aware of recent press articles in relation to certain aggrieved franchisees, and of the background to the significant commercial dispute between Yum Brands and the operator of a substantial number of KFC outlets. These matters played a part in the Western Australian Government's desire to examine the operation of the sector in Western Australia. The collapse of the Kleins jewellery group has also received substantial media coverage.

Some media commentators have questioned the Code, without conducting any real analysis or demonstrating any real understanding of how the Code operates, and called in a very non-specific way for reform. This is legitimate media behaviour and to some extent a consequence of the many success stories in franchising. Journalists feel the need to try and balance the ledger. The FCA accepts that media comment may have played a part in the convening of the inquiries. However it should play no part in its recommendation or the action Government takes in response.

Current research and anecdotal evidence from those associated with franchise complaints confirms that the level of complaints is low. Statistically franchisee non-compliance with the system has in fact been identified as the most significant cause of disputes. Anecdotally there also appears to be a strong correlation between complains and a failure on the part of the franchisee to conduct due diligence and obtain independent legal, accounting and business advice.

The FCA has itself received complaints from various parties involved in franchising since the launch of its Members Standards in 2005. On investigation many of the allegations of franchisor misconduct, including those that have achieved significant press coverage, have not in fact been substantiated. Further, where misconduct may have occurred, existing legal remedies were already available and appeared adequate. Interestingly, on a cursory analysis, few of the apparent root causes for the complaints appeared to relate to inadequate disclosure, but rather:

- unwise investment decisions where a franchisee failed to undertake due diligence or seek independent legal, business and accounting advice prior to entering into the commercial arrangements;
- differences of commercial opinion as part of the ongoing franchise relationship;
- conduct by a franchisor that would appear to be illegal by virtue either of the Code or s52 of the Trade Practices Act;
- conduct of third parties such as landlords;
- mismatched expectations of business success or an underestimation of the amount of work required to achieve success;
- cost overruns in establishment costs or underestimation of start-up costs including working capital.

The FCA recognises that there have been in recent times a handful of quite public allegations of inappropriate business conduct in franchising. No doubt there are instances of inappropriate behaviour that have not come to our attention. However these complaints need to be considered in the context of the 66,000 franchised units and almost 1,000 franchise systems. Given the size of the market and the interdependent and long-term nature of the franchise relationship, often described as a business marriage, the divorce statistics in franchising are remarkably low.

4.8 Consultation and member input

The FCA submission was prepared after extensive consultation with its membership and is intended to compliment and provide background for the formal meetings with the Inquiry.

We would welcome the opportunity to address any queries arising from this response. We would also welcome the opportunity to provide input from the perspective of practising franchisors and franchisees to any proposed recommendations of Government at any level.

5. Detailed Response to the WA Inquiry

The WA Inquiry was conducted by Mr Chris Bothams, a former franchisee who has a sound understanding of franchising and of small business generally. The WA Report critically assesses the submissions, and is quite thoughtful in its consideration of issues. The WA Inquiry noted the inherent risks in relying on unsubstantiated evidence, commenting that “the Inquiry was not an investigation and was unable to verify allegations made in many submissions.”[12] At the same time the WA Report considers that some change is necessary.

The WA Report is consistent with the conclusions of previous Federal inquiries, is quite balanced, and its recommendations more thoughtful than the SA Report. The WA Inquiry notes that “the Code serves the industry well”, and “most franchise systems operate within the spirit and intent of the

[12] WA Report Chairman’s letter to the Minister, page 1

Franchising Code of Conduct"[13]. The main focus of the recommendations contained in the WA Report is pre-entry education to improve overall understanding of the Code and franchising, and improvements to the disclosure provisions of the Code.

The detailed response of the FCA in relation to the specific recommendations put forward by the WA Inquiry is as follows:

General Comments

(1) The FCA does not believe that current laws disadvantage franchisees. Indeed the laws provide strong protection for franchisees. The regulatory framework in Australia is the most comprehensive regulatory framework in the world, and features:-

(a) A comprehensive prior disclosure process set out in the Franchising Code of Conduct. In addition to the disclosure document requirement common in most countries with franchise legislation there are additional requirements concerning transfer (which cannot be unreasonably withheld), termination (only in prescribed circumstances), cooling off after signing the franchise agreement, legal and business advice certification and mediation based dispute resolution;

(b) A general prohibition on misleading or deceptive conduct contained in s52 and 51A of the Trade Practices Act which has extensive application to franchising, notably in relation to any statements by franchisors during the recruitment process which are misleading;

(c) A general prohibition on unconscionable conduct which applies to the franchise relationship and has been used effectively in franchising in several cases;

(d) A well resourced and effective regulator - the Australian Competition and Consumer Commission - to monitor compliance and take action against those that transgress the Code or the TPA.

Franchise Education

(2) [Recommendation 1.1] The FCA supports the recommendations of the WA Inquiry in relation to pre-franchise education. The FCA believes that the biggest improvement that could be made to the franchise sector is the enhancement of pre-entry education. In the experience of the FCA the vast majority of franchisees who complain about unrealised expectations have entered into a franchise relationship without having sufficient understanding of the nature of that relationship, without appreciating how difficult it is to operate a business, or having failed to conduct adequate due diligence. The FCA is very supportive of all recommendations of the WA Inquiry in relation to franchise education. The FCA views pre-entry education as critical, and in the interests of all stakeholders. We also concur on the desirability of this being driven by the Commonwealth Government, with assistance from State and Territory Governments.

The mandatory preamble on the front page of the disclosure document to be given to franchisees includes the statement that a franchisee "should also consider educational courses, particularly if you have not operated a business before."[14] This is an important mechanism to draw potential franchisee's attention to the issue of education. However there are currently only a very limited range of courses available. Previous attempts by the FCA to obtain federal funding for such courses have been unsuccessful.

The FCA agrees that ideally the momentum for pre-entry training should come from the Commonwealth, with the assistance of State and Territory Governments. The Commonwealth is best placed to develop a national pre-entry training scheme that

[13] Chairman's letter to the Minister included page 1 of the WA Report.

[14] *Franchising Code of Conduct* (herein "Code") Annexure 1, 1.1(d)

ensures consistency of outcomes across Australia. In the meantime, and in light of the refusal of previous requests for Commonwealth funding, the State Governments could take the lead by providing funding towards professional advice and educational courses for prospective franchisees. Such proactive measures would greatly assist small business as they await the creation of a national training scheme.

(3) [Recommendation 1.2] The FCA endorses the recommendation that the Commonwealth Government provide funding to State and Territory Governments to cooperatively develop an effective marketing strategy to facilitate the promotion of the information and advisory services available to both franchisees and franchisors.

(4) [Recommendation 1.3] The FCA has no objection to the provision by the Government of a periodical publication about franchising issues, trends and concern.

Risk and Responsibilities

(5) The FCA does not support recommendation 2.1 of the WA Inquiry that the Commonwealth Government amend the Code to make it mandatory for franchisors to include, as part of its disclosure document, a clear statement that highlights the rights and responsibilities of, and risks to, the franchisee. It is not the franchisor's responsibility to assess individual risk. Further, any regime that attempted to impose such an obligation on franchisors would carry with it massive compliance costs. Disclosure documents, already large, would balloon in size as advisors produced standard form wording to describe every conceivable risk. As a consequence a primary purpose of the Code, being to provide information franchisees can readily read and understand and provide to advisors and obtain cost-effective advice, would be frustrated.

Under the *Franchising Code of Conduct*, franchisors are already required to disclose more than 250 items as a starting point to the franchisee's due diligence, in the disclosure document. This covers information regarding the rights and obligations of a franchisee, including:

Franchisor's obligations:[15]
References to the relevant conditions of the attached franchise agreement that deal with obligations of the franchisor, including:

(a) any obligation to provide training:

 (i) before the franchised business starts; and

 (ii) during operation of the franchised business; and

(b) any obligation that continues after the franchised business ceases to operate.

Franchisee's obligations:[16]
References to the relevant conditions of the franchise agreement that deal with obligations for a franchisee for the following matters:

(a) selection and acquisition of site and premises;

(b) requirements for starting the franchised business;

(c) development of the site, premises, vehicles and equipment;

(d) training:

 (i) before the franchise business starts;

[15] *Code*, 15.1 for Annexure 1 businesses; 9.1 for Annexure 2 businesses
[16] *Code,* 16.1 for Annexure 1 businesses, 10.1 for Annexure 2 businesses

(ii) during operation of the franchised business;

(e) opening the franchised business;

(f) complying with standards or operating manuals;

(g) warranties and customer service;

(h) territorial development and minimum performance criteria;

(i) maintenance and appearance of site, premises, vehicles and equipment;

(j) insurance;

(k) marketing;

(l) indemnities and guarantees;

(m) participation requirements for the franchisee or its directors, management or employees;

(n) records and reports;

(o) inspections and audit.

It is already mandatory for franchisors to highlight the rights and responsibilities of the franchise, both before they enter into the agreement, and within 4 months after the end of each financial year after entering into it (Part 2, s.6). A copy of the franchise agreement must be provided with the disclosure document. The agreement will also explicitly cover the rights and responsibilities of the franchisee. It is a legitimate expectation of the franchisor that the prospective franchisee will read the agreement before signing.

This suggests any problems are not the result of a lack of information, but the inability of some franchisees to fully understand the information that is provided. While the disclosure document contains some of the information needed to make an informed decision[17] franchisees must ultimately accept responsibility for the investment decision. The focus should be on better training and education as recommended in Part 1, as apposed to requiring the same information in a slightly different form.

(6) The FCA supports recommendation 2.2 and agrees that franchisees may benefit from receiving more information on the possible risks of a franchised business, and their responsibilities as a franchisee. The ACCC checklist could also include risk factors, thereby addressing recommendation 2.1 without creating massive additional cost to franchisors. The FCA believes that risk and due diligence information is best provided by the ACCC rather than by individual franchisors. The FCA believes the underlying pillars of the franchise regulation framework should be:-

(a) Responsible franchisor behaviour, and the provision by franchisors of a disclosure document that provides useful information to assist a prospective franchisee to make an informed decision; and

(b) Effective franchisee due diligence using the franchisor's information as a starting point.

The FCA believes that risk assessment is fairly the responsibility of the franchisee, not the franchisor. Regulators such as the ACCC can provide general information on risk to support the franchisee. The Code disclosure process is already very

[17] The disclosure document is not intended to be an exhaustive source of all information. As must be stated on the front page, it contains "some of the information you need in order to make an informed decision." Irrespective of the Code requirements, if a franchisor provides a compliance disclosure document but fails to disclose a material fact that would have altered the franchisee's decision to proceed, the franchisor is likely to have breached s.52 of the Trade Practices Act.

comprehensive, and includes a requirement to obtain legal and business advice. That process is aimed at ensuring franchisees have experts to assist them to evaluate risk.

Rebates and Additional Disclosure

(7) [Recommendation 2.3] The FCA objects to the proposal for mandatory disclosure of rebate amounts. Rebate rates and amounts are highly sensitive information. Mandatory disclosure would put franchises at a disadvantage against non-franchised competitors, and would create substantial additional compliance cost. There is no real benefit to a prospective franchisee of disclosure. It is of no real relevance to a franchisee whether a franchisor receives rebates from suppliers or not, what matters is the cost to the franchisee of goods or services supplied.

The Code currently requires disclosure of the name of any business that provides a rebate to a franchisor. There is no material benefit to a franchisee to require a franchisor to disclose the *amount* of rebate or financial or commercial benefits received. The *Trade Practices Act* has a comprehensive and powerful array of remedies relating to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct to address pricing and supply issues. Franchising is no different to other forms of commerce.

Rebate rates constitute commercially sensitive information. To require such information to be revealed is to put franchisors at a distinct disadvantage against non-franchised competitors. It will also ultimately disadvantage franchisees, as it will inhibit a franchisor from negotiating effectively with suppliers, as suppliers will have access to the information provided by other suppliers. In that sense it is arguably anti-competitive, in that it facilitates suppliers negotiating collectively to the detriment of a franchise network.

(8) In relation to the other issues mentioned in recommendation 2.3, the FCA would be prepared to consider any further improvements to the quality of information provided to franchisees as part of the disclosure process, including improved disclosure of the franchisor's financial position, the services to be provided to the franchisee and the business experience of franchisors. However the FCA questions whether the actual recommendations of the WA Inquiry add any real value to the current situation, as the issues seem to already be covered in the current disclosure requirements under the Code.

For example the WA Inquiry recommends that franchisors provide details of "what services they will provide to franchisees in explicit terms", yet the Code[18] already requires a disclosure of the franchisor's obligations. It is not clear how "services" differ from "obligations" of the franchisor to the franchisee. Franchisors are already required to disclose any obligations of the franchisor, including obligations to provide training before the franchised business starts, during operation of the business and after the franchised business ceases to operate. The obligations clause is non-exhaustive. Services such as marketing may be included (it is frequently in the franchisors commercial interests to do so), but are not currently required.

Similar logic applies to the recommendation in relation to information concerning the franchisor's financial position, which is already sufficiently covered in the Code. Currently a franchisor must provide a statement signed by at least one director that there are reasonable grounds the franchisor will be able to pay its debts as and when they fall due,[19] together with financial reports for the last two completed financial years;[20] or a solvency statement with a copy of an independent audit that has been undertaken.[21]

Current disclosure requirements are extensive and more than adequate in the context of the purposes of the Code or any reasonable requirement of a prospective

[18] *Code,* 15.1 for Annexure 1 businesses; 9.1 for Annexure 2 businesses
[19] *Code,* Annexure 1, 20.1; Annexure 2, 11.1
[20] *Code,* Annexure 1, 20.2; Annexure 2, 11.2
[21] *Code,* Annexure 1, 20.3(a); 20.3(b); Annexure 2, 11.3(a); 11.4(b)

franchisee. The signed statement to be provided to franchisees is in effect an annual solvency warranty. This goes far beyond disclosure, and gives franchisees substantial additional legal rights. The combined effect of these provisions is to provide sufficient evidence of a franchisor's ongoing financial viability.

The FCA has no concern with the expansion of the Code to include this information under the disclosure requirements. It should be noted that the Code already requires disclosure of the name, position held, and qualifications (if any) of each officer of the franchisor.[22] These requirements are relatively standard internationally and the Code mandates disclosure of the relevant business experience of the franchisor and each officer of the franchisor in the last 10 years.[23] In the case of a franchisor this includes:

(a) Length of experience in:

(i) operating a business that is substantially the same as that of the franchise; and

(ii) offering other franchises that are substantially the same as the franchise; and

(b) Whether the franchisor has offered franchises for other businesses and, if so:

(i) a description of each such business; and

(ii) for how long the franchisor offered franchises for each such business.

If desired, further information could be obtained by the potential franchisee by seeking references or asking questions to the franchisor or industry associations, as part of their due diligence.

(9) [Recommendation 2.4] The FCA is supportive of the proposal for periodic review of the Franchising Code of Conduct, and has no objection to the 2010 date proposed.

Registration and Monitoring

(10) [Recommendations 2.5 & 2.6] The FCA cannot support the recommendation that all franchisors register their franchise systems and lodge their disclosure document annually with the ACCC for the following reasons:-

(a) Registration is an additional bureaucratic process that adds nothing other than significant extra cost to the current regime;

(b) Registration is proposed without any vetting of documents, due to the cost and difficulty involved. Yet prospective franchisees will probably not understand the distinction, and assume that documents registered with the ACCC will have been vetted;

(c) Registration is unnecessary, as the ACCC can already investigate franchisor compliance and call for franchise documentation to be provided to it;

(d) As the Commonwealth Government determined in 2007, registration with the ACCC could be seen as an endorsement of the franchise that gives undue credibility to any claims made. This could in fact have a detrimental affect on the due diligence undertaken by a potential franchisee.

Linking a commercial document to a trusted source encourages a potential franchisee to place undue weight on the material without conducting proper due diligence. The concept is arguably contrary to the purpose of the Code, and could lead to higher levels of franchisee dissatisfaction. The International Franchise Association has commented to the FCA that registration is costly

[22] *Code,* Annexure 1, 2.6; Annexure 2, 2,6
[23] *Code,* Annexure 1, 3.1 – 3.2

and in the USA has been essentially superseded by a comprehensive Federal disclosure regime. Australia already has such a regime.

(11) [Recommendation 2.7] The FCA supports the recommendation that the ACCC undertake a regular review of a random sample of disclosure documents to monitor compliance with the Franchising Code of Conduct and publish the results of their findings annually. The ACCC would already appear to have under the Trade Practices Act the necessary power to undertake such a review.

End of Agreement Arrangements

(12) [Recommendations 3.1 & 3.2] The FCA has no concern with the recommendation to provide specific information in the disclosure document in relation to end of agreement arrangements. Indeed the FCA made this suggestion in its submission to the WA Inquiry. (We do however note that without education and/or professional advice, franchisees may still not turn their minds to the issue.)

The FCA does not support the amendment of franchise legislation to provide guaranteed rights of renewal to existing franchisees, or impose an obligation on a franchisor to negotiate "in good faith" to give an existing franchisee a renewal. This impacts on the freedom of parties to negotiate and would unilaterally alter the commercial terms of existing franchise agreements in favour of one party.

(13) The FCA supports Recommendation 3.3 that the code be amended to require franchisors to conduct a pre-expiry review with the franchisee at least one year prior to the expiry of the franchise agreement. The purpose of the review is to inform the franchisee of any variations between the existing and new agreement and any conditions that need to be met in order for agreement renewal.

(14) [Recommendation 3.4] The FCA supports the recommendation that the Code be amended to require franchisors to specify, in the disclosure document, a reasonable period of notification in which to inform the franchisee of their intention not to renew the agreement. The FCA suggests that, in a way similar to clause 21(3) of the Code, the provision specify a maximum reasonable period. Further industry discussion would be necessary to deal with transition and other issues. For example existing agreements may need to be exempted from this requirement.

Dispute Resolution

(15) [Recommendations 4.1 & 4.2] The FCA supports measures to augment and further streamline dispute resolution. However we note that the level of disputation in Australian franchising is statistically very low, and compares very favourably with the levels of disputation in other jurisdictions including the USA.

Existing avenues are highly effective, and extremely low cost. The Code provides for the appointment of a mediator within three weeks from the time the complaint is issued.[24] If the parties cannot agree on who should be the mediator, the mediation advisor will appoint a mediator within 14 days.[25] The mediation based dispute resolution procedure has been extremely successful, with the Office of Mediation Adviser reporting over 80% of disputes are successfully resolved. The cost of mediation is minimal, and far less than even the simplest court or tribunal procedure.

The mediation process is augmented by other dispute mechanisms. The ACCC has been an active and efficient regulator. An aggrieved franchisee can at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or Trade Practices Act. The ACCC is well regarded, is duty bound to investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act, and has a strong track record of taking enforcement action where necessary. The FCA has supplemented the ACCC and the Codes procedures with an

[24] *Code*, s.29(3)(a)
[25] *Code*, s.30(1)

informal dispute resolution mechanism pursuant to FCA Member standards. This includes peer counselling and mandated education.

The FCA remains open to the idea of a separate franchising arbitration system. However the FCA considers this is likely to be more costly, and there would need to be substantial further work done in relation to issues such as:

- the source of its authority;
- whether it would be legal or administrative;
- would decisions or awards be enforceable in the courts in Australia and overseas;
- how it would be funded;
- who would be appointed to it;
- where it would sit;
- how frequently it would sit;
- an indication of time frames, including waiting periods to have a matter heard, and how long a decision would take; and
- how much it would cost parties to appear before it.

Without more specific detail, it is difficult to ascertain how the current system can be further improved.

The FCA notes that the Victorian Small Business Commission provides a highly efficient and effective service that could be replicated, although the FCA is concerned that much of the success of the Victorian system has been as a result of the personal attributes of the incumbent. The FCA is not confident that the Victorian system would necessarily be capable of replication in other States. Further, the FCA remains strongly of the view that any regulation should be solely at the Federal level.

(16) In relation to the recommendations concerning mediation, the FCA makes the following observations:-

(a) The Code already requires parties to attend mediation and try to resolve the dispute.[26] It is a breach of the Code and therefore the Trade Practice Act, to refuse to attend or make a genuine attempt to resolve the dispute.[27]

(b) The Inquiry noted that "there is no mechanism under the Code for mediated agreements to be enforced and no follow-up to ensure that both parties adhere to the mediated outcomes."[28] It recommended making mediated agreements enforceable to ensure both parties adhere to the agreed resolutions. This of course begs the question – enforceable by whom? The courts? This of course means more cost. The ACCC? It is the experience of the FCA that once mediation is successful in resolving the dispute, it is very unusual for the parties not to adhere to the mediated settlement.

(c) The Inquiry recommended that there be prescribed penalties for refusing to attend mediation or refusing to make a genuine attempt to resolve the dispute. The FCA supports this recommendation in concept, although implementation is likely to be challenging. Some may say that failure to mediate is its own penalty, given the success rate of mediation and the high cost of other options. We note that the Code already requires parties to attend mediation and try to resolve the dispute.[29] Any offence of "refusing to make a genuine attempt to resolve the dispute" would need to be defined extremely carefully. For instance, is this an objective or subjective standard? What does a genuine attempt look like, and who will be responsible for deciding and enforcing this? If this is a question of law, only Chapter III courts will have jurisdiction to determine the matter. The proposal potentially makes the mediation itself a matter of dispute, which can only further complicate matters.

<u>Enforcement</u>

[26] *Code*, s.29(6)
[27] As was noted in the WA Report, p. 25
[28] Ibid, p.25
[29] *Code*, s.29(6)

(17) [Recommendation 5.1] The FCA provides in principle support to the recommendations on enforcement of the Franchising Code. Greater detail is needed to allow us to comment more fully. Additional ACCC funding is a matter for the Government and the ACCC, but the FCA acknowledges the important role played by the ACCC. The FCA believes the allocation of funding to the FCA would also be a very effective way of implementing aspects of the educational program, as occurred for example with the introduction of the Goods & Services Tax.

(18) [Recommendation 5.2] As to the establishment of a dedicated unit within the ACCC, the FCA understands dedicated resources already exist. However again this is a matter for the ACCC.

(19) [Recommendation 5.3] The FCA does not support the amendment of the Trade Practices Act 1974 to prescribe penalties for breaches of the Franchising Code of Conduct. The ACCC may currently take action at any time against a franchisor for non-compliance with the Code, including seeking court enforceable undertakings, injunctions or court orders and declarations. The Trade Practices Act provides for further powerful remedies in relation to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct.

The Inquiry noted "While the Code contains a plethora of provisions, no penalties are explicitly stipulated. The Inquiry believes that compliance with Code requirements would be further improved if strong penalties, including penal terms for criminal offences, were prescribed under the Code and committed to by the regulator."[30]

On balance the FCA prefers the current position, where a court has very broad discretion to determine the sanctions that ought to apply to breaches of the Code, to the recommendation that the Code be amended to introduce specific penalties for breaches of the disclosure requirements under the Code. In the opinion of the FCA franchisees are better protected by the current law.

(20) [Recommendation 5.4] The FCA is prepared to work cooperatively with other stakeholders in accordance with Recommendation 5.4, which notes that the Commonwealth Government work with the judicial system and the franchising sector to introduce a more streamlined approach to accessing compensation and recovery of costs where a particular court decision impacts on a group of franchisees. However the FCA rejects any proposal aimed at setting up the franchise sector as a paradise for plaintiff law firms seeking to run class actions. In the experience of the FCA in the rare cases where a group of franchisees is affected the ACCC is more than happy to become involved. Where funds are available (and often there are no funds) the ACCC will readily negotiate to secure funds for distribution to affected franchisees.

Without more specific details, it is difficult to comment further. We would require further detail on what a more streamlined approach would look like, and where responsibility for funding would lie.

The FCA has offered to work with the WA Government and other bodies to further improve the regulatory framework and fine tune any recommendations to ensure they add value without undue additional compliance cost.

6. Detailed Response to the SA Inquiry

As a general comment the FCA considers that the SA Inquiry has raised a number of valid issues, but the recommendations made are typically either unlikely to improve the situation or will have broader or unintended consequences that have not been thought through.

The SA Report is quite emotive in its tone, and not particularly rigorous in its analysis of issues. The SA Inquiry appears to have accepted without challenge many submissions put before it notwithstanding the warnings given by the FCA and others including the ACCC that anecdotal evidence can be unreliable. The SA Report also seems to place a rather unhealthy reliance on

[30] WA Report, p.31

unsubstantiated assertions from fairly junior franchising academics with a known bias towards franchisee activism. Indeed the SA Inquiry would appear to have commenced the process with a degree of bias, as Mr Tony Piccolo, one of the Committee members, had commented extensively on the likely conclusions of the SA Inquiry before the Committee had actually commenced taking evidence.[31]

The SA Inquiry does not consider in any detail the current regulatory framework, but appears simply to launch into a series of recommendations to address perceived inadequacies in the law. This is unfortunate, as a detailed consideration of the recommendations will show several areas where the SA Report has made recommendations that are already law.

The broad position of the FCA is that the current Federal regulatory regime serves the sector well, there are no endemic problems, and the main areas for improvement lie in pre-entry franchisee education and minor changes to the disclosure information.

The detailed response of the FCA to the specific recommendations put forward by the SA Inquiry is as follows:

<u>Retail Leasing</u>

(1) The FCA is supportive of enhanced information to franchisees concerning retail tenancies. However the SA Inquiry has not addressed the real issue – the behaviour of shopping centre owners in areas such as providing inadequate tenure and seeking excessive rent reviews, particularly at end of term.

The recommendation to amend the definition of "lessee" to include "licensee", purportedly to improve the position of franchisees, is unlikely to have that effect and is more likely to increase compliance costs on franchisors. The Code currently requires franchisors to provide extensive information concerning lease and occupancy issues, and the FCA is concerned that this seemingly innocuous change will in fact create a separate disclosure obligation upon the franchisor to the franchisee in relation to occupancy licence.

The Committee seems to imply that there is a power imbalance between franchisors and franchisees in retail leasing, when in fact the power imbalance is between landlords on the one side and franchisors and franchisees jointly on the other. In its verbal presentation to the SA Inquiry the FCA noted that the SA Inquiry seemed strangely unsupportive of FCA suggestions to moderate the behaviour of landlords. The SA Inquiry also seemed not to fully appreciate that it is typically the landlords that insist on the franchisors holding head leases in shopping centres, and that the first consequence of franchisee failure (and a reason why franchisors seek to do all they can to avoid it) is that the franchisor is left with a substantial lease liability.

As a general comment the FCA considers that the members of the SA Inquiry did not have a good understanding of this issue, and the recommendations fall short of addressing the real issues of relevance to franchisors and franchisees alike.

(2) The FCA is supportive of the recommendation to amend the SA Retail and Commercial Leases Act 1995 (SA) to prohibit unconscionable conduct in retail leasing, including enforcement and dispute resolution processes to facilitate that prohibition. Unconscionable conduct (as the community would see that term, as opposed perhaps to the current interpretation of unconscionable conduct by the courts) is common. The FCA is aware of numerous instances where landlords have provided inadequate tenure to franchisors and franchisees, have acted unreasonably in relation to the conduct of renovations, have used turnover information provided by tenants to extract above market rentals, have manipulated shopping centre mix and have acted harshly towards sitting tenants at the time of lease renewal.

[31] See for example the article in The Bunyip (Gawler SAA) page 20 where Mr Piccolo comments on his alleged experience with "horror stories" of "franchisees sent to the wall". He is quoted as saying that "the inquiry will focus on franchisors who break the law with apparent impunity, not people who make bad business decisions", and "the committee is interested in hearing from current or ex-franchisees who have been treated badly by their franchisors".

Reporting

(3) The FCA sees no real value in the recommendation that the SA Minister for Consumer Affairs require prospective franchisees and franchisors to identify their proposed business as a franchise when they register their business name with the Office of Consumer and Business Affairs. This is likely simply to add additional compliance cost for no real benefit. The same can be said of the recommendation to create a SA State database for regulators and researchers. Any such activity should be undertaken at a Federal level, and should not carry significant compliance cost.

Research information is already able to be accessed, and should not be an industry responsibility. The FCA conducts regular surveys on franchising, and organisations such as IBISWorld conduct separate industry surveys. The FCA has lobbied in the past for information concerning franchising to be included in official data collection by the Government in census activities, which is the appropriate way for information to be collected. The creation of State databases serves no purpose, and will simply add bureaucracy and cost.

Education

(4) The FCA strongly endorses the recommendation that the Minister for Consumer Affairs provide educational information (including access to seminars) relating to franchising to all businesses registered as franchises (both franchisees and franchisors). This information should be provided both at the initial registration phase and regularly during the life of the business.

Education and training is critically important for the future development of the sector. As noted in our submissions, this is particularly the case in relation to pre-entry franchisees. The mandatory preamble on the front page of the disclosure document to be given to franchisees includes the statement that a franchisee "should also consider educational courses, particularly if you have not operated a business before."[32] This is an important mechanism to draw potential franchisee's attention to the issue of education. However there are currently only a very limited range of courses available. Previous attempts by the FCA to obtain federal funding for such courses have been unsuccessful.

We applaud the Committee's recognition of the need for greater educational information. As Professor Spencer submitted to the Inquiry "copious amounts of disclosure is…[not] the answer."[33] Without sufficient training and education, prospective franchisees may not turn their minds to important business risks and obligations, even when they are explicitly covered in the franchise agreement and disclosure document.

The FCA considers that the enhancement of pre-entry education to prospective franchisees is the most important improvement that could be made to the franchise sector. Many franchisees come to the franchise sector with no previous business experience. At a macro level it is quite remarkable that the franchise sector is able to so successfully convert employees to business proprietors in the vast majority of cases. However it is beyond rational argument that some people enter the sector, albeit willingly, with an inadequate understanding of the difficulties and risks involved.

In the experience of the FCA the vast majority of franchisees who complain about unrealised expectations have entered into a franchise relationship without having sufficient understanding of the nature of that relationship, without appreciating how difficult it is to operate a business, or having failed to conduct adequate due diligence.

The FCA also strongly supports the Committee's undertaking to provide information "regularly during the life of the business." This is in the interests of all stake-holders, and will greatly assist the further development of franchising in Australia.

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[32] *Code*, Annexure 1, 1.1(d)

[33] SA Report, p. 84

The only proviso is our preference for this activity to be driven by the Commonwealth Government, with assistance from State and Territory Governments, rather than by way of unilateral action by State Governments.

Registration

(5) The FCA is concerned that any process which required all franchisors to register their franchise systems and lodge their disclosure document annually would add little other than extra cost to the current regime. Registration with the ACCC could be seen as an endorsement of the franchise that gives undue credibility to any claims made. This could in fact have a detrimental affect on the due diligence undertaken by a potential franchisee.

The FCA's concerns are that:-

(a) Registration is an additional bureaucratic process that adds nothing other than significant extra cost to the current regime;

(b) Registration is proposed without any vetting of documents, due to the cost and difficulty involved. Yet prospective franchisees will probably not understand the distinction, and assume that documents registered with the ACCC will have been vetted;

(c) Registration is unnecessary, as the ACCC can already investigate franchisor compliance and call for franchise documentation to be provided to it;

(d) As the Commonwealth Government determined in 2007, registration with the ACCC could be seen as an endorsement of the franchise that gives undue credibility to any claims made. This could in fact have a detrimental affect on the due diligence undertaken by a potential franchisee.

A mandatory federal registration scheme for franchise disclosure documents is arguably inconsistent with the structure of the Code and the objective of the disclosure document. According to the Code, the purpose of the disclosure document is to:

- give to a prospective franchisee… information from the franchisor to help the franchisee make a reasonably informed decision about the franchise;[34] and
- give a franchisee current information from the franchisor that is material to the running of the franchised business.[35]

The disclosure document is not intended to be exhaustive, and the disclosure document is not intended to replace due diligence of the prospective franchisee, nor the obtaining of independent legal, accounting and business advice.

The Australian Government observed in February 2007 that the registration of disclosure documents with a federal body (in this case the ACCC) could be "seen as providing creditability to their claims and [ACCC] endorsement."[36] The ability to access commercial information from a trusted government body gives the distinct impression that:

(a) the information contained is correct; and

(b) minimal to no further review of the business is needed.

Linking a commercial disclosure document to a trusted source encourages a potential franchisee to place undue weight on the material, without following the other necessary avenues to properly assess the business proposal. At the same time it

[34] *Code,* 6A(a)
[35] *Code,* 6A(b)
[36] WA Report, p.8

would be totally inappropriate to introduce another regulator to administer legislation enacted under the Trade Practices Act, which is the ACCC's responsibility.

It is also worth noting that the peak industry body for the USA franchise sector, The International Franchise Association has commented that registration in the US is a costly and unnecessary process that has been essentially superseded by a comprehensive Federal disclosure regime. Australia already has such a regime.

The previous Federal Government recognised the inappropriateness of this proposal, because the ACCC "is not in a position to ensure the quality, nor the substance, of the documents."[37]

If any registration scheme were to be introduced the only feasible model would be one administered by the FCA, as otherwise the cost would be prohibitive. The FCA has considered proposals for an industry based and self-administered scheme that involved vetting and registration, but shelved such plans due to liability concerns and compliance cost issues.

Continuous Disclosure

(6) The recommendation that the Franchising Code of Conduct be amended to require the franchisor to provide continuous and freely accessible disclosure to current and prospective franchises overlooks the fact that a continuous disclosure requirement already exists in the Code.[38]

Clause 18 of the Code already requires a franchisor to tell all franchisees about a materially relevant fact within 14 days after the franchisor becomes aware of it.

Clause 19 of the Code requires a franchisor to provide a current disclosure document to an existing franchisee within 14 days of request by the franchisee at any time.

The compliance cost of requiring a franchisor to update its disclosure document on a daily basis, if that is what the Report is recommending, is excessive and unjustified. The disclosure document currently requires disclosure of over 250 fields of information. Franchisors would be required to continually record, compile, access, review and disclose any change to the business, no matter how trivial. If penalties are prescribed, as is suggested at 7.2.9, franchisors may feel it necessary to seek frequent and potentially costly legal advice to ensure continuing compliance. This would be further exacerbated if criminal sanctions are prescribed, as was suggested in some submissions. The overall effect would be to massively increase the compliance costs of franchising in Australia.

Disclosure

(7) The FCA supports the recommendation that item 11 of Annexures 1 and 2 of the Franchising Code of Conduct be amended to require the franchisor to disclose a summary of its particular experience operating a franchise business.

The FCA notes however that the Code already requires disclosure of the name, position held, and qualifications (if any) of each officer of the franchisor.[39] The Code also mandates disclosure of the relevant business experience of the franchisor and each officer of the franchisor in the last 10 years.[40] In the case of a franchisor this includes:

[37] Australian Government response to the review of the disclosure provisions of the Franchising Code of Conduct, February 2007

[38] This recommendation is a good example of the lack of rigour of the SA Inquiry, and its reliance on evidence from people without a detailed understanding of the current regulatory regime. In this respect the SA Inquiry can be contrasted with the WA Inquiry, which was conducted by someone experienced in franchising and with the support of the WA Small Business Development Corporation.

[39] *Code,* Annexure 1, 2.6; Annexure 2, 2,6

[40] *Code,* Annexure 1, 3.1 – 3.2

(a) Length of experience in:

(i) operating a business that is substantially the same as that of the franchise; and

(ii) offering other franchises that are substantially the same as the franchise; and

(b) Whether the franchisor has offered franchises for other business and, if so:

(i) a description of each such business; and

(ii) for how long the franchisor offered franchises for each such business.

Again it appears the SA Inquiry did not consider the existing law prior to making this recommendation. If any change is required, the FCA notes that item 3, and not item 11, would appear to be a more suitable place to include this information. (We note that Item 11 of Annexure 1 deals with Sites or Territories, while item 11 of Annexure 2 deals with financial details).

Communication Between Franchisees

(8) The FCA has seen no evidence of franchisors preventing or obstructing communication between prospective and existing franchisees. Indeed the Code facilitates such process by requiring disclosure of contact details in the disclosure document, and enables contact to occur without the franchisor's knowledge or involvement. The FCA does not consider any amendment to the Code is required in this area.

The basis of the SA Inquiry's recommendation is very unclear. The Committee notes "in cases where the information is not available to the franchisor or there is a request in writing from [a] franchisee not to disclose, the obligation to disclose does not arise".[41] The FCA does not understand the Committee's difficulties with this conclusion. Item 6.5 provides that a franchisor should not be required to disclose information not available to it. This is a reasonable condition to ensure a franchisor takes appropriate but not excessive steps in preparing the disclosure document.

Item 6.6 notes "A franchisor does not have to provide details of a franchisee if the franchisee has requested in writing that the details not be disclosed." The proposed recommendation would make this clause unlawful, because it would appear to "obstruct" communication between a prospective and an existing franchisee. However revealing a person's details when they have explicitly requested against it represents a fundamental violation of privacy law. This is at odds with the *Privacy Act 1988* and legal notions of consent more generally.

The Committee also referred somewhat superfluously to "a practice of inserting confidentiality clauses in franchise contracts to prevent the spread of different categories of information during subsequent disclosure processes" that was "not uncommon among franchisors." This it was said appears to be "a clear attempt to defeat the purpose of the disclosure provisions in items 6.5 and 6.6."[42] The FCA has no evidence of this, and none was presented in the SA Report. In any event, such a situation would only circumvent 6.5 and 6.6 if the current franchisee requests in writing that their details not be disclosed. A confidentiality clause where the franchisor asks them not to disclose any details would be insufficient to override the franchisor's disclosure obligation.

Risk Statement / ACCC Checklist

(9) The FCA supports the provision by the ACCC or other bodies of information which describes the risks and consequences of franchisor failure, and indeed the operation

[41] SA Report, p. 36
[42] SA Report, p. 37

of businesses generally. However the FCA does not support any requirement that a franchisor must produce a risk statement for every franchisee. Due diligence and risk assessment is the franchisee's responsibility, aided (as required by the Code) by professional advice and educational material from the regulator and others.

The Committee's recommendations in this area are somewhat confused, as whilst they purported to endorse Recommendation 21 of the Matthews Inquiry, that recommendation referred both to a Risk Statement to be prepared by the franchisor and to ACCC educational material, noting that both "should clearly describe the risks and consequences associated with franchisor failure".

The FCA supports the approach of the WA Inquiry to this issue. The WA Inquiry recommended the ACCC develop a standard checklist of known potential risks for prospective franchisees to investigate.[43] The FCA is extremely supportive of this proposal. A checklist document would adequately "describe the risks and consequences associated with franchisor failure." A checklist would also address the demand for a "Risk Statement" without imposing on the franchisor an unreasonable obligation, and the massive cost that would be associated with the assessment and documentation by the franchisor of individual risks associated with each transaction. The ACCC is ideally placed to address this issue, and the current material produced by the ACCC with industry input is excellent. The ACCC's considerable experience as a consumer educator would make it more adept at identifying and explaining risk concepts to prospective franchisees.

It would be contrary to the intent of the Code, and the Code's implicit acceptance that franchisees have responsibility for due diligence, to require franchisors to develop such material.

<u>Financial Disclosure / Rebates</u>

(10) The FCA does not support the recommendation that the Code be amended to remove the exception in item 20.3, as the exemption does not diminish (and indeed arguably enhances) the quality of information available to franchisees and provides a reasonable alternative for private companies not wishing to make public their actual financial statements.

(11) The FCA does not support the recommendation the Code be amended to include a requirement to disclose not just that rebates are paid and to whom, but the amount or the methods of calculation of any rebates and/or other financial or commercial benefits received by franchisors or master franchises in relation to goods or services supplied to franchisees. This recommendation has previously been rejected correctly by Government as it breaches commercial confidentiality and places franchised businesses at a disadvantage when compared to others.

The Code currently requires disclosure of the name of any business that provides a rebate to a franchisor. There is no material benefit to a franchisee to require a franchisor to disclose the *amount* of rebate or financial or commercial benefits received. The *Trade Practices Act* has a comprehensive and powerful array of remedies relating to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct to address pricing and supply issues. Franchising is no different to other forms of commerce.

Rebate rates constitute commercially sensitive information. To require such information to be revealed is to put franchisors at a distinct disadvantage against non-franchise competitors. It will also ultimately disadvantage franchisees, as it will inhibit a franchisor from negotiating effectively with suppliers, as suppliers will have access to the information provided by other suppliers. In that sense it is arguably anti-competitive, in that it facilitates suppliers negotiating collectively to the detriment of a franchise network.

[43] Recommendation 2.2; WA Report

Enforcement and Penalties

(12) The Committee noted “the Committee was sympathetic to the principle of supporting a robust system with robust sanctions”[44], but no detail is provided The Trade Practices Act currently contains powerful remedies that enable a court to award substantial damages, grant injunctions, amend or terminate agreements in whole or in part, undertake corrective activity or make such other orders as a court sees fit. The Trade Practices Act also contains further powerful remedies in relation to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct.

The FCA prefers the current position, where a court has very broad discretion to determine the sanctions that ought to apply to breaches of the Code, to the recommendation that the Code be amended to introduce specific penalties for breaches of the disclosure requirements under the Code. In the opinion of the FCA franchisees are better protected by the current law.

(13) The FCA rejects the recommendation that section 51AC of the Trade Practices Act 1974 (Cth) be amended by the inclusion of a statutory definition of unconscionability or alternatively by the insertion in the Act of a prescribed list of examples of the types of conduct that would ordinarily be considered to be unconscionable. The FCA considers that the law currently works well in this area and no further change is required.

Dispute Resolution

(14) The FCA supports any sensible mechanism to further improve the alternative dispute resolution measures available under the Code. The FCA is comfortable with the recommendation that mediation of disputes be made mandatory, and that additional alternative dispute resolution mechanisms be considered, to allow a timely and cost effective resolution that would not disadvantage franchisees.

However the FCA notes that the existing mediation based dispute resolution mechanism is highly effective, and extremely low cost. The Australian situation, where around 80% of franchising disputes are resolved by mediation, is the envy of the rest of the world. The average cost of participation in mediation, including legal representation, would be well under $5,000, and it is possible for parties to represent themselves and reduce costs still further. In the context of an investment of several hundreds of thousands of dollars this would not seem to be prohibitive. The costs of court action, even involving an administrative tribunal, would be far higher. It is hard to imagine an effective structure that would operate at a lower average cost.

The FCA notes that the Code already requires parties to attend mediation and try to resolve the dispute.[45] It is a breach of the Code and therefore the Trade Practice Act, to refuse to attend or make a genuine attempt to resolve the dispute. The Code provides for the appointment of a mediator within three weeks from the time the complaint is issued.[46] If the parties cannot agree on who should be the mediator, the mediation advisor will appoint a mediator within 14 days.[47] The mediation based dispute resolution procedure has been extremely successful, with the Office of Mediation Adviser reporting over 80% of disputes are successfully resolved. The mediation process is already augmented by alternative dispute resolution mechanisms.

The FCA also notes that the ACCC has been an active and efficient regulator. An aggrieved franchisee can at no cost, seek to have the ACCC investigative any matter where there has been an alleged breach of the Code or Trade Practices Act. The ACCC has a strong track record of taking enforcement action where necessary. The FCA has further supplemented the Codes procedures with an informal dispute resolution mechanism that includes peer counselling and mandated education.

[44] SA Report, p.42
[45] *Code*, s.29(6)
[46] *Code*, s.29(3)(a)
[47] *Code*, s.30(1)

Without more specific detail, it is difficult to ascertain how the current system can be further improved. However the FCA remains open to further suggestions.

(15) The FCA does not at this point support the creation of a Franchise Ombudsman, or a Franchise Tribunal, or a specific Franchise Arbitration Unit within the ACCC, or other relevant entity to administer the enhanced dispute resolution system. However the FCA would be prepared to discuss the matter further.

It is not clear what such person would be expected to achieve, or whether the person would be expected to replace or supplement the activities of the ACCC. The ACCC brings its extensive powers to the table as industry regulator. Any ombudsman is unlikely to have the same power, and any additional structure is likely to add cost and bureaucracy. So the FCA remains sceptical about any such initiative, and whether it would add any real value to the sector.

Statutory Good Faith

(16) The FCA does not support the amendment of the Code by inserting a provision imposing a duty to act in accordance with good faith and fair dealing by each party of the franchise relationship. There is already a duty implied at law, and any new definition will simply add cost and create uncertainty where none currently exists. The FCA is also concerned that such a proposal may be used to create a de facto automatic right of renewal of franchisee agreements. Indeed the FCA notes that the SA Inquiry has recommended amending the Code by inserting a provision imposing a duty to act in accordance with good faith and fair dealing by each party to the franchise relationship.

The FCA is aware of the current dispute between a major franchisee of KFC restaurants and the franchisor Yum Brands. This dispute was a significant reason behind the establishment of the WA Inquiry into franchising. The franchisee (which is a very substantial corporation) is arguing that Yum should have to either grant a further term, or pay compensation including goodwill if the franchisor wished to take over the sites. In the opinion of the FCA lobbying from interests associated with Competitive Foods has led to the recommendation that legislation be enacted to create a specific statutory good faith obligation to negotiate at the end of the term for a renewal.

The High Court of Australia has ruled on this issue and the law is clear – once a franchise term ends, it ends. This level of certainty enables all those involved in franchising to understand their legal rights, and negotiate accordingly. The FCA strongly opposes any move to create a statutory right that would thereby advantage one party to a contract over another. The FCA would be pleased to expand upon its views on this issue.

Mandatory Termination Payments / Compensation

(17) The FCA rejects the recommendation that the Code be amended to include a provision mandating that franchise agreements must include the basis on which termination payments or goodwill or other such exit payments will be paid at the end of the agreement. This is unnecessary interference with the freedom of the parties to contract. Presumably evidence to the SA Inquiry gave the Committee the impression that termination payments, goodwill and exit payments are commonly made, when the reverse is true.

The FCA believes there may be an argument for improved disclosure in this area so that a franchisee cannot falsely believe that there is some entitlement to compensation on termination or exit. If so, the FCA would support the inclusion of a requirement for more specific disclosure on this issue in the disclosure document.

However this amendment appears clearly designed to advance the interests of Competitive Foods in its dispute with Yum Brands, which is a private matter and ought not influence industry policy or legislation.

(18) The FCA rejects the recommendation that the exclusion or inadequate determination of goodwill or other such exit payments by a franchisor during negotiations with a franchisee regarding a franchise agreement constitute "unconscionable conduct" and should be included in any discussions regarding an amendment to section 51AC of the *Trade Practices Act*.

Again this recommendation appears clearly designed to provide a requested outcome to one party to an existing dispute between Competitive Foods and Yum Brands, which is a private matter and ought not influence industry policy or legislation.

ACCC and Administration

(19) The FCA has no objection to the recommendation that the ACCC publishes the outcomes of any investigations in which franchisors are found to be acting unlawfully or persistently in breach of the Franchising Code of Conduct, or that such findings should further be kept on a publicly accessible register.

(20) The FCA notes that the Code already contains provisions which address the recommendation that the Code be amended to include a requirement to disclose a copy of the franchisor's, or associate's, head lease over a premises; and any sub-leases over the premises occupied by the franchisee for the purpose of conducting the franchise business.

(21) The FCA supports the recommendation that the ACCC considers providing further resources for the explicit purpose of providing educational support to the franchise industry. Such support should take the form not only of printed and electronic materials, but seminars and information lines through which franchise participants might seek help. The FCA would be pleased to work with the ACCC in this area.

(22) The FCA believes the ACCC has been a vigilant and effective regulator of the franchise sector, and does not consider it necessary that (although would not object to) the ACCC strengthen its involvement in the development of case law in the area of unconscionable conduct by supporting actions brought under section 51AC of the *TPA* and review its enforcement and funding strategies to support such an aim.

(23) The FCA does not object to any consequential amendments to the ACCC's jurisdiction with regard to franchising to accommodate and complement the operation of additional dispute resolution measures and any body – such as an Ombudsman or tribunal - established to administer such measures.

Appendix 1

FCA Submission to the Inquiry into the Operation of Franchise Businesses in Western Australia

Inquiry into the Operation of Franchise Businesses in Western Australia

Submission from

FRANCHISE COUNCIL OF AUSTRALIA

January 21, 2008

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7. Introduction

As the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising the Franchise Council of Australia welcomes the opportunity to provide input to this Inquiry.

Industry statistics confirm that franchising continues to prosper throughout Australia, including in Western Australia. The FCA does not believe there are any endemic problems in franchising, a view confirmed by the recent Federal review of the Franchising Code of Conduct. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public.

All participants in the franchise sector acknowledge that the current Federal regulatory framework is working well. The *New Deal Fair Deal* Reforms were introduced in 1998 with bi-partisan support, and the Government's legislative response which takes effect March 1, 2008 also has bi-partisan approval. The Mathews Committee Report on the operation of the Franchising Code of Conduct noted as follows:-

> "*Strong support for the Code has been registered throughout the review process. It is widely seen as pivotal to the continued success of the franchising industry".*[48]

The FCA has been strongly supportive of the current Federal regulatory framework, including the recent reforms which will provide additional protection for prospective franchisees. The FCA believes the current regulatory environment creates a fair balance between the need for effective regulation supported by a strong and well resourced regulator, and the importance of minimising compliance costs for this entrepreneurial sector.

The FCA is aware of recent press articles in relation to certain aggrieved franchisees, and of the background to the significant commercial dispute between Yum Brands and the operator of a substantial number of KFC outlets. No doubt these matters have played a part in the Government's desire to examine the operation of the sector in Western Australia. It is not the role of the FCA to take sides in any matter. Rather the FCA represents and promotes the growth and development of franchising, as opposed to the interests of franchisors or franchisees alone. In preparing this submission the FCA has sought input from its franchisor, franchisee and supplier members including the FCA Legal Committee. The FCA strongly believes that franchising best practice requires collaboration between franchisors and franchisees, as opposed to the adversarial approach advocated by some with vested interest in promoting litigation.

The Background Paper prepared to assist those making submission to the Inquiry has been helpful in assisting the FCA to provide useful information to the Inquiry.[49] The following Executive Summary sets out the FCA's broad response to the specific terms of reference of the Inquiry. These matters are also discussed in more detail in section 7. Section 3 provides background on the policy position of the FCA and its attitude to franchise regulation, with sections 4, 5 and 6 providing a detailed analysis of the development and operation of the current regulatory regime. Section 8 contains some general remarks and observations on issues that from experience we find are raised in inquiries of this nature. The appendices contain the 2006 FCA Industry Report, which contains a broad collection of industry statistics and information and remains fundamentally current, and the FCA Member Standards.

[48] Foreword by Graeme Mathews, p4, Review of the Disclosure Provisions of the Franchising Code of Conduct.

[49] The FCA notes the intent of the background paper, being to provide very broad general guidance to those making submissions, and has therefore not commented specifically on any matters in the paper. There are some errors in the background paper which would warrant correction, and some comments with which the FCA would wish to take issue or comment upon, if the background paper had any broader purpose.

8. Executive Summary

The broad position of the FCA in relation to the specific terms of reference for this Inquiry can be summarised as follows:-

(1) The parties to a franchise agreement should be left free to negotiate the commercial terms to bind them in their business relationship. It would be totally inappropriate, and distort many existing commercial arrangements, to provide franchisees with specific rights of renewal or other statutory entitlements at the end of a franchise agreement;

(2) There is no demonstrable need for further disclosure of the respective rights of the parties to a franchise agreement either in relation to renewal or extension of a franchise agreement, or generally. It is (from March 1, 2008) a mandatory requirement that the franchise agreement be provided with the comprehensive disclosure document and in the form it is intended to be executed. Disclosure is supported by a process that ensure franchisees have ample time to make a considered decision and are strongly encouraged to obtain legal and business advice;

(3) It would be totally inappropriate, and distort many existing commercial relationships, to legislate in relation to the rights of the parties to goodwill at the end of a franchise agreement. The current legal position is clear, supported by High Court of Australia legal precedent and well understood by market participants. Further, it is consistent with principles applying to commercial leases and other non-franchise business relationships. The inclusion of a legislative right to goodwill under a franchise agreement would lead parties to avoid franchising, which would be damaging to franchisors, franchisees and the Australian economy;

(4) It would be totally inappropriate to require the parties to a franchise agreement to negotiate franchise agreements "in good faith". There are already substantial protections for franchisees entering into franchise agreements, including the Franchising Code of Conduct and s52 of the Trade Practices Act. There is also an existing implied duty of good faith and fair dealing implied into a franchise agreement in the context of the ongoing relationship.[50] The insertion of a good faith obligation in relation to franchise negotiations, or in relation to extending the agreement after termination, would create massive legal uncertainty and interfere with many existing commercial arrangements;

(5) The prohibitions on unconscionable conduct contained in the Trade Practices Act and the State Fair Trading legislation operate effectively in the context of the franchise relationship, and the ACCC has been active in enforcement. There are several precedents for the application of the unconscionable conduct provisions in a franchise context.[51] The arrangements work less effectively in the context of commercial leasing, but this is as a result of other factors more related to abuse of market power by landlords;

(6) There is no justification for legislating in relation to franchising matters on a State basis. The Code requirements and the Trade Practices Act prohibitions on misleading or deceptive conduct provide a comprehensive regulatory umbrella for the sector. There is already an implied duty of good faith and fair dealing implied into every franchise agreement. The purpose of State Fair Trading legislation in the business context is to essentially mirror the Federal Trade Practices Act and provide coverage to those few limited areas not covered by the jurisdiction of the TPA under the Corporations power of the Constitution. The FCA would strongly resist any attempt to introduce different State based remedies, whether they be in relation to goodwill or good faith or any other issue;

[50] See Far Horizons Pty Ltd v McDonald's Australia Ltd, where Byrne J noted "there is to be implied in a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose. Such a term is a legal incident of such a contract."

[51] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

(7) The level of disputation in Australian franchising is statistically very low. It also compares very favourably with the levels of disputation in other jurisdictions including the USA. The mediation based dispute resolution procedure set out in the Code has been extremely successful, with the Office of Mediation Adviser reporting that over 80% of disputes it sees are successfully resolved via the mediation process. The cost of mediation is minimal, and far less than even the simplest court or tribunal procedure. The ACCC has been an active and efficient regulator. Any aggrieved franchisee can, at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act. The ACCC is well resourced, is duty bound to investigate all claims where there is a breach of the Code or the TPA, and has a strong track record of taking enforcement action where necessary. The FCA has supplemented these procedures with informal dispute resolution mechanisms pursuant to the FCA Member Standards. Although the FCA has seen media reports of alleged inappropriate conduct against franchisees, the FCA's experience (and indeed that of the ACCC according to its public statements) is that the allegations made in the media are often not substantiated by fact;

(8) In the opinion of the FCA, the Australian regulatory regime represents world's best practice. However the FCA is supportive of affirmative action to improve good practice in franchising. Indeed the FCA, through its various events and educational activities, actively promotes continuous improvement in franchising. From a regulatory perspective the FCA would like to see mediation made mandatory, and for all franchisees to be compelled to obtain legal advice prior to signing. In the FCA's experience there is a high correlation between franchisee failure or mismatched expectations, and failure to obtain expert advice. A constructive role for the State Government could be the funding of professional advice for prospective first time franchisees, and/or mandatory educational courses for prospective franchisees. More broadly, the FCA supports ongoing review of the regulatory regime at a Federal level, but does not consider any regulatory change is necessary at present. The Australian regulatory environment is already more prescriptive and comprehensive than most regimes overseas. Interestingly the UK, Singapore, Hong Kong and New Zealand – countries that are probably the closest to Australia in terms of legislative framework – in fact have no specific franchise legislation at all.

(9) It is inappropriate to seek to somehow enshrine "good practice" into legislation, as that is not the role of legislation. Legislation should establish mandatory standards, not attempt to codify "good practice". The Franchise Council of Australia endeavours, though its Member Standards and through educational and other initiatives, to provide guidance on best practice. However this is always done as guidance, not regulation. In franchising "good practice" is driven by the mutuality of interest of franchisor and franchisee. So, for example, many franchise systems have internal dispute resolution mechanisms that come into play well before mediation. In the context of the franchise term, it is not uncommon for franchisors to allow a franchisee to continue to extend the term of a franchise beyond the initial agreed term. However this is driven by mutuality of commercial interest, as otherwise the franchisor has to find and train a new franchisee or operate the business itself, which many franchisors prefer not to do. However it would be totally inappropriate to legislate any of these common practices as a mandatory requirement.

(10) The FCA is strongly supportive of the current Federal regulatory environment. The FCA is opposed to State regulation of franchising, as this may create unnecessary administrative and compliance cost or become a barrier to cross-border or national franchise networking. It is difficult to envisage a franchising issue which would exist only in a single State or Territory. From a broader policy perspective, there are important initiatives State Governments could take to enhance the growth and development of franchising. The FCA considers the following issues to be important:-

(a) The FCA would be keen to receive a commitment by State Governments to fully harmonise legislation that has impact beyond State boundaries and avoid the duplication, inconsistency and cost of State based regulation not only in relation to franchising, but in relation to taxation, retail tenancies, workplace issues, occupational health and safety, business regulation and property law;

(b) The FCA believes there is a real opportunity presented by the Labor State and Federal incumbency for all Governments to move beyond lip service to genuine reform of red tape and business compliance costs. Typically this will require the simplification of legislation and the dismantling of State based public service bureaucracies which become self-justifying and act as an impediment to harmonisation in favour of more efficient nationally integrated infrastructure. The recent Productivity Commission report on the additional cost of the concurrent regulation of consumer affairs at Federal and State level discussed in section 5 is compelling evidence of the extent of possible savings.

As the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising, the Franchise Council of Australia welcomes the opportunity to provide input to this Inquiry. The FCA is concerned to ensure that the franchise sector operates efficiently and fairly, and there is a strong positive perception of franchising in Western Australia.

The FCA trusts the material included in this submission will assist the Inquiry. Although the FCA is not privy to the content of submissions made by other parties to the inquiry we have endeavoured in section 8 to anticipate and briefly respond to issues that have been raised in the past. If a matter is not sufficiently addressed in this submission or you require further comment or information the FCA would be pleased to provide it.

9. The Franchise Council of Australia

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers involved in franchising in Australia. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. Details of the activities of the FCA can be found at www.franchise.org.au Additional information on the FCA and a list of current members of the FCA are set out in the Report on the Current State of Australian Franchising in Appendix 1.

The FCA has as its core aim the promotion of the growth and development of franchising in Australia. The FCA believes collaboration (as opposed to an adversarial relationship) between franchisors and franchisees has been one of the reasons for the success of the Australian franchise sector, and remains critical to its future success. The FCA represents franchising, and the joint and separate interests of all stakeholders, as opposed to the interests of one component of the sector over another component.

The Western Australian Small Business Minister has established this inquiry to consider existing laws in terms of whether they disadvantage franchisees or provide insufficient protection for franchisees. Press reports have quoted instances of alleged inappropriate behaviour by franchisors as the cause of failure of some franchisees, although no specific detail has been provided. These are important issues for the franchising community. The FCA would like to work with the State Government and the Inquiry to better understand the nature of the issues that have been raised with them, and provide input into the best manner of resolving any identified problems. The FCA can also play an important role in helping the Inquiry to verify the accuracy of representations made to the Inquiry, as in our experience there can often be a divergence between assertions and fact. Some of the franchising matters that have received extensive media publicity are being promoted by people with an often undisclosed self-interest in fermenting discontent and an adversarial approach to franchising. The FCA can help the Inquiry to sift through to the real facts.

The FCA has always been very concerned at any allegations of inappropriate conduct in franchising. As a result, in its submission to the recent Federal Government Inquiry into franchising, the FCA made several recommendations to improve the Franchising Code of Conduct and provide additional information and protection to franchisees. The FCA supported the legislative amendments to the Code made by the Federal Government (with bi-partisan support) and which take effect March 1, 2008. Further, the FCA has introduced its own Member Standards to provide additional guidance to FCA members on what is required of franchisors, franchisees and service providers to ensure responsible franchising. The Member Standards are supported by educational programs and a complaints process that enables the FCA to remain in touch with the issues causing concern in the franchising community.

The FCA is actively seeking information from its franchisee community as to the issues relevant to its franchisee stakeholders, including matters before this Inquiry. It has already conducted franchisee forums around the country, and this submission has drawn from that input. The members of the Western Australian Chapter of the FCA also met to discuss the terms of reference and provide input into this submission. In relation to the legal issues raised the FCA has sought input from its Legal Committee, which comprises representatives of approximately 20 franchise law firms and includes representatives from all States including Western Australia. The feedback from the members of the Legal Committee was unanimous, and indeed quite stridently so, in support of the retention of the existing legal arrangements in relation to certainty of expiration of franchise agreements and goodwill on termination. The FCA Legal Committee, and indeed the FCA itself, strongly supports the legal position established by the High Court of Australia in this area.

More broadly the FCA board has identified franchisee inclusiveness as one of its top priorities for the ensuing year. To give effect to this priority franchisee representatives have been appointed in each State, and Gloria Jeans franchisee Tony Melhem has been appointed to the FCA board to specifically represent the franchisee interests in view of the recent retirement of long time franchisee director John Longmire.

The FCA remains committed to the promotion and development of franchising in Australia. In particular the FCA supports any improvements that can assist prospective franchisees to be better informed.

The FCA has always supported initiatives which acknowledge the need for entrepreneurial and contractual freedom but promote the two pillars upon which the current regulatory framework has been built - responsible franchisor behaviour and effective franchisee due diligence.

The FCA looks forward to working with the Inquiry and the Western Australian Government to assist them to meet the objectives of the Inquiry and more broadly to foster the growth and development of franchising in Western Australia.

10. The Development of Australian Franchising

The franchise sector in Australia makes a very substantial contribution to the Australian economy. The statistical information provided in the Background Paper produced to provide information to assist those making submissions to the inquiry provides statistics from 2006. More recent information shows that the sector has continued to grow and develop. Industry turnover is estimated by IBISWorld Research at $128 Billion, which equates to approximately 3.2% of Australian Gross Domestic Product[52]. The sector has around 1,000 franchise systems, 66,000 units and employs 600,000 people. The indirect impact of franchising is estimated at 1.5 times these figures based on research on franchising in the US conducted for the International Franchise Association by Price Waterhouse Coopers.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. Since 1998 the sector has not only grown, but matured and developed into one of the primary engines for economic growth in Australia. We have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practice.

The FCA is a strong supporter of the regulatory framework established by the Federal Government in 1998. It considers the *New Deal Fair Deal* reforms have made a very important contribution to the success of Australian franchising. The Background Paper makes reference to these reforms, but in the context of the discussion on “fairness” should be clarified in a number of respects:-

(1) Although important, the introduction of the Code was only one part of the New Deal Fair Deal reforms;

(2) The reforms included the introduction of a prohibition in s51AC on unconscionable conduct. The ACCC has successfully taken action in a franchising context on several occasions based on alleged unconscionable conduct by franchisors[53];

(3) The reforms established the ACCC as the designated regulator of the sector, and provided significant resources to the ACCC to take action where appropriate.

The FCA believes that Australia’s regulatory framework represents world’s best practice in terms of striking a balance between strong and effective regulation and the fundamental principles of free enterprise. It features the comprehensive Franchising Code of Conduct requirements, which are administered by the ACCC. In addition to the Code, the Commonwealth Trade Practices Act’s prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions. It is beyond rational argument that the Australian regulatory environment for franchising is the most comprehensive of any nation including the US.

The FCA believes that franchisors that break the law must be strongly punished, as their conduct affects the general reputation of the sector and the value of the assets of reputable franchisors and

[52] The reference to 14% of GDP is in fact incorrect. 3.2% is the correct figure.

[53] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

franchisees. The FCA has been supportive of ACCC enforcement action. The ACCC has moved quickly, such that there has not often been a need for civil action by franchisees. Interestingly, in the vast majority of cases where either a franchisee or the ACCC have taken court action they have been successful. Importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA does not pretend that franchising is perfect, and indeed has been at pains to ensure that potential franchisees are not lured to the sector by a belief in the infallibility of a franchised business. The FCA, and more recently the ACCC, have emphasised that franchising not only requires responsible franchisor behaviour, but proper franchisee due diligence. Many of the problems the FCA sees in franchising would not have arisen had the potential franchisee sought appropriate specialist legal and business advice and undertaken proper due diligence prior to purchasing the franchise. This remains probably the biggest ongoing challenge for the sector.

11. The Current Regulatory Environment

11.1 Balancing contractual freedom and regulation

The FCA is strongly supportive of the current regulatory environment. In our view it strikes an ideal balance between contractual freedom and flexibility that encourages growth and entrepreneurial behaviour, and regulatory intervention to support the contractual process and ensure informed and fair bargains are made.

The FCA believes that the two key principles that underlie effective franchising are responsible franchisor behaviour, and proper franchisee due diligence and risk awareness. The Code and the TPA prohibitions on misleading or deceptive conduct and unconscionable conduct support these principles, and do not undermine the important principle of freedom of contract. The Code requires responsible and lawful franchisor behaviour through a comprehensive disclosure regime, mandatory mediation based dispute resolution, constraints on restricting transfer and controls on termination. The Code facilitates proper franchisee due diligence and risk awareness by providing extensive information and franchisee contact details in the disclosure document, and creating a framework for franchisees to obtain independent advice and then sign (with the protection of the 14 day disclosure period and the 7 day cooling off period) without undue haste.

The FCA believes the Franchising Code of Conduct and the Trade Practices Act provide important protection for franchisees, and the ACCC has been a highly effective industry regulator. Australia's level of disputation, at just over 1%, is substantially lower than the US, which is estimated by the International Franchise Association at around 6%. Further, over 80% of disputes in Australia are successful resolved by mediation, whereas in the US arbitration and litigation are the more dispute resolution common methods. Another encouraging statistic is that the level of franchising complaints to the ACCC continue to fall, and is at historically low levels notwithstanding the substantially increased high profile of the ACCC. As a consequence the FCA considers Australian franchising is world's best practice.

The regulatory framework has only recently been comprehensively reviewed at a Federal level. The FCA supported the review of the Code conducted in 2006, and the Federal Government's response. These amendments take effect March 1, 2008. Obviously any review by this Inquiry needs to take into consideration the fact that these reforms, which include additional disclosure requirements in areas such as rebates and former franchisee information, have yet to take effect. Fundamentally the FCA believes the recently improved disclosure provisions in the Code are adequate and work well for the market.

The danger with any review is that regulatory change will be recommended without proper analysis of the nature and extent of any problem or assessment of the regulatory impact and cost. Given the objective evidence available as to the overall healthy state of the sector any recommendations should only be made after very careful analysis, properly tested evidence and having regard to the impact and cost of any proposed change.

11.2 State regulation of franchising

Although the FCA welcomes the interest shown by the Western Australian Government in franchising, and is appreciative of the opportunity to discuss franchising issues with the Inquiry, the FCA is strongly supportive of the regulation of franchising solely at a national level.

There would be no issues in franchising in Western Australia that would be unique to the Western Australian market. Over 95% of franchisors are small businesses, and they have limited capacity to absorb the costs of excessive regulation. Most franchise systems operate, or at the very least intend to operate, across State boundaries. State regulation of franchising would create unnecessary duplication and cost at a time when all Governments are championing a reduction in regulatory red tape.

On this point, and although only generally relevant, we note that the costs of regulatory duplication have been independently recognised quite recently. In early December the Productivity Commission released a report that estimated that the concurrent regulation of consumer affairs at Federal and State level cost an estimated $4.9 billion above the cost of a unified Federal scheme. The franchise sector cannot afford even a fraction of this additional cost, and the FCA and its members would strongly resist any attempt to regulate at a State level given the existence of the current Federal regime.

It is also useful to consider the US experience, where they do have concurrent Federal and State regulation. According to the International Franchise Association the consequence of inappropriate State legislation is not only substantial extra compliance cost, but often that franchise systems simply withdraw from business activities in that State. For example the damage to the State of Iowa due to the introduction of its franchise legislation has been significant, with 135 companies reducing or halting expansion in Iowa, with a consequent cost of $207 million in lost sales and 7,500 jobs. 27 US States have since rejected Iowa type laws, and the legislation has been broadly condemned.

11.3 Understanding the current regulatory environment

Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of that framework are:-

(1) the Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. In addition to typical requirements to disclose the franchisor's business background, relevant financial information, previous litigation and solvency history and other relevant matters the Code uniquely requires the franchisor to:

   (a) include a list and contact details of existing franchisees, which facilitates contact with those parties as part of due diligence. As of March 1, 2008 franchisors will also have to disclose details of former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence; and

   (b) requires a director to certify the solvency of the franchisor as at the end of the last financial year, which provides considerable additional comfort to prospective franchisees.

(2) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(3) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(4) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to prove it had reasonable grounds for making any representation as to a future event;

(5) the prohibition on unconscionable conduct in s51AC of the TPA; and

(6) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct.

The history of litigation in franchising shows that this protection is meaningful and effective. In the vast majority of cases where either a franchisee or the ACCC has taken court action they have been successful. More importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA contends that these statistics clearly demonstrate that franchisees are not disadvantaged by current laws, and that current laws provide strong protection against franchisors that act unlawfully. The dispute resolution mechanisms are world's best practice in terms of success and cost effectiveness, and franchisees have ready access to low cost remedies such as mediation. The ACCC is an active, expert and well-resourced regulator that is duty bound to investigate, at no cost to a franchisee, any allegation that a franchisor has breached the Code or the TPA.

The FCA has enacted its own Member Standards to supplement these statutory remedies, and provide some additional remedies. Again there is no cost to a complainant.

11.4 Disclosure as part of the contractual process

The Code not only facilitates the provision of extensive information through the disclosure document, but does so as part of a process that is designed to ensure as far as is reasonably possible that a prospective franchisee makes an informed decision to purchase the franchise. The information to be disclosed includes a list with contact details of existing franchisees, which enables a prospective franchisee to make contact with those actually involved in the business to verify any information provided by the franchisor. From March 1, 2008 this requirement is extended to include a list of former franchisees. The disclosure document must be provided at least 14 days prior to signing the franchise agreement, which allows ample time to obtain advice and avoids the risk of high pressure selling. Even then there is a mandatory 7 day cooling off period, so that a franchisee can essentially change its mind and exit the arrangement without penalty.

Importantly disclosure is intended only as part of the franchisee's due diligence process. The Code expressly notes in clause 6A the purpose of the disclosure document, being to give to a prospective franchisee "<u>information</u> from the franchisor to <u>help</u> the franchisee make a reasonably informed decision about the franchise". On the front page of every disclosure document as a mandatory requirement is a detailed statement advising that the disclosure document contains "<u>some</u> of the information you need in order to make an informed decision", and telling prospective franchisees "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

The advice process established by the Code is intended to reinforce the disclosure process by endeavouring to ensure the disclosure document and other information is not only read and understood by the franchisee, but considered by an independent legal, business and accounting adviser. A franchisor must receive from a prospective franchisee before signing the franchise agreement a certificate that the franchisee has either obtained advice, or been told that the advice should be sought but has decided not to seek it. It is hard to imagine a more comprehensive process. Indeed no other regulatory regime in Australia, and probably in the world, combines the concepts of disclosure, advice and pre-contractual certification so comprehensively. The concepts of cooling off, legal and business advice and disclosure of former franchisees are uniquely Australian.

11.5 Disclosure and compliance costs

There are currently over 250 separate pieces of information to be included in the disclosure document, which must be in a prescribed order and layout. No doubt there are other pieces of information that could be included. However any change to the current format will result in compliance costs not just in making changes to the document, but in accessing the necessary information and recording information for future documents. Depending on the nature of the information franchisors may not have kept records on the matter, so information may need to be accessed from archives or other records, at substantial cost. Any additional disclosure obligations must be considered in the context of the relevant compliance costs. This issue is particularly relevant given the stated purpose of the Code, being to provide "some" of the relevant information, as opposed to "all" relevant information.

11.6 Current complaints

Current research and anecdotal evidence from those associated with franchise complaints confirms that the level of complaints is low. Statistically franchisee non-compliance with the system has in fact been identified as the most significant cause of disputes. Anecdotally there also appears to be a strong correlation between complaints and a failure on the part of the franchisee to conduct due diligence and obtain independent legal, accounting and business advice.

As mentioned above, the FCA has itself received complaints from various parties involved in franchising since the launch of its Member Standards in 2005. On investigation many of the allegations of franchisor misconduct, including those that have achieved significant press coverage, have not in fact been substantiated. Further, where misconduct may have occurred, existing legal remedies were already available and appeared adequate. Interestingly, on a cursory analysis, few of the apparent root causes for the complaint appeared to relate to inadequate disclosure, but rather:-

- unwise investment decisions where a franchisee failed to undertake due diligence or seek independent legal, business and accounting advice prior to entering into the commercial arrangements;
- differences of commercial opinion as part of the ongoing franchise relationship;
- conduct by a franchisor that would appear to be illegal by virtue either of the Code or s52 of the Trade Practices Act;
- conduct of third parties such as landlords;
- mismatched expectations of business success or an underestimation of the amount of work required to achieve success;
- cost overruns in establishment costs or underestimation of start-up costs including working capital.

The FCA recognises that there have been in recent times a handful of quite public allegations of inappropriate business conduct in franchising. No doubt there are instances of inappropriate behaviour that have not come to our attention. However these complaints need to be considered in the context of the 66,000 franchised units and almost 1,000 franchise systems. Given the size of the market and the interdependent and long-term nature of the franchise relationship, often described as a business marriage, the divorce statistics in franchising are remarkably low.

11.7 Consultation and member input

The FCA submission was prepared after extensive consultation with its membership and is intended to compliment and provide background for the formal meetings with the Inquiry. It provides an overview of the sector and will identify many of the issues before the market at the moment and will also suggest some of the weaknesses in the current system.

The FCA has included with this submission some additional material providing background, or addressing specific issues. Although these documents have been prepared for other purposes it was felt that their inclusion was appropriate to assist the Inquiry in its deliberations and enable the Inquiry to gain a greater understanding of the issues before the sector. These important appendices include:

- An industry report on the current state of Australian franchising; and
- The FCA Member Standards and complaint process

We have also provided in section 5 below a commentary on the existing disclosure provisions to help the Inquiry in its deliberations.

We would welcome the opportunity to address any queries arising from our submission, or to respond to matters raised by any other submissions. We would also welcome the opportunity to provide input form the perspective of practising franchisors and franchisees to any proposed recommendations of the Inquiry to Government. Our position, and indeed our corporate objective as an organisation, is that we will support any initiative that is in the best interests of Australian franchising.

12. Disclosure Under the Franchising Code of Conduct

12.1 Introduction

The Franchising Code of Conduct provides a comprehensive regime of disclosure unparalleled in the Australian legal system.

Disclosure underpins the operation and effectiveness of the Code, and supports the fundamental legal principle that whilst freedom of contract should apply, contracts should be made between informed parties. The disclosure process is supplemented by a legal advice process to further ensure the parties have the opportunity to be fully informed.

This regime is even more effective when seen in the context of the general prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act and supporting provisions. Even without the disclosure obligation contained in the Code, the prohibition on misleading or deceptive conduct as interpreted by Australian courts of itself prevents a franchisor from providing information that is false, misleading or deceptive. It also probably prevents a franchisor from withholding information that is material and relevant to the decision, as in relationships such as a franchise relationship the courts have been prepared to find that silence of itself can be misleading. This would particularly be the case given the existence of the Code – if the franchisor is in possession of any material and relevant information that contradicts or renders misleading any information contained in the disclosure document the franchisor would be exposed to a misleading conduct claim if the franchisor did not disclose it.

12.2 The Effectiveness of Disclosure

The effectiveness of the Code's disclosure process should fairly be judged against the stated purpose contained in clause 6A of the Code, which provides (paraphrased, and with emphasis added):

The purposes of a disclosure document are:-

*1.1.1.1 to give to a prospective franchisee … **information** from the franchisor to **help** the franchisee make a **reasonably informed** decision about the franchise; and*

*1.1.1.2 to give a franchisee **current information** from the franchisor that is material to the running of the franchised business.*

It is clear from an analysis of this purpose, noting in particular words that have deliberately not been used, that:-

(1) the requirement is to provide "information", which can fairly be read as meaning "some" as opposed to "all" or even "current" information. [54]

(2) The disclosure document is intended to "help", not "ensure" the franchisee makes a reasonably informed decision; and

(3) The decision is to be "reasonably informed", as opposed to "fully" informed.

In other words the Code sees the disclosure document as an aid to the decision, and a starting point for the franchisee's own due diligence. Clause 11 supports this intention by establishing an advice process aimed at ensuring prospective franchisees understand that they should obtain legal, business and accounting advice.

The disclosure document is clearly not intended to be exhaustive. Further the specific obligation to update the document annually, and for only limited continuous disclosure of materially relevant facts under clause 18 of the Code, shows it is only intended to be relatively current. The information is intended to relate to the franchise system and agreement generally and the business history and other details of the franchisor. Investment information is intended to show a range and relate to the overall

[54] The requirement in (b) for "current" information relates only to information relevant to running the business, as opposed to the decision to purchase. The generally accepted interpretation of (b) is that it is intended to provide a purpose to renewal and extension of an existing franchise, as opposed to a grant of a new franchise where (a) is relevant, and to the obligation contained in clause 19 to provide a current disclosure document to any existing franchisee on request.

nature of the business as opposed to the specific franchisee being purchased by an individual franchisee.

In evaluating the effectiveness of disclosure against the stated purposes, it is suggested that there should be two main criteria – the structure of the disclosure requirements, and the substance of disclosure. Each factor is considered below.

12.3 The Structure of Disclosure

The requirement to provide a disclosure document and make ongoing disclosure of certain materially relevant facts is similar to disclosure regimes applying under the Corporations Act in the fundraising and financial services arena. However the franchising disclosure regime is supplemented by a requirement for advice before entering into a franchise agreement that is unique in Australia, and indeed in the world. This system is further supplemented by a 7 day cooling off process that enables the franchisee to terminate the franchise agreement without cause.

Conceptually it is difficult to see how the structure of the disclosure arrangements could be improved:-

- The disclosure document is in writing, the format and layout of the document is prescribed and the document is indexed, thereby facilitating ease of review and comparison with other systems. (Interestingly no such requirements apply under corporate law disclosure.)

- The disclosure process allows a mandatory 14 day period between provision of disclosure and signing, which is ample time for consideration and to obtain advice. (Again no such requirement exists under corporate disclosure.)

- The disclosure process applies not just to grants of franchises, but renewals and extensions and to the making of any non-refundable payment. It is therefore comprehensive;

- The requirement for advice extends to legal, business and accounting advice, which is all that any prospective franchisee would fairly expect to require. (By way of comparison the advice certificate process instituted by many banks, which is generally considered to be an industry best practice benchmark, relates only to legal advice. No legal advice requirement exists under corporate law disclosure.)

- Although the franchisor is entitled to enter into a franchise agreement if advice is not obtained, it is only able to do so if the franchisee confirms in writing that the franchisee has been told that the particular kind of advice should be sought, "but has elected not to seek it." This places a strong obligation on the franchisor to "tell" the franchisee advice "should be sought", and is a clear warning to prospective franchisees. Arguably any prospective franchisee that proceeds without getting advice could legitimately be expected to accept responsibility for such a decision.

The only area for possible structural improvement would be to remove the discretion for a franchisee to elect not to seek advice. The proposal to make the obtaining of advice a mandatory requirement is supported by the FCA because the FCA believes that this would in fact actually reduce even further the opportunity for mismatched expectations. However the FCA considers that some due diligence responsibility must be accepted by prospective franchisees. Arguably this responsibility should apply to a franchisee that elects at the franchisee's peril not to seek advice despite being told to do so.

12.4 The Substance of Disclosure

The franchisor and franchisee are entering into a written contractual relationship. The fundamental rights and obligations of the parties will be set out in the contract, and the parties are free to include in the contract such provisions as they shall consider appropriate, subject to law and the specific requirements of the Code. The principle of freedom of contract underpins all business dealings, and is recognised by the nature of the disclosure obligations under the Code.

The Code also acknowledges that the principles of privity of contract are relevant to disclosure. For the most part disclosure needs to focus on the intended party to the franchise agreement, being the franchisor. Any departure from this principle needs to be justifiable in terms of relevance to the overall relationship or the decision to purchase the franchise.

12.5 The prescriptive nature of disclosure

Annexure 1 to the Code sets out the substantive disclosure requirements. The disclosure document must be in the form and order and using the headings set out in Annexure 1. The following comments are offered in the context of considering the substance of disclosure:

1. First page

The mandatory preamble reinforces the intent that the decision is "**a serious undertaking"** and "**legally binding"**, the disclosure document contains "**some"** of the information you need and the decision should be "**informed"**.

The preamble specifically advises franchisees to **"read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with the requirements of a franchised business."**

The franchisor contact detail, signature and preparation date requirements are non-controversial and sensible.

2. Franchisor details

These requirements are relatively standard internationally. They provide information on the franchisor and all associates. Further information could be obtained by company and other searches as part of due diligence if relevant.

3. Business experience

Again these requirements are relatively standard internationally. They provide information on the business experience of the people likely to be involved in the business. Further information could be obtained if desired as part of due diligence by seeking references, asking questions to the franchisor or via industry associations.

It may be useful to extend clause 3.2(b) beyond just the franchisor to at least associated companies if not associated individuals as well.

4. Litigation

These requirements are relatively standard internationally. They provide information on the franchisor. Further information could be obtained by company, court record and other searches as part of due diligence if relevant. The nature of proceedings to be disclosed is extensive and would appear to cover any claim likely to be relevant to a franchisor.

At the suggestion of the FCA the Federal Government has extended (with effect from March 1, 2008) the obligations in clause 4.1 beyond just the franchisor to franchisor directors, enhancing disclosure.

5. Payments to agents

The FCA suggested to the Mathews Committee that it may be appropriate to add the words "and the nature or purpose of the payment" at the end of the sentence concerning disclosure to agents. This is not known to be an area of great concern for prospective franchisees, and was not either recommended by the Mathews Committee or implemented by the Government.

6. Existing franchisees

This is a comprehensive and important provision that supports and facilitates the exhortation contained in clause 1 for the prospective franchisee to contact existing franchisees.

The FCA suggested to the Mathews Committee that clause 6.4 may be able to be improved, as the categories are somewhat ambiguous and overlapping. There is some argument that the substance of disclosure could be improved in this area. To assist franchisors complete this section accurately perhaps additional guidance could be provided, and franchisor's encouraged to choose the primary category. However compliance costs need to be considered, as franchisor's current recordkeeping systems will be structured around the existing categories and some adjustment time would be required should any changes be made.

The FCA supports the Government's changes (effective March 1, 2008) to include a requirement for the franchisor to disclose contact details of former franchisees as well as existing franchisees.

7. Intellectual property

This section is comprehensive and important. We are not aware of any compliance issues.

8. Franchise site or territory

This section is comprehensive and important. We are not aware of any compliance issues.

9. Supply of goods or services to a franchisee

Disclosure in this section is comprehensive and important. It links in to other sections of the Trade Practices Act, in that admissions made in answer to what are very specific questions can immediately alert advisors or indeed any investigating regulator to any potential breaches of the law. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

The March 2008 Code changes will further tighten the requirements concerning disclosure of rebates to require disclosure of the name of the business providing the rebate.

The FCA's view is that the Trade Practices Act has a comprehensive and powerful array of remedies relating to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct to address pricing and supply issues. Franchising is no different to other forms of commerce, and no further action is required in this area.

10. Supply of goods or services by a franchisee

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

11. Sites or territories

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

12. Marketing or other cooperative funds

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

13. Payments

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

It is not possible for the disclosure document to be customised for every transaction, it is an overarching document intended to apply to every franchise granted. It is not intended to provide exact or specific information on the particular franchise involved, as to do so would be impossible without imposing massive compliance costs on franchisors. The information provided is a "range", and is intended only as a starting point for the franchisee's further enquiries. Prospective franchisees and their advisors would secure more than enough initial information to make their own calculations and seek any additional information. It should also be noted that any potential for a prospective franchisee to be misled as to actual costs in relation to their particular investment is addressed by the s52 prohibition on misleading or deceptive conduct, which provides a more than adequate remedy. The Code provides an excellent starting point, and the categories are comprehensive.

14. Financing

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

15. Franchisor's obligations

A copy of the franchise agreement must be provided with the disclosure document. The franchise agreement is normally already indexed, and it is a legitimate expectation of the franchisor that the prospective franchisee will read the agreement before signing.

16. Franchisee's obligations

See 15 above.

17. Summary of other conditions of agreement

See 15 above.

18. Obligations to sign related agreements

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

19. Earnings information

This clause largely repeats existing law, and fundamentally serves as a reminder to franchisors in the context of potential claims under s52 and s51A of the Trade Practices Act. Any breach of this section of the Code would almost certainly be a breach of s52 or s51A. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

20. Financial details

20.1 This is an important and often overlooked additional protection provided to franchisees, as it is in effect an annual solvency warranty. It goes far beyond disclosure, and gives franchisees substantial additional legal rights.

20.2 Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

21. Updates

Disclosure is adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

22. Other relevant disclosure information

This clause is procedural and self-explanatory.

23. Receipt

This clause is procedural and self-explanatory.

13. WA Inquiry Discussion Points

13.1 **Should a franchisee be given rights at the end of a franchise agreement, and what should those rights be?**

No. The FCA believes that the parties to a franchise agreement should be left free to negotiate the commercial terms to bind them in their business relationship. It would be totally inappropriate, and distort many existing commercial arrangements, to provide franchisees with specific rights of renewal or other statutory entitlements at the end of a franchise agreement.

The FCA understands that other submissions to the Inquiry may suggest that a franchisee should have a definite right of renewal, or the franchisor should be somehow obliged to negotiate in good faith with the franchisee for renewal or to pay compensation. That is not the current law, and would represent a major commercial change that would impact many existing commercial arrangements. Such a right does not apply even in the highly prescriptive provisions of Oilcode that apply to the petroleum sector, and has recently been rejected in the context of commercial leasing by the Productivity Commission in its Draft Report.

The Productivity Commission comments are insightful in terms of broad policy in an area of law very relevant to, and to some extent conceptually similar to, franchising. Commenting upon the disparity in negotiating strength between landlords and tenants, especially in large shopping centres, the Commission took the view that “hard bargaining and varying business fortunes should not be confused with market failure warranting government intervention.”[55] The Commission favoured a more laissez-faire approach to tenancy legislation and advocated against greater prescriptiveness. In accordance with this approach, certain key proposals were put forward by the Commission in relation to the retail tenancy market:

(1) maintain and, where practicable, improve features of the current system which seem to be working well, namely dispute resolution and information disclosure;

(2) progressively relax current provisions in retail tenancy legislation across all jurisdictions in areas that have sought to govern market behaviour, such as minimum lease terms;

(3) improve the alignment of regulations and practices governing retail tenancies with those regulating tenancies in the broader market for commercial tenancies; and

(4) move, where practicable, towards national consistency in legislation.

Although the FCA is satisfied with the current regulatory environment, it is worth noting that the application of these principles to the franchise sector would in fact lead to a relaxation of parts of the current legislation. The comments certainly are relevant in the context of any possible increase in regulation.

13.2 **In relation to renewing or extending a franchise agreement, is there a need for more up front disclosure about the respective rights of both parties?**

Not as far as the FCA is aware. There is no demonstrable need for further disclosure of the respective rights of the parties to a franchise agreement either in relation to renewal or extension of a franchise agreement, or generally. It is (from March 1, 2008) a mandatory requirement that the franchise agreement be provided in the form it is intended to be executed, and the disclosure process is supported by a requirement for franchisees to obtain legal and business advice, or certify that they have elected not to do so. The legal rights of the parties are clear from reading the franchise agreement, and the disclosure document provides further clarity. Professional advice provides further support to the process. The only workable improvement, which in the view of the FCA would be unnecessary, would be to include a specific warning on the front of the disclosure document. However the FCA sees

[55] Productivity Commission Draft Report *The Market for Retail Tenancy Leases in Australia*, XXIX.

little likely benefit in such a warning particularly given that existing warnings as to obtaining advice, attending courses and generally conducting appropriate due diligence are often ignored by prospective franchisees.

A disclosure document prepared in accordance with the comprehensive requirements of the Franchising Code of Conduct provides sufficient information to assist a prospective franchisee to make an informed decision in relation to the franchise. The disclosure process has been further strengthened by the recent amendments to the Code which take effect March 1, 2008. The FCA supported the recent Code amendments, and believes they should be allowed to come into effect before any further regulation is contemplated;

13.3 **Is there a need to prescribe the respective parties' rights to goodwill at the end of the franchise agreement?**

No. It would be totally inappropriate, and distort many existing commercial relationships, to legislate in relation to the rights of the parties to goodwill at the end of a franchise agreement.

The current legal position is clear, supported by High Court of Australia legal precedent[56] and well understood. Further, it is consistent with principles applying to commercial leases and other non-franchise business relationships. The inclusion of a legislative right to goodwill under a franchise agreement would lead parties to avoid franchising. The accuracy of the information provided will depend on the level of compliance by franchisors. However the Code is highly prescriptive as to the information required, the format and layout and even the headings to be used, so any deficiencies in information are readily apparent. Strong sanctions apply in the event of non-compliance, and the ACCC is a vigilant and effective regulator;

13.4 **Is there a need to include a requirement for franchise agreements to be negotiated in good faith?**

No. It would be totally inappropriate to require the parties to a franchise agreement negotiate franchise agreements in good faith.

There are already substantial protections for franchisees entering into franchise agreements, including the Franchising Code of Conduct and s52 of the Trade Practices Act. There is also an existing implied duty of good faith and fair dealing implied into a franchise agreement in the context of the ongoing relationship. The insertion of a good faith obligation in relation to franchise negotiations, or in relation to extending the agreement after termination, would create massive legal uncertainty and interfere with many existing commercial arrangements.

Over 95% of franchisors are small businesses, and there is no demonstrable inequality of bargaining power. Quality franchisees are in short supply, and existing legislative protections apply to prevent misleading conduct, undue pressure etc.

The suggestion also misunderstands the concept of good faith. There is an existing implied duty of good faith and fair dealing already implied into a franchise agreement in the context of the ongoing relationship. The position was succinctly stated in Far Horizons Pty Ltd v McDonald's Australia Ltd, where Byrne J noted "there is to be implied in a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose. Such a term is a legal incident of such a contract."

The good faith concept supplements the contractual process by ensuring powers are exercised for the purpose intended. It is not appropriate to try and cloak the creation by statute of some new contractual right under the guise of good faith. It is indeed arguably legally impossible, or at best uncertain, to require parties to undertake activities such as negotiation in good faith. The FCA believes that the insertion of a good faith obligation in relation to franchise negotiations, or in relation to extending the agreement after termination, would create massive legal uncertainty and interfere with many existing commercial arrangements.

[56] Insert correct details of BP v Ranoa Oil case

13.5 **In relation to the franchisor/franchisee relationship, do the current unconscionable conduct provisions contained within the Trade Practices Act 1974 provide adequate protection?**

Yes. The prohibitions on unconscionable conduct contained in the Trade Practices Act and the State Fair Trading legislation operate effectively in the context of the franchise relationship, and the ACCC has been active in enforcement. There are several precedents for the application of the unconscionable conduct provisions in a franchise context.[57] What is important to note in the context of franchising is the balance achieved not just by the unconscionable conduct provisions themselves, but by the intervention of the ACCC. These cases show that the ACCC will intervene, and can achieve an outcome, in franchising cases notwithstanding that the letter of the law may be somewhat more limited. This can be contrasted with other cases in which the ACCC has been involved in the unconscionable conduct area in retail leasing, where action taken against major landlords under unconscionable conduct has been less successful.

13.6 **Is there a case for including the principles of goodwill and good faith in the Fair Trading Act 1987(WA)?**

No. There is no justification for legislating in relation to franchising matters on a State basis. Further, it is totally inappropriate to legislate in relation to matters such as good faith and goodwill.

The FCA understands that some submissions to the Inquiry may seek to argue, based on US precedent, that it is possible for State and federal law to co-exist in relation to franchising. We have asked the International Franchise Association to comment directly on this issue, but understand from discussions with them that the vast majority of US State regulation in fact pre-dated the introduction of Federal legislation. Further we are advised that States such as Iowa that have sought to introduce relationship laws in franchising have suffered major adverse economic impact. In short national franchise systems have avoided those States.

13.7 **Is there a need to improve the regulatory and other avenues available for dispute resolution between franchisors and franchisees?**

The existing avenues are highly effective, and the FCA doubts that any suggested improvements would actually benefit franchising.

The level of disputation in Australian franchising is statistically very low. It also compares very favourably with the levels of disputation in other jurisdictions including the USA. The mediation based dispute resolution procedure set out in the Code has been extremely successful, with over 80% of disputes being successfully resolved. The cost of mediation is minimal, and far less than even the simplest court or tribunal procedure.

The ACCC has been an active and efficient regulator. Any aggrieved franchisee can, at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act. The ACCC is well resourced, is duty bound to investigate all claims where there is a breach of the Code or the TPA, and has a strong track record of taking enforcement action where necessary.

The FCA has supplemented these procedures with informal dispute resolution mechanisms. The FCA Member Standards process is included in Appendix 2 to this submission. The FCA is able to bring into play informal initiatives such as peer counselling (where a franchisor or franchisee or supplier is counselled by a peer) and mandated education to supplement the legal remedies available under the Code

In any business relationship involving two independent parties there are likely to be disagreements, misunderstandings and arguments. Further, despite the higher than normal success rate of franchised businesses when compared to other small businesses, not all franchised businesses are successful. The media occasionally reports inappropriate conduct against franchisees, and there are instances of illegal or inappropriate conduct. However

[57] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

when we have looked into the facts behind many of the media stories our experience (and indeed that of the ACCC according to its public statements on the matter) is that the allegations made in the media are not substantiated by fact;

13.8 **Are there any requirements on either franchisors or franchisees – both legal and non-legal – that exist in other countries that should be adopted to improve the Australian franchising industry?**

No. In the opinion of the FCA, the Australian regulatory regime represents world's best practice.

Ideally the FCA would like to see mediation as mandatory, and for all franchisees to be compelled to obtain legal advice prior to signing. In the FCA's experience there is a high correlation between failure to obtain expert advice and franchisee failure, or mismatched expectations. However such requests have been rejected previously in the context of suggested amendments to the federal regulatory environment, and the FCA would not support the WA Government acting unilaterally on this issue. Perhaps the State Government could take the lead by providing funding towards professional advice for prospective first time franchisees, and/or mandatory educational courses for prospective franchisees.

More broadly, the FCA supports ongoing review of the regulatory regime at a Federal level, but does not consider there to be any significant regulatory change that should be made. The Australian regulatory environment is already more prescriptive and comprehensive than most countries. It should be noted that in the UK, Singapore, Hong Kong and New Zealand – countries that are probably the closest to Australia in terms of legislative framework.

In terms of any non-legal trends, the Australian franchise sector interacts with the franchising community on a global basis. The FCA is an active member of the World Franchise Council, and frequently sponsors or hosts trade missions to or from all over the world. The Australian franchise sector thereby has ready access to the latest trends and business practices from overseas.

13.9 **"Good practice" in franchising**

It is very dangerous to consider "good practice" in the context of legislation, as that is not the role of legislation. Legislation should establish mandatory standards, not attempt to codify "good practice".

The Franchise Council of Australia endeavours, through its Member Standards and through educational and other initiatives, to provide guidance on best practice. However this is always done as guidance, not regulation. In franchising "good practice" is driven by the mutuality of interest of franchisor and franchisee. However franchising techniques are used across all industry sectors, and the business issues facing those sectors can be very different

An example of "good practice" in relation to an issue identified by this Inquiry – behaviour at the expiration of a franchise agreement – might be that a franchisor allows a good performing franchisee to continue to extend the term of a franchise beyond the initial agreed term in many instances. This is usually driven by mutual commercial interest, as otherwise the franchisor has to find and train a new franchisee or operate the business itself, which many franchisors prefer not to do. However it would be totally inappropriate to legislate this as a mandatory requirement. Indeed there would be many circumstances (including possibly the current dispute between Yum and one of its large KFC franchisees) where it would provide one party with direct commercial value or advantage. Commercial value is to be achieved by agreement, not legislation.

As to good practice generally, the FCA would simply note that many franchise systems have processes in place that supplement the regulatory environment. For example many franchisors have their own internal dispute resolution processes that endeavour to identify and resolve issues before they escalate into a formal dispute. This may involve Franchise Advisory Councils, or internal dispute escalation processes that ensure that senior management become aware at an early stage of any problem. The regulatory framework is only one part of the structure of the franchise sector that has laid the foundations for the success of Australian franchising.

13.10 Other matters relevant to the operation of franchise businesses in WA

The FCA is strongly supportive of the current Federal regulatory environment. The FCA is opposed to State regulation of franchising, as franchising is essentially a national activity and there would be no issue in franchising in Western Australia that would not apply across State borders.

The FCA considers the following issues to be important:-

(a) The FCA seeks a genuine commitment by State Governments to fully harmonise legislation that has impact beyond State boundaries and avoid the duplication, inconsistency and cost of State based regulation not only in relation to franchising, but in relation to taxation, retail tenancies, workplace issues, occupational health and safety, business regulation and property law;

(b) A commitment from State Governments to move beyond lip service to genuine reform of red tape and business compliance costs. Typically this will require the simplification of legislation and the dismantling of State based public service bureaucracies which become self-justifying and act as an impediment to harmonisation in favour of more efficient nationally integrated infrastructure.

Education

The Code expressly recommends to franchisees in the mandatory preamble required to be included on the face of disclosure documents that they "consider educational courses, particularly if you have not operated a business before." However there are only a very limited range of courses available, and previous attempts by the FCA to obtain federal funding for such courses have been unsuccessful.

Education has been determined to be critically important for the future development of the sector, in particular education of pre-entry franchisees.
The FCA continues to focus on educating our franchisor members about best practice, and those initiatives are ongoing. We, the ACCC and others have also focused on providing extensive information to prospective franchisees via our participation at franchise exhibitions, our FCA website and our publications.

Although prospective franchisees these days are much better informed than has ever been the case, there remain substantial opportunities for improvement. Perhaps franchisee education could further emphasis the risk of failure, as sometimes the publicity of the success of franchising, and even the increased security provided by the regulatory environment, makes prospective franchisees too optimistic. However it is hard to imagine more strident warnings than currently appear on the front of all disclosure documents.

There is an argument that franchise advice and education should be mandatory prior to entry into a franchise system however this then becomes a philosophical question which raises issues of government control in the economic structure of the country. Education is vital but should it be mandatory?

As to other issues, the FCA is not privy to the detail of complaints or submissions received by the Inquiry, and would be pleased to provide further comment on specific issues. The FCA is concerned to ensure that the franchise sector operates efficiently and fairly, and there is a strong positive perception of franchising in Western Australia.

In summary, based on information collected by the FCA as part of its franchisee forums and in policing the FCA Member Standards, the FCA does not believe there are any endemic problems in franchising that are not addressed by current regulation. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public.

14. General remarks and observations

The FCA has learnt from past experience that a number of matters are consistently raised by people who make representation to franchising inquiries. We felt it may assist the Inquiry if we provided our comments on some of these issues in anticipation. We would of course be prepared to expand upon our comments at any time.

The substance of previous inquiries into franchising.

The Howard Government in 1998 introduced the New Deal Fair Deal reform package, which was focused on improving trading conditions for small business. This followed a comprehensive Parliamentary Inquiry into the franchise sector. This Inquiry took evidence from all major cities and recorded over two hundred submissions. The Mathews Committee review of the Franchising Code of Conduct commenced in late 2006, and the Government's legislative response will take effect March 1, 2008. The Code amendments have bi-partisan support, and are well accepted in the franchise sector.

Disputation in franchising

Disputation is low by world standards. Research indicates a significant drop in disputation and an increase in mediation services to resolve franchise disputes as forecasted by the Parliamentary Committee when it recommended such action. Griffith University research indicates that disputes are less than 1%, with 30% of that 1% being listed as action taken by the franchisor for lack of system compliance by the franchisee. This means that the majority of disputes happen when franchisees do not follow the prescribed system, the very essence of franchising.

Good faith should apply on termination of a franchise agreement

There is currently a dispute between a major franchisee of KFC restaurants and franchisor Yum brands that we understand from media reports has been a significant reason behind the establishment of the WA inquiry into franchising. In summary, the franchisee (which is a very substantial corporation) is arguing that Yum should have to negotiate with it at the end of a franchise term to either grant a further term, or pay compensation including goodwill if the franchisor wishes to take over the sites. It is being suggested that Government legislate to create a specific statutory good faith obligation to negotiate at the end of term for a renewal.

The High Court of Australia has ruled on this issue, and the law is clear – once a franchise term ends, it ends. This level of certainty enables all those involved in franchising to understand their legal rights, and negotiate accordingly. The FCA strongly opposes any move to create a statutory right that would thereby advantage one party to a contract over another.

The FCA would be pleased to expand upon its views on this issue.

Media coverage of alleged problems

In recent times, amongst the overwhelmingly positive coverage the franchise sector has received, some media commentators have reported alleged problems within the franchise sector. A number of major franchise systems have been named as having ongoing franchise disputes, but little has been provided by way of specifics. The FCA has seen little factual support for these claims. Indeed to date the FCA has been satisfied with all explanations provided when it contacted the franchise systems in question for their comment. It would appear that there has been a rather orchestrated and consistent email campaign from a small group of disgruntled former franchisees, and encouraged by journalists keen to publish unsubstantiated assertions rather than investigate the facts.

Some media commentators have questioned the Code, without conducting any real analysis of indeed demonstrating any real understanding of how the Code operates, and called in a very non-specific way for reform. Others have criticised the ACCC, and challenged the effectiveness of the mediation system.

This is legitimate media behaviour, and to some extent a consequence of the many success stories in franchising. Journalists feel the need to try and balance the ledger. However media reports should not be the basis of policy changes. The FCA accepts that media comment may have played a part in the convening of the Inquiry, but it should play no part in its recommendations or the action Government takes in response to the Inquiries recommendations.

Questions on the effectiveness of the ACCC

The ACCC has been active in taking action against franchisors that have breached the law, having undertaken around 20 effective prosecutions. Complainants who challenge the effectiveness of the ACCC seem to treat this number as proof of the ACCC's inaction, when in the FCA's opinion it is reflective of the generally excellent standards of behaviour within the sector. The ACCC has moved very quickly in all cases, and set clear precedent in the areas of Code compliance and unconscionable conduct that benefit all in the franchise sector.

The ACCC has recently instituted a process for providing a more transparent record of its enforcement activity. To some extent this was driven by a desire to correct misinformation being publicly circulated about the ACCC's activities, and the behaviour of franchisors entities under investigation. A review of this section of the ACCC website will show that the ACCC has been thorough and professional in its activities. The ACCC has also commented publicly that there have been significant differences between assertions of fact published in the media in relation to various companies, and the facts as established by ACCC investigations.

Since 2002 the ACCC has provided leadership on the management of the Code with regular meetings with the franchise sector with its Franchise Consultative Committee. This Committee meets twice a year to discuss issues pertaining to the sector. From these meetings there have been a number of initiatives have been instigated. The FCA Member Standards were introduced to endeavour to further improve industry behaviour and address matters that, whilst not breaches of the law, might benefit from some form of third party intervention. The ACCC has recently introduced its Franchisee Start Up Checklist, and there are various educational initiatives in progress.

Is there sufficient pre-entry education of franchisees?

No. Education has been determined to be critically important for the future development of the sector, in particular education of pre-entry franchisees. The FCA has proposed many initiatives, but funding has not been made available. The FCA focuses upon educating our franchisor members about best practice, and those initiatives are ongoing. We, the ACCC and others have also focused on providing extensive information to prospective franchisees via our participation at franchise exhibitions, our FCA website and our publications. Prospective franchisees these days are as a result much better informed than has ever been the case, a fact verified by our franchisor members in industry forums. With full employment, franchisee recruitment is a competitive business and standards are continually rising not to meet compliance obligations, but to secure the best franchisees by providing the best returns and security of investment.

Do existing laws prevent "churning" in franchising.

Yes they do. Prior to 1998 there were allegations of "churning" in franchising in Australia. What was happening, in a small number of franchise systems, was that franchisors were in essence selling franchises that were not viable. When the franchisee failed, the franchisor in essence resold the same franchise. This happened in particular in the service sector, where the costs of the franchise were relatively low and there were not premises or other complications. Although franchisees lost money, and would have had a pretty good legal claim under s52 of the Trade Practices Act, the cost of legal action to recover perhaps $20,000 - $30,000 was somewhat prohibitive, particularly as the franchisors themselves were often marginal in terms of asset backing.

The Government quite rightly addressed these issues in the New Deal Fair Deal reforms, which included the Franchising Code of Conduct but also featured a new prohibition on unconscionable conduct and provided increased funding for the ACCC to regulate the sector. The Franchise Council of Australia also acted, including a specific prohibition in their Member Standards on selling a franchise when there was no reasonable prospect of it being profitable.

The reforms in 1998 have strengthened the law and protected franchisees in the following specific areas:-

- the mere introduction of the Code, backed by the ACCC's careful supervisory eye, has introduced barriers to entry for franchise systems that keep out most of the marginal operators;
- any allegation of "churning" in Australia post 1998 would constitute a clear breach of not just the Code, but s52 of the TPA and probably s51AC (unconscionable conduct). The ACCC would therefore have to become involved on receipt of any complaint;
- the ACCC has done an excellent job of enforcement. As soon as the ACCC receives a complaint alleging breach of the law they act promptly and professionally.
- the Code requires specific disclosure of the history of a particular premises or site. This has been augmented by the most recent reforms;
- the franchisor has to provide substantial information concerning its financial history, in fact over 250 separate pieces of information;
- the Code requires specific disclosure of franchisee exits. This has been further augmented by the most recent reforms, which in effect enable a prospective franchisee to contact all recent previous franchisees including those who may have departed the system.

The commercial reality is that franchise systems get no financial or other joy from the business failure of a franchisee. Invariably the franchisors lose money as well, through unpaid royalties, the costs of operating the business while a solution is sought, the costs of recruiting and training a new franchisee, the cost of concessions given to any new franchisee to get the business back up and running etc.

Systematic failure, or unsolvable problems?

The Inquiry will no doubt receive submissions from various parties asserting that the current regulatory framework is inadequate. The real issue to determine is whether, in the context of the stated objectives of the Code, there is a systemic problem within the sector that requires change to a successful regulatory structure. The FCA is not privy to all submissions, so cannot provide a pre-determined response. However our own experiences with the FCA Member Standards provides some insight into the likely nature of submissions you will receive. To the extent that they are of commercial substance they are likely in the main to relate to matters already covered within the Code, to matters that would be a breach of existing law such as the Trade Practices Act, to conduct of third parties such as landlords, to matters that resulted from poor franchisee due diligence or to matters for which it would be almost impossible to provide any legislative protection.

Any change will create costs

It should be recognised the cost of compliance is already quite high, and any changes at all will add to the cost. The FCA and its members would strongly resist any proposal which increased compliance cost in a sector already burdened with comprehensive Federal Government compliance.

"Franchisor does not fully disclose"

The Code requires franchisors to disclose more than 250 items as a starting point to the franchisee's due diligence. The disclosure document is not intended to be an exhaustive source of all information – as stated on the front page it provide "<u>some</u>" of the information required to make an informed decision. Franchisees must accept responsibility for the investment decision. They cannot simply assert that the franchisor did not "fully disclose." Franchisees are clearly warned to "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

Further,s52 of the TPA applies to disclosure. Irrespective of the Code requirements, if a franchisor provides a compliance disclosure document but fails to disclosure a material fact that would have altered the franchisee's decision to proceed the franchisor is likely to have breached s52 of the TPA. The Code does not provide a defence to a s52 claim – that claim is judged on its separate merits.

The Code provides for the franchisee to seek legal, business and accounting advice. If advice is obtained any non-disclosure would be apparent to the relevant expert, and therefore the franchisee.

"Franchisor does not disclose trading figures"

Many franchise systems do provide historical trading figures as a matter of course, whilst others will provide them on request. There is no obligation on a franchisor to do so, and considerable risk in the context of a potential s52 claim should the franchisor provide any financial information. Such an obligation could not be mandated in the Code, as it would expose franchisors to unreasonable compliance costs and liability. A prospective franchisee has access to existing franchisees, and can thereby obtain much of this information other than via the franchisor. Ultimately this is a factor for the franchisee to consider when making an informed decision – if figures can not be substantiated, the franchisee should not proceed.

The franchisor is restricted in providing income projections by the Code and is restricted to historical information unless the franchisor wishes to take on the additional liability for projections contained in s51A of the TPA. Some franchisors provide a variety of trading actuals from franchisees within the system. Others provide full disclosure of all franchisees trading. Others provide nothing fearing the implications of Section 51A and 52 of the Trade Practices Act.

"Poor advice received"

Such an assertion should be treated with caution. It is true that the quality of understanding of franchising outside the franchise sector, and indeed possibly within it, is variable. However most advisers would have professional indemnity cover should poor advise be provided.

A far bigger problem is franchisees failing to seek advice.

There is an argument that franchise advice and education should be mandatory prior to entry into a franchise system however this then becomes a philosophical question which raises issues of government control in the economic structure of the country. Education is vital but should it be mandatory?

The FCA is currently establishing an accreditation system for those providing advice to franchisees, and is broadening its educational activities to legal and accounting professional bodies. The FCA considers no other action is necessary.

"the Franchisor has too much power"

The relationship between the franchisor and the franchisee is a contractual relationship akin to a commercial partnership. It is not a relationship of equals. The franchisor generally has more risk and money invested, has developed the brand and requires trading consistency within the market. Therefore the franchise business format model requires the franchisor to control aspects of the franchisee's behaviour that are relevant to the brand and the performance of the network. Decisions may need to be made that could affect the franchisee. This is the nature of franchising, and is clearly outlined within the franchise agreement. It should not be a surprise if a franchisee has undertaken appropriate due diligence.

Understanding the franchise relationship and the rights the franchisee has is a vital element within the relationship and this is why the Government advised franchisees to seek advice prior to entering the agreement. If a franchisee does not seek advice and then disputes the franchise agreement and the Disclosure document - is this the franchisor's responsibility of the franchisee's?

Retail Leasing Issues

As identified in the Fair Trading Inquiry in 1997, the practice of the landlords in major shopping centres continues to impact upon the relationship between the franchisor and the franchisee. The Landlord has monopolistic powers within standalone shopping centres and although most state legislation seems adequate the manipulative powers of the landlord prevails.

State legislation does not address the three major issues:

- excessive rent reviews;
- inadequate tenure and lease terms; and

- unequal information and bargaining power.

Issues of lease renewal and other tenancy matters can impact upon a franchisee and they can remain captive to a site because of the power the landlord has which therefore impacts upon the Franchising Code of Conduct provisions and the relationship between the franchisor and franchisee.

In its submission to the Mathews Committee the FCA recommended that the Federal Government review the retail leasing market and introduce a Code of Conduct for Shopping Centre management. This Code should provide that:

(1) landlords cannot increase rent beyond a specified multiple, say 15%, without providing clear written justification and being subject to an appeal process to ensure franchisors and franchisees are not held to ransom in their captive market;

(2) lease terms must be such as to ensure an adequate return or investment for a tenant;

(3) landlords must provide on request all available rental information in a shopping centre in the event of any rental dispute.

Appendices

1. FCA Industry Report

(Please note that the information, statistics and list of members in this Industry Report were accurate as at May 2006. Some aspects of the Report are no longer current. The FCA Chairman is now Mr John O'Brien, and some of the statistics have been superseded by the statistics contained in the body of this submission. However the essence of the Report remains relevant.)

2. FCA Member Standards

Appendix 1

FCA Industry Report

FRANCHISE COUNCIL OF AUSTRALIA REPORT ON THE CURRENT STATE OF AUSTRALIAN FRANCHISING

Prepared by the Franchise Council of Australia
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15. The Franchise Council of Australia

The Franchise Council of Australia (FCA) was formed in 1983 and is the peak industry body in Australia, with responsibility for representing all sectors of the franchise community. It is a not-for-profit membership based association, and does not receive ongoing government funding.

As franchising is a global activity, the FCA is affiliated with franchise associations around the world and was a founding member of the Asia Pacific Franchise Confederation. It is also an active member of the World Franchise Council. This enables the FCA to have access to the latest global information on franchising, and to receive information on any franchising trends that may have relevance to the Australian market. The international links are also intended to assist Australian systems to enter foreign markets.

The FCA has excellent relations with the Australian Competition & Consumer Commission (ACCC), the Office of Small Business, Austrade and other industry bodies. The FCA meets regularly with the ACCC and is a key member of the ACCC Franchising Consultative Committee.

Membership of the FCA is open to individuals and organisations that are involved in franchising. There are several membership categories designed to accommodate franchisors, franchisees, advisors and service providers. A list of current members of the FCA is included at Appendix 1.

The FCA is structured to enable the organisation's professional management team to access the collective intellect of its members to supplement the skills and experience they bring to the FCA. Chief Executive Richard Evans, a former Federal parliamentarian with extensive franchising and small business experience, has day-to-day responsibility for the operations of the FCA, with his personal focus being the interface between the franchise sector and other stakeholders such as Government and the public. Other FCA employees have specific skills in education, event management and member services.

At a strategic level, a board of ten directors manages the FCA. Five directors are State Chapter Presidents, who each preside over a State Chapter Committee and are elected by the respective state chapter members. The other five directors are elected on a national basis at the Annual General Meeting. At least three of the five nationally elected directors must be either a franchisor or franchisee. There are State chapters in New South Wales, Queensland, South Australia, Victoria and Western Australia, with a National Secretariat based in Melbourne.

A list of current directors and senior executives of the FCA is set out in the table below. A brief summary of their franchising experience has been included to illustrate the skills and experience available to the FCA.

Chief Executive Officer	Richard Evans	A former franchisee who entered Federal politics as the Member for Cowan in 1993. Richard served on the House of Representatives Committee that handed down the landmark Fair Trading Report, which resulted in the introduction of the Franchising Code of Conduct and other reforms.
Chairman	Stephen Giles	Partner with Deacons and generally acknowledged as Australia's leading franchising lawyer. Author of numerous publications including Franchising Law & Practice, The Franchisor's Manual and Going International – A Guide for Australian Franchise Systems.
Deputy Chairman	John O'Brien	Managing Director and owner of Poolwerx Corporation, John O'Brien (PoolWerx Corporation) has the unique distinction of having been an Australian Franchise Council Franchisee of the Year (Queensland), inaugural Australian Master Franchisor of the Year, Franchisor of the Year (services category – twice), and current Australian Franchisor of the Year outright. His experience in the franchising sector spans more than 20 years.
Victorian President & Finance Director	George Yammouni	George Yammouni, B.Bus., Director, George Yammouni, B.Bus., Director, George is the CEO of the Bathroom Werx Group (which includes Mend-A-Bathroom) - a National Franchise System which specialises in bathroom restorations and renovations. Having started life as a Franchisee in 1986, he acquired the Australian Franchise in 1988 and then began franchising in 1990. Serving on Victorian Chapter Committee since 1993 and is currently Chair of the FCA Board Finance Committee.
NSW President	Ken Roseberry	Ken Roseberry is Chief Executive Office of Fastway Couriers, a position he has held since 2002. Fastway was established in Australia in 1993, boasts nearly 500 franchisees Australia-wide, and is a previous winner of the FCA's 'Franchise System of The Year'. Fastway now operates in 12 countries. Ken's other career highlights include being the CEO of; Australian Geographic, Qantas Holidays, Tourism Queensland, the Gold Coast Indycar Grand Prix, and promoter of the 1988 Bicentennial First Fleet Re-Enactment. Ken holds an MBA and has served on the FCA NSW Chapter for the past two years, being elected as Vice President in 2005.
Qld President	Philip Ciniglio	Philip has over 30 years of business, sales and marketing experience through his involvement with large global corporate organisations such as Bridgestone, Century Yuasa Batteries and Retail Food Group, having held senior positions in General Management, marketing, sales management and franchising. Philip has been associated for over 20 years with the Franchise Council of Australia and is currently a Director on the National Board and President for the Queensland Chapter.
WA President	Steve Hansen	Stephen is the Managing Director of the fast food chicken chain "Chooks Fresh & Tasty", formerly River Rooster. Steve started his career in banking, spending 4 years in PNG and many branches in the West. Steve started in franchising in 1983 as a franchisee, becoming a franchisor in 1991 with the River Rooster Brand. Steve has been involved with the FCA WA chapter for over 8 years and is passionate about franchising.
SA President	Steve Butler	Steve Butler is the National Franchise Manager for Beaumont Tiles, who are the largest distributor of ceramic wall and floor tiles in Australia. He has been in this position for 5 years. Prior to this he owned 3 South Australian Beaumont Tiles franchise outlets for a period of 15 years and has been in this industry for just under 30 years. He has served on the committee of the FCA in South Australia for 3 years, Vice President last year and recently taking on the role of President.
	Chris Malcolm	Chris Malcolm has been active in franchising for over 15 years. Initially with Solomon's carpets, he has more recently been involved with the Clark Rubber brand and has reinvented it as a vibrant modern retail network. Chris had a 2-year chairmanship of the Franchise Council of Australia during the mid 1990s and guided the Association through a restructuring process that resulted in a reinvigorated organisation with a national focus. Chris served for 5 years on the national board of the FCA, and is an active participant in the franchising debate.
	John Longmire	John owns five Just Cuts salons in the ACT and employs 80 staff. Prior to entering franchising John worked in government for 15 years. He started in franchising in June 1994 with the first Just Cuts salon outside of Sydney and is now part of an Australia-wide network of 120 salons. John was Highly Commended Franchisee of the Year in 1995 and 1996, the NSW/ACT Franchisee of the Year in 1998, and 1999 and the National Franchisee of the Year in 1999.
	Noel Carroll	Noel Carroll co-founded Michel's Patisserie, a multi-award winning franchise system he built to over 350 outlets. Michel's was Franchise System of the Year in 2003 and 2004. Noel has recently also taken an interest in two emerging franchise systems in the health and hairdressing field. Prior to Michel's, Noel's 15 year corporate career included senior management roles with S.A. Frozen Foods, R.M. Gow Frozen Food Division, McCain Foods, Sara Lee and Defiance Milling.

16. Executive Summary

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers to the franchise sector. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. A list of current members of the FCA is set out in Appendix 1.

The franchise sector in Australia makes a very substantial contribution to the Australian economy. Industry turnover is estimated at $111.5 Billion, or 3.2% of Australian Gross Domestic Product. The sector has around 900 franchise systems, 53,500 units and employs 550,000. The indirect impact of franchising is estimated at 1.5 times these figures.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has changed in recent years, with the sector maturing substantially since 1998 both in terms of size and conduct. Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished to some extent by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. The predecessor body to the FCA, the Franchisors Association of Australia, was fundamentally a franchisor networking group, and was described in Federal Parliament as unrepresentative and “controlled by a small cabal of franchisors”. This is a far cry from the multi-representative and highly professional industry body the FCA is today.

The regulatory framework established by the Federal Government in 1998 has made a very important contribution to the success of Australian franchising. It provides strong regulatory protection for franchisees through the Franchising Code of Conduct, which is administered by the Australian Competition and Consumer Commission. A copy of the Franchising Code of Conduct is in Appendix 2. In addition to the Code, the Commonwealth Trade Practices Act’s prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions. As a consequence we have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world’ best practices.

The FCA worked closely with the Government in preparing the Franchising Code of Conduct. This work continues today to ensure there is ongoing review and amendment of the Code as required. There is also a strong ongoing collaborative relationship with the Australian Competition and Consumer Commission in regard to the Code, and the application of the Trade Practices Act within franchising.

The current regulatory environment finds the correct balance, providing a strong regulatory framework without unnecessarily impeding the flair of franchising entrepreneurs. Mr. Peter Reith, Federal Minister for Workplace Relations & Small Business, in his Foreword to the Franchising Code of Conduct commented as follows:

> *"Franchising is one of the fastest growing business sectors in Australia. Franchising is a unique way of doing business, built on mutual trust. The growth and development of franchise systems is dependent upon the relationship between the franchisor and its franchisees…. The Commonwealth Government is strongly committed to the growth and prosperity of the franchising sector."*

Although growth slowed for a very short period while the sector came to grips with the new compliance obligations, growth has continued since 1999 at similar rates to the pre-Code period. Importantly the regulatory framework has dramatically reduced the levels of disputation and enhanced the public perceptions of franchising. Largely as a result of the mediation based dispute resolution process contained in the Code, strong enforcement oversight by the ACCC and pro-active educational activities conducted by the FCA, disputation in Australian franchising is now extremely low. The Franchising Australia 2004 Survey estimates that around only 1% of franchisees are in “substantial dispute”, with “substantial dispute” being very broadly defined beyond just litigation to include anything involving a solicitors letter or above. This compares extremely favourably with the United States, where the level of disputes is estimated at around 6% and many disputes are resolved in the courts. The Code’s mediation based dispute resolution process has been an outstanding success, with around 75% of all franchise disputes in Australia resolved by mediation.

The FCA has further strengthened the franchise sector framework by introducing its Member Standards of Conduct. The Member Standards do not impose new legal obligations on franchisors, but they provide greater detail in terms of typical expectations of franchisors and service providers and introduce additional mechanisms for the FCA to be able to monitor behaviour and intervene pro-actively to ensure disputes are resolved quickly and cost effectively. A copy of the FCA Member Standards is in Appendix 3. Most franchise complaints today do not involve breaches of the law, but rather mismatched expectations. By taking control of the complaints process, the FCA aims to ensure such mismatched expectations do not escalate into court cases or media field days that harm the hard earned good reputation of Australian franchising.

With the prospect of an enhanced compliance process, and widespread adoption of comprehensive risk management systems, business risk for franchisees and franchisors is likely to further reduce. New developments in the area of specific franchise insurance products and further innovations in franchise sector lending are likely to drive further growth and development of the sector. Franchise systems are well placed to surf the wave of industry mega-trends, and meet the increasingly demanding needs of customers due to the unique relationship of the franchisor and franchisee. Franchisors can focus on branding, systems design and compliance management, while franchisees can concentrate on the customer relationship, delivering superior customer service and providing the coalface information needed to drive innovation and system improvements.

17. The Economic Impact of Franchising in Australia

17.1 Franchising Australia 2002

The FCA has commissioned regular independent surveys of the franchise sector. All paint a similar picture of growth, development and business success. One of the most relevant remains *Franchising Australia 2002, the Commonwealth Bank Franchising Survey*, released in August 2002. The survey was undertaken by Griffith University and sponsored by the Commonwealth Bank, and provided one of the most comprehensive reports on the status of the franchising sector in Australia. Much of the information remains relevant today.

The report confirmed the continued growth and increasing maturity of franchising in Australia. It also provided an insight into the economic contribution, development, trends and concerns of the sector. Speaking at the FCA national conference, FCA Chairman Stephen Giles welcomed the survey as further evidence of the value of the franchise sector to the Australia economy:

> *"It is now beyond rational argument that franchising delivers competitive advantage to the franchisors and franchisees that embrace best practice franchising principles in their business. The franchise sector delivers $80 billion in annual turnover, employs 500,000 people, has around 420,000 permanent employees, generates $292 million in annual export earnings, and has 90% of its business owners earning profits beyond wages. These are stunning figures."*

The FCA Chairman went on to note that the survey confirmed, contrary to some perceptions, that there is a very low level of disputes in franchising.

> *"It is pleasing to see that less than 1% of franchisees were involved in a "substantial dispute" with their franchisor, meaning a dispute involving litigation, mediation or correspondence with a solicitor. 81% of franchisors recorded no substantial disputes at all in their system in the past 12 months. These are important statistics for those thinking of buying a franchise, and further signs of the increased maturity of the sector."*

The key points of the Franchising Australia 2002 Survey, which was the first of its kind since 1999, were summarised as follows:

- There were approximately 700 franchise systems in Australia, or 3 times as many per head of population as in the USA. (This figure has now risen to around 900 according to Franchising Australia 2004 and the IBISWorld Report.) Over 90% of these systems were home grown. On average, Australian franchisors have been operating for 15 years, and franchising for 9 years.

- There were almost 50,000 franchised outlets. (This figure has now risen to around 60,000.) The number of franchised units had grown by 8.5% since 1999. An indicator of the success of franchising, and indeed the increasing maturity of the sector, was that the average number of franchised units per franchise units had grown by 100% since 1999.

- Franchising was big business in terms or export earnings, much bigger than had previously been appreciated. $292 million per annum was generated from overseas operations of Australian franchisors in 2001. 25% of Australian franchisors had expanded overseas, with 62% indicating an intention to do so in the next 3 years. This was up from 22% in 1999. New Zealand was the most popular destination (74%) followed by the UK (36%), USA (34%), Singapore (34%), South Africa (26%) and Europe (26%).

- The sector employed approximately 500,000 people, with permanent employment having risen dramatically to 83.5% of the workforce. This figure is now estimated at around 600,000.

- The level of disputation in franchising continued to fall, with less than 1% of franchisees in serious dispute with their franchisor. As with the 1999 survey, the top causes of substantial disputes were lack of compliance with the system (27%) and payment of fees (15%). Franchise re-sales provided further evidence of the strength of the sector, with 74% of franchisee exits resulting from sale of their business. Where the exit was due to franchisor or franchisee termination, lack of suitability to franchising and personal/family reasons were the main exit reasons identified.

- Franchised businesses remained affordable, with average start up costs being $62,500 for mobile and $208, 000 for fixed location franchisees (excluding GST).

- Although there is risk attaching to every business, 90% of franchisees were reported as earning profits beyond employee wages. This figure compared extremely favourably with the small business sector generally.

- Although the Franchising Code of Conduct had improved franchisor/franchisee relationships (53%), been beneficial to the sector (79%) and required franchisors to keep more detailed records (62%), there remained issues to be addressed to improve the effectiveness of the Code. The embryonic nature of the franchise mediation was demonstrated by the survey finding that, despite the requirements of the Code to attempt to resolve disputes through mediation, more disputes were in fact resolved through litigation (23%) than mediation (17%). It is important to note that this figure has now changed very dramatically, with most franchising disputes referred to mediation, and mediation achieving success in around 75% of cases.

- Cost of compliance, difficulty and uncertainty in compliance, excessive disclosure requirements and the ACCC influence over the sector rated highly as concerns in the regulatory area. These concerns have largely evaporated.

- Lack of suitable franchisees and insurance cover and cost were rated the most critical business issues by franchisors.

17.2 Franchising Australia 2004

The results of the Franchising Australia 2004 Survey conducted by Griffith University confirmed the continued growth in franchising in Australia and revealed that franchising techniques were in use in most industry sectors.

The research identified a total of 850 business format franchisors in Australia. The sector comprised 50,600 franchised outlets, together with around 3,400 company owned outlets. The growth from 1994 had been substantial, as the Australian Bureau of Statistics reported a total of only 24,500 franchised outlets in 1994. The growth in franchised outlets was 14 percent per annum from 1991 to 1994 (ABS) and 15.5 percent from 1989 to 1991, confirming a decade of strong performance.

Probably as a result of compliance responsibilities associated with the introduction of the Franchising Code of Conduct, the growth in 1999 reduced to around 6%. However, between 2002 and 2004 growth increased again to 14%.

The 1998 Survey revealed that the total turnover of business format franchised outlets was $22.4 billion, with $14.1 billion in turnover for company outlets, yielding a combined total of $36.5 billion. Motor vehicle and automotive fuel retailers were not included in these figures. If these groups are added, the estimated turnover is in excess of $80 billion. The total number of people employed in business format franchise systems (including motor vehicle retail franchises and automotive fuel retail franchises) at the time of the 2004 survey was around 600,000. 33% were permanent full-time employees, 50% permanent part-time and 17% casual employees.

17.3 Other relevant statistics

The various franchising surveys have provided the following additional information on franchising in Australia:-

- 10% of franchises are owned by couples, 74% are owned by men and 9% by women. A significant proportion (43%) of those owners are in the 41-50 years age group. Single unit franchise ownership is the norm in Australia, although the number of multi-unit franchise owners continues to grow. Master franchising and sub-franchising are common expansion methods, particularly for mobile or service franchise systems.

- Franchising continues to expand through all regions of Australia. New South Wales and Australian Capital Territory (31%) have the greatest concentration of outlets, similar to the population distribution. However, Queensland (22%) and Western Australia (13%) continue to exhibit a greater acceptance of franchise systems in that they host noticeably larger proportions than their populations.

- Of the total franchise systems in Australia, 95% were business format franchise systems, 0.4% were motor vehicle franchise systems and 0.1% were major auto fuel retail franchise systems.

- Australia is the most franchised nation per head of population in the world. That is, there are more franchise systems in Australia compared to our population than any other country, and Australia has at least three times as many franchise systems per head of population than the United States.

- The average length of time that current franchise systems have been franchising is 8 years.

- Franchising enjoys a small business success rate more than 2 and a ½ times greater than stand-alone small business. Each year, only 1% of franchisees leave their businesses.

- In 2002 24% of Australian franchise systems operated overseas, with a further 27% of systems planning to commence foreign operations within the next 3 years.

17.4 IBISWorld Report information

The IBISWorld Industry Report of 3 February 2006, which is the most recent industry report, confirmed the substantial contribution of franchising to the Australia economy. IBISWorld estimated that in 2004/05:

- the sector generated gross revenue of $111.5 billion;

- gross domestic product was $27.3 billion, or 3.2% of total Australian GDP;

- this turnover was an increase of 9.7% on 2003/04;

- there were 53,500 units;

- there were 900 franchise systems; and

- the sector employed 550,000 people, for a total wage bill of $15.9 billion.

Strong growth had been experienced in previous years, with turnover growth rates of 16.1%, 11.0% and 9.7% in the past 3 years. In the same period the number of franchise units had grown by 5.1%, 8.5% and 5.7% and the number of franchise systems by 10.7%, 9.7% and 5.9%. Employment had grown by 15.8%, 12.7% and 8.4%, and total wages by 18.3%, 12.4% and 8.1%.

The IBISWorld Industry Report determined food retailing to be the leading segment at 31.0%, with non-food retailing (furniture, books, whitegoods and clothing) at 30.0% and property and business services (real estate, finance, building) at 24.0% and other including education, training, domestic services, automotive and childcare) at 15.0%. It noted that financial services and retail food had experienced the strongest growth in recent years, but every area of commercial activity had been subject to some growth via franchising.

The distribution of franchise units amongst the States and Territories was generally consistent with population levels and availability of suitable premises. New South Wales had 31% of franchise units, followed by Queensland and Victoria at 22% each, Western Australia at 9%, South Australia at 8%, Tasmania at 4% and ACT and Northern Territory at 2% each.

In the 5 years to 2004/05:
- the sector experienced average revenue growth of 5.5%;
- gross domestic product grew by 4.0% per annum; and

- the number of systems grew by an average of 5.8%.

Turning to the future, IBIS World offered the following predictions:

	Revenue	Growth	GDP	Growth
2005	$111.5 Billion	9.7%	$27.3 Billion	8.3%
2006	119.3 Billion	7.8%	$29 Billion	6.0%
2007	$125.3 Billion	5.0%	$30.3 Billion	4.5%
2008	$132.8 Billion	6.0%	$31.9 Billion	5.5%
2009	$139.4 Billion	5.0%	$33.6 Billion	5.2%
2010	$145.7 Billion	4.5%	$35.2 Billion	4.8%

This yields an average annual growth of 5.5% in revenue, and 5.2% in GDP, which compares favourably to the predicted growth in Australian GDP of 3.5% over the same period.

IBISWorld concludes that the sector will transcend from the growth to mature stage of its lifecycle, but notes that "there is still room for the domestic growth in the franchising sector as low failure rates and low levels of disputation along with the relative security and stability of the sector attract small business investors. Investors are increasingly looking for new expansion opportunities internationally….as much future industry growth will come from offshore opportunities" (p39). BRW (June 23-29, 2005) predicts that the sector is set to continue experiencing strong growth, and IBIS World quotes PriceWaterhouseCoopers as predicting that the sector will double in the next 15 years and account for around 24.0% of Australian GDP.

17.5 Indirect impact of franchising

The International Franchise Association released a report on the direct and indirect impact of franchising in the United States by PriceWaterhouseCoopers. PWC determined that the direct and indirect impact of franchising in the US economy was approximately 1.5 times the direct impact. Although no similar report has been conducted in Australia, there are such strong similarities between US and Australian franchising that the indirect impact of franchising in Australia is likely to also be around 1.5 times the direct impact.

17.6 International statistics

The growth and development of franchising has been a global mega trend. The following information extracted from statistics provided by the World Franchise Council in 2004 indicate the penetration of franchising into many developed economies.

Country	**Franchise Brands**	**Total Outlets**	**Sector Turnover (Billions)**	**Sector Employment**	**Total Population**
EUROPE					
Austria	330	4,700	EU 3.00	60,000	8,174,000
Belgium	100	3,500	US 2.80	30,000	10,348,000
Czech Rep.	90	300			10,246,000
Denmark	128		US 0.07	22,316	5,413,000
Finland	177	3,666	EU 4.88	46,000	5,214,000
France	835	62,981	EU 94.78	400,000	60,424,000
Germany	845	45,200	EU 28.00	406,000	82,424,000

Great Britain	718	31,300	EU 13.30	327,000	60,270,000
Greece	430	6,540			10,647,000
Hungary	300				10,032,000
Italy	708	44,426	EU 16.90	117,783	58,057,000
Latvia	8				2,306,000
Netherlands	453	19,600	EU 18.80	187,000	16,318,000
Poland	210	13,500	EU 1.10		38,626,000
Portugal	489	8,500	US 3.40	53,000	10,524,000
Russia	95	1,850			143,782,000
Slovenia	106	980			2,011,000
Spain	650	42,554	EU 14.00	186,000	40,280,000
Sweden	300	9,600	EU 8.42	67,000	8,986,000
Switzerland	180				7,450,000
Canada	850	80,000	US 90.00	1,000,000	32,507,000
USA	1500	760,000	US 1,500.00	9,700,000	293,027,000
LATIN AMERICA					
Argentina	300	10,000	US 2.00	180,000	39,144,000
Brazil	814	59,028	US 1.00	531,000	184,101,000
Columbia	120	4,667		35,000	42,310,000
Mexico (year 2005)	720	462,000	US 50.00	500,000	104,959,000
ASIA					
PPR China	2,100	120,000	US 29.60	2,400,000	1,298,847,000
Hong Kong	92	3,000			6,855,000
India	850	48,000	US 3.80	300,000	1,065,070,000
Japan	1,100	220,000	US 170.00	2,000,000	127,333,000
Malaysia				500,000	23,522,000
Philippines (year 2003)	850	68,000		1,000,000	86,241,000
Singapore	380	3,000	US 2.00		4,353,000
PACIFIC					

Australia		720	US 62.00	600,000	19,913,000
New Zealand	350				3,993,000
AFRICA					
Egypt					76,117,000
South Africa	391	22,895	US 19.90	285,000	42,718,000

18. History of franchise regulation in Australia

18.1 The Current Regulatory Regime

The franchise sector in Australia is regulated by the Franchising Code of Conduct, which was introduced with effect from October 1 1998, as part of a range of Federal Government initiatives called the *New Deal: Fair Deal* reforms.

The Franchising Code of Conduct is a mandatory industry code prescribed by regulations under the Trade Practices Act (TPA) Pt IVB. The Franchising Code of Conduct was introduced by the Trade Practices Amendment (Fair Trading) Act 1998 in response to strong criticisms of business conduct in the franchising sector, in a report to the Federal Government known generally as the Fair Trading Report. At the same time the Federal government also introduced section 51AC of the TPA, which prohibits unconscionable conduct in small business transactions. Although not specifically targeted at franchising, section 51AC, in tandem with the broad and general prohibition of misleading or deceptive conduct under section 52 of the TPA, confers significant additional protection on franchisees.

The Franchising Code of Conduct is an important development for the Australian franchising sector. It imposes significant obligations on franchisors in relation to prior disclosure, substantive obligations and dispute resolution. The Code was modelled on the previous voluntary Franchising Code of Practice, but evolved considerably in scope and application during the exposure draft stage. During this stage the Franchising Policy Council, appointed to advise the government on its initial content and ongoing review, consulted widely with the sector. As a result some of the clauses in the draft Code which dealt with relationship or conduct issues, such as those which imposed obligations to pay compensation on termination of a franchise in certain circumstances, were removed.

The introduction of the Code does not limit the operation of the general law, which continues to govern the formation and general operation of franchising relationships. The main areas of law influencing franchising are contract, restrictive trade practices, intellectual property, consumer protection, fair trading, and revenue laws, in addition to retail leasing. Franchising is also subject to the TPA, which focuses upon competition and consumer protection. Of particular relevance to franchising is the prohibition on “misleading or deceptive conduct” contained in section 52.

18.2 The Origins of the Franchising Code of Conduct

The debate on the difficult issue of whether franchising should be subjected to a specific regulatory regime, commenced shortly after the introduction of business format franchising in Australia in the early 1970s.

Since 1981 the franchising sector in Australia has been subjected to a variety of regulatory regimes. Initially there was no regulation except under the general law (pre-1981). Then, in effect by accident, the sector was subject to quasi-regulation under the “prescribed interest” or “investment security” provisions of the Corporations Law (1981-87), to deregulation (1987-93), and to self-regulation pursuant to a voluntary Code of Practice (1993-96).

Until 1981 franchising was regulated only by the general laws governing all commercial relationships. The only exception was the regulation imposed on retail petroleum franchising through the *Petroleum Retail Marketing Franchise Act 1980* (Cth). However this changed when the Supreme Court of Western Australia held in *Commissioner for Corporate Affairs v Casnot Pty Ltd* (1981) ACLC 40-704, that an advertisement for a cleaning franchise was subject to regulation under the “prescribed interest” provisions of the then *Companies Act 1981*. These provisions dealt with the offering to the public of certain “investment schemes”.

This decision subjected franchising to an inappropriate regime more applicable to company securities and shares. This was compounded by the decision in *Commissioner for Corporate Affairs v Casnot Pty Ltd*, which allowed the National Companies and Securities Commission (NCSC) to assume jurisdiction for franchising, requiring franchisors to comply with a number of statutory requirements.

The Corporations Law provisions prohibited a company from issuing a "prescribed interest" unless the company:

- was a public company;
- had issued a prospectus;
- had in place an approved trust deed; and
- had appointed an approved trustee.

The promoter and relevant employees were required to hold security dealers and dealers' representatives licences. The legislation went on to specify quite significant requirements to be inserted in the documentation. Compliance with these requirements imposed a substantial cost upon a franchisor. Significant civil and criminal sanctions applied to any breach of those requirements.

The problems created for the franchising sector were ameliorated by the governing body (then the NCSC, and now known as the Australian Securities and Investments Commission), which had the power to exempt a company from compliance. The NCSC accepted arguments that a franchisee was seeking a business opportunity rather than making a passive investment, and hence it was appropriate for there to be less protection. The acquisition of a franchise was known to carry certain risks, which a franchisee was better equipped to assume, and indeed influence, than a passive investor. Accordingly the NCSC issued a formal release (Policy Statement 118) which provided that franchisors would be exempt if they complied with certain less onerous requirements. The exemption was available if the franchisor was a company, whether private or public, and the franchise agreement contained certain provisions, relating inter alia to:

- the use of a trust fund;
- the consent to assignment;
- a cooling-off period; and
- an obligation of disclosure.

The regime saw the first disclosure document requirement, which was conceptually a precursor to the disclosure document that is central plank of the Franchising Code of Conduct.

The NCSC was required to approve the franchise agreement and disclosure document before the exemption could apply.

Whatever the problems that resulted from the absence of regulation, they were not resolved by the arbitrary, complex, onerous and inappropriate regulation pursuant to the "prescribed interest provisions". Between 1981 and 1987 the interest provisions imposed a regime not specifically structured for franchising. By the mid-1980s the situation had become unworkable. National Companies and Securities Commission Policy Statement 118 requirements were less onerous, but nevertheless inappropriate for franchising. The requirements only applied when the prescribed interest was offered to the public, which led one commentator to advise that, "the sure way to avoid the Companies Act regime is to avoid advertising franchise opportunities to the public". Additionally, where it is considered necessary to advertise it was thought that it may be possible to structure the advertisement so that it merely provides a broad and vague outline of the proposal, and invites the reader to apply for information. However, a more basic problem was the emerging judicial divergence of opinion among State Supreme Courts as to whether the sale of franchises actually constituted prescribed interests.

The quasi-regulated era was brought to an end by the removal of franchising from the scope of the Companies Act by legislative amendment in 1987. Franchising then operated in a deregulated era, governed only by the general laws regulating all commercial activity until 1993.

A Franchising Task Force was established in 1990 to "examine impediments to the growth and efficiency of the franchising sector" and to "examine and report on the potential of self-regulatory codes for countering marketing failure in franchising, focussing on Business Format Franchising". The Task Force recommended a self regulatory Code of Practice administered and maintained by a council of representatives from all areas of the franchising sector. The recommendations were accepted by the Commonwealth, state and territory governments and the Code of Practice came into operation on 1 February 1993. The Code of Practice was authorised by the Trade Practices Commission on the basis of public benefit; it attempted to raise standards in the sector and to apply these nationally and uniformly across a diverse range of industries. Additionally, as an alternative to government legislation, the Code would avoid the attendant costs of implementation and enforcement.

There were 5 editions of the Code during its short life, primarily in the nature of improvements and clarifications than changes of major significance.

Voluntary compliance with the Code was sought from franchisors, advisers and service providers. They were encouraged to register and thereby certify that they agreed to comply with those provisions of the Code that applied to them. The main Code provisions affected franchisors, and dealt with prior disclosure, cooling off periods, dispute resolution, certification and standards of conduct. Registration was voluntary. Non-compliance led to deregistration, but did not prevent that franchisor from operating as such .

The main features of the Code were:

- Disclosure — Franchisors were required to provide a standard form of disclosure document to prospective franchisees at least 7 days prior to signing a franchise agreement. The disclosure document need to be updated annually and was available to existing franchisees upon request. A disclosure document also had to be provided by a vendor franchisee and its franchisor to a purchaser of that franchisee's business.
- Cooling off — Franchisees were to be provided with a 7-day cooling-off period following execution of the franchise agreement. A franchisee who exercised the “cooling-off” option was to be refunded all fees paid less reasonable expenses specified in the franchise agreement.
- Dispute resolution — The Code laid down an alternative dispute resolution procedure with which the parties had to comply.
- Certification — Prior to the execution of the franchise agreement the franchisor had to require the franchisee to produce a certificate from a solicitor certifying that the solicitor had explained the franchise agreement to the franchisee, or have the franchisee sign a statement that the franchise agreement has been explained by a solicitor.

In line with the Task Force's recommendations, the Code imposed no specific requirements in relation to termination, intellectual property rights, tenure, assignment, approvals or other terms and conditions of the franchise agreement, including goodwill.

The Code nevertheless provided in paragraph 12 that franchisors and franchisees:

(1) will not participate in unconscionable conduct, in relation to franchise arrangements; and

(2) should act in an ethical, honest and lawful manner, and endeavour to pursue best franchise business practice on the time and place. They should in their dealings with one another at least avoid the following conduct, where such conduct would cause significant detriment to either party's business:

(a) substantial and unreasonable overvaluation of fees and prices;

(b) conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party; and

(c) conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

However, the body entrusted with the administration and enforcement of the Code, the Franchising Code Council (FCC), had no power to deregister any party who failed to comply with paragraph 12. The standards of conduct operated as ethical standards to which participants in the franchising sector should aspire, rather than mandatory provisions to which participants had to comply under threat of deregistration.

The Franchising Task Force which recommended the introduction of the voluntary Code acknowledged in its report that its conclusions would satisfy neither those who had called for strict mandatory legislative arrangements, nor those who believed that there was nothing wrong with the sector and that no form of regulation, even voluntary self-regulation, was necessary. Nevertheless, at the time of its introduction in 1993 there was a strong hope that it would be a sufficient response to the problems affecting the franchising sector. It was described by the then Minister for Small Business as:

> *the most progressive industry/government franchising initiative undertaken in the world [which has attracted] strong interest in its development from the franchising community overseas. This*

Code of Practice and the self-regulatory regime which will support it, provides an excellent model for how the business community and government can work in partnership to promote business development.

However, the reality did not match the hyperbole. Fourteen months into its 2 year trial period, the government, prompted by increasing concerns as to the effectiveness of the Code, initiated an independent review of its operation and effectiveness. The Gardini Report was submitted in October 1994 and released in March 1995. It identified two major weaknesses in the Code: its lack of coverage across the franchise sector, and failure of the "standards of conduct" provisions to address serious franchise problems.

The Code eventually "died" with the demise of the FCC in December 1996 as a result of:

- funding pressures (the outgoing government's promise of government funding fell victim to cost-cutting measures of the new government elected in March 1996;
- concerns among members of the FCC regarding their vulnerability to defamation actions brought by franchisors whom the FCC threatened to deregister; and
- disputes among franchisor and franchisee members of the FCC as to the role, viability and integrity of the Code and the self-regulatory regime.

The Code lapsed with the demise of the FCC. Australia was again returned to a deregulated environment, where franchising was regulated only by the general laws that regulated all commercial activity. It was obvious that the unregulated environment would be a temporary stage which lasted only until the new government determined its policy for the franchising sector.

18.3 The *New Deal: Fair Deal* Reforms

In June 1996 the Government appointed the House of Representatives Standing Committee on Industry, Science and Technology with wide terms of reference to report on business conduct issues in fair trading in general, and franchising in particular. In May 1997 the Committee handed down its Report. This Report, *Finding a Balance — Towards Fair Trading in Australia* was highly critical of some practices within the franchising sector.

The Report found that the problems had considerable economic and social costs, in that they contributed significantly to business failure. The social costs identified by the Committee included stress, marriage breakdown, poor health and suicide. The economic costs of the business conduct issues raised with the Committee included an inability of small firms to gain a return on sunk costs, and market inefficiencies arising out of exploitative conduct.

Faced with an orchestrated media campaign highlighting unfair conduct issues, the accumulated experience of over 20 reports over the last two decades, and the harsh criticisms and unanimous recommendations of a backbench committee of both government and opposition members, the government was left with no option but to act quickly and decisively.

Its *New Deal: Fair Deal* reform package released in September 1997 contained initiatives of great significance to the franchising sector. These included the enactment of a "business unconscionability" provision modelled on the "consumer unconscionability" provision of section 51AB of the TPA, and the introduction of a mandatory Franchising Code of Conduct . These regulations were proscribed under the TPA pursuant to a new Pt IVB which provided the legislative infrastructure for Codes of Conduct.

Two Exposure Drafts of the Code were released for public comment — the first modelled closely on the voluntary Franchising Code of Practice, and the second a more comprehensive document moving significantly beyond prior disclosure obligations to regulation of the franchisor/franchisee relationship. The final form of the Code prescribed by regulations came into effect in stages on 1 July 1998 and 1 October 1998.

The package contained a number of measures including:

- new protection for small business in the TPA, through prohibiting unconscionable conduct in terms similar to the strong protection already provided for consumers;
- new protection for small business franchisees through a mandatory and stronger Franchising Code of Conduct underpinned by the TPA;

- a safety net of minimum legislative standards for protection of retail tenants to be negotiated through State and Territory legislation;
- stronger enforcement by the ACCC of small business' fair trading rights, including representative legal actions on behalf of small business, small business commissioners, a Codes of Conduct Enforcement Unit and funding for test cases;
- support for alternative dispute resolution to provide small business with quicker, less costly and more efficient remedies than traditional court litigation; and
- support for the development of information packages on fair trading.

A feature of the reforms was that they comprised of an integrated package, which the government argued was designed, "to induce behavioural change on the part of big business towards smaller business, and to provide to small businesses, that are unfairly treated, adequate means of redress". Additionally, the Government accepted the Committee's conclusions, and acted on each of the seven areas of reform identified - unfair conduct, retail tenancy, franchising, misuse of market power, small business finance, access to justice and education .

The Trade Practices Amendment (Fair Trading) Act 1998 which came into effect on 1 July 1998 enacted the "business unconscionability" provision (s51AC) and the legislative framework for the prescription, by regulations, of codes of conduct. The first mandatory industry code, the Franchising Code of Conduct, came fully into effect on 1 October 1998.

18.4 The Franchising Code of Conduct

The Franchising Code of Conduct is a mandatory industry code prescribed under section 51AE of the *Trade Practices Act 1974*. Section 51AD of the TPA makes it an offence to contravene a prescribed industry code. The Code became fully operational on 1 October 1998 and was amended by the *Trade Practices (Industry Code – Franchising Amendment) Regulations 2001*, which came into effect on 1 October 2001. The ACCC administers the Code.

The purpose of the Code is to regulate the conduct of participants in franchising, particularly the conduct of franchisors. A particular focus is on ensuring prospective franchisees are able to make an informed business decision about whether or not to enter into a franchise agreement. The Code also regulates the content of certain conditions to be included in franchise agreements, and dictates a procedure for dispute resolution.

The Code applies to franchise agreements entered into, renewed or extended after October 1998. Section 4(1) defines a "franchise agreement" as:

(1) a written, oral or implied agreement;

(2) involving the grant of a right to carry on business of offering, supplying or distributing goods or services;

(3) under a trade mark, advertising or commercial symbol;

(4) using a system or marketing plan substantially determined by the franchisor; and

(5) requiring the payment of an initial fee.

Motor vehicle dealership agreements are specifically declared to be franchise agreements and certain relationships such as co-operatives and partnerships are excluded. There are also some limited exceptions where a franchisor is resident outside Australia, or where the goods or services supplied under the agreement are likely to account for no more than 20% of the franchisee's gross turnover.

The definition of a franchise agreement is quite broad and has the potential to capture a wide range of licensing, distribution and agency arrangements not traditionally considered to be strictly franchise arrangements. Consequently, the definition has tended to be read down by the courts with a focus on ensuring that there is a system or marketing plan actually being imposed by the alleged franchisor before the Code will be applied.

There are comprehensive disclosure obligations on the part of a franchisor intending to enter into, extend or renew a franchise agreement covered by the Code. A franchisor must provide a detailed disclosure document to a prospective franchisee at least 14 days prior to signing a franchise agreement. The franchisor must also provide a copy of the Code and a copy of the franchise agreement to the franchisee. In the case of a sub-franchise situation, both the sub-franchisor (master franchisee) and the franchisor are required to prepare a disclosure document. This may be done either jointly or individually.

The disclosure document requires the franchisor to provide approximately 250 items of information listed under 23 categories. The disclosure document must be in the form, order and numbering prescribed by the Code. It must also use the prescribed headings and have an indexed table of contents. The information required to be disclosed includes details of the franchisor, the business experience of those involved in the franchise system, litigation history, existing franchisee contact particulars, intellectual property ownership, territorial or supply restrictions, marketing or other cooperative funds, and a range of costs and payments relevant to the franchise and the franchisor's financial position.

There is provision for a short form disclosure document where a franchised business has an expected annual turnover of less than $50,000. The benefit of this exemption is compromised by the fact that a franchisor is still required to provide all the information in the long form disclosure document if requested by the franchisee. As a consequence this form of disclosure document is virtually never used.

A disclosure document must be updated within three months of the end of each financial year, regardless of whether the franchisor is recruiting new franchisees or not. The content of a disclosure document must be carefully monitored to ensure that it contains no misleading or deceptive information. Similarly, a franchisor must be careful about the information regarding pricing and supply conduct, to ensure it does not fall foul of the anti-competitive conduct provisions of the TPA.

A franchisor must advise a prospective franchisee to obtain professional legal, business and accounting advice before entering into the franchise agreement. The franchisee must sign a statement to the effect that he or she has received such advice, or been told to receive such advice but elected not to.

The Code dictates how the following issues are regulated in a franchise agreement:

(6) Cooling Off Period - a franchisee is entitled to terminate the franchise agreement and recover all fees paid under the agreement if it does so within 7 days of entering the agreement;

(7) Marketing Funds - if a franchisee is required to contribute to a marketing fund, then the franchisor must prepare an annual financial statement in respect of the fund and have the statement audited;

(8) Transfer - a franchisor must not unreasonably withhold consent to the transfer of a franchised business to a new franchisee;

(9) Termination - if a franchisee has breached the franchise agreement, then the franchisee must be informed of the breach, and given a reasonable time to remedy it. If it cannot be, or is not remedied, then the franchisor can only terminate on reasonable notice. Similarly, if the franchisee is relying on a power of termination in the agreement (other than for breach), reasonable notice must be given. There is no definitive answer of what will constitute reasonable notice as it depends on individual circumstances;

(10) Liability disclaimer – a franchise agreement cannot require the franchisee to give a general release from liability.

The Code requires parties to give a notice of dispute in the event of disagreement. If the matter cannot be resolved between the parties according to the internal complaint handling procedure, then the dispute should proceed to mediation. The mediation must be conducted in Australia and attended by someone with the power to settle the dispute on behalf of each party.

A breach of the Code will allow for the application of the TPA remedies, including damages, injunctions, specific performance, termination, and variation of agreements entered into. Where there has been a serious breach of the Code, such as a failure to provide a disclosure document, the court may declare all the franchise agreements entered into by the franchisor void, and order the franchisor to refund all the money paid by the franchisees under these agreements. As a part of any remedy for a breach of the TPA, it is common for the court to order that a franchisor adopt a trade practices compliance program which can itself be an expensive exercise.

The Code is merely the starting point of a franchisor's legal obligations. Franchisors have specific obligations under an array of different laws. Other laws, such as the TPA itself, the Corporations Law, Occupational Health & Safety laws and retail tenancies legislation in each State apply to franchising in the same way as they apply to other businesses. The general law of contract also applies to franchising, as franchising is essentially a contractual relationship.

19. The role of the FCA in the past and future growth and development of franchising in Australia

19.1 Representation

The FCA has played a key role in the development of franchising in Australia. When it became obvious that some form of franchise regulation was necessary to curb some of the excesses of the free market dealings, and restore the reputation of franchising as a credible business method, the FCA embraced the need for regulation. The FCA worked collaboratively with the Federal Government to develop a regulatory framework that addressed the perceived weaknesses of a de-regulated environment, yet did not unnecessarily restrict the entrepreneurial flair of franchisors or important principles of freedom of contract. The outcome was a regulatory framework that enhanced the contractual process by providing a comprehensive disclosure document to assist prospective franchisees to make an informed decision, and introducing a requirement for franchisor's to encourage franchisees to seek independent legal and business advice prior to signing the franchise agreement.

The Franchising Code of Conduct addressed important issues such as transfer, termination and dispute resolution, providing additional certainty for franchisors and franchisees alike. In many ways the disclosure requirements have reduced the risk of application of the section 52 TPA prohibition on misleading or deceptive conduct.

The FCA then combined with the Australian Competition and Consumer Commission to educate the franchise sector on the Code and the new regulatory requirements via national seminar roadshow. The FCA also conducts regular training as part of its Diploma of Franchising program, and produces a variety of publications to assist franchisors with compliance.

The FCA has also represented the sector in discussions concerning the Goods and Services Tax, TPA, retail tenancies , and red tape reforms, industrial relations issues and a range of other small business matters. To date the focus has been fundamentally on matters that have a specific impact on franchising, but in more recent times that representation role has widened.

The primary focus of the FCA will continue to be political representation, as that is the area most important to its members. In 2003 as part of a deliberate strategy to enhance its capacity to effectively represent the franchising community, the FCA appointed former Federal politician Richard Evans as its Chief Executive Officer. The FCA is now an active member of various Governmental committees, including the ACCC Franchising Consultative Committee.

It is likely that the FCA's representative role will extend beyond franchising into the general small business sector. The FCA is deliberately positioning itself as being representative of successful small businesses, with the aim of helping to harness the political influence of the sector for constructive purposes. The FCA believes that small business is currently very poorly represented, with many so-called small business groups being very narrowly focused or unrepresentative of the genuine needs of the sector. The vast majority of franchisors and franchisees are small business people, and the success rates of franchising justifies the FCA taking a broader role in small business policy issues.

The FCA represents the whole franchising community – franchisors, franchisees, service providers and suppliers. The FCA sees this as an important role, as this collaborative approach is culturally consistent with the mutual interdependence of the franchisor and franchisee relationship. The FCA has vigorously opposed the formation of organisations purporting to represent franchisees, but in reality being self-interested organisations intent on fermenting discontent and litigation.

The FCA believes that by representing franchising, as opposed to franchisors or franchisees alone, the FCA is helping to create a truly a collaborative approach to franchising in Australia. As a business method franchising is a team game, and it is important for the FCA to foster teamwork and collaboration, not an adversarial framework.

To effectively represent the whole community the FCA realises that it will need to develop initiatives that appeal to the separate interests of its constituents. The representative efforts in relation to retail tenancies have been important for franchisees, as have the Franchisee of the Year Awards. In recent times franchisee specific seminars and events have been scheduled, and more are likely. It is also likely that the FCA will take some of its activities, particularly franchisee events, into regional locations.

19.2 Education

The FCA has been very active in franchise sector education, its activities including:

- educating the franchise sector upon introduction of the Franchising Code of Conduct and related reforms, including conducting with the ACCC a national roadshow, producing a range of compliance materials and generally assisting with sector education concerning the Code;

- educating the franchise sector upon introduction of the Goods and Services Tax, conducting a national roadshow, producing a compliance video, producing a Franchisors Guide and a Franchisees Guides and generally assisting with sector education concerning the GST;

- developing an Accredited Franchise Executive program, later superseded by the Diploma of Franchising, which is a portable qualification recognised under the Federal Government's educational competencies;

- conducting national and State conferences on franchise sector issues, together with a range of special interest seminars, workshops, training modules and educational events;

- running monthly breakfasts or similar events in each State as a forum for information exchange, practical continuing education and networking;

- sponsoring franchise exhibitions, and conducting public education forums to enhance the understanding of franchising by the general public; and

- producing general information, press releases, newsletters and other material and making the information available to journalists, Federal and State Parliamentarians and the public via a range of means including the FCA website (www.franchise.org.au).

Future educational initiatives are likely to include specific compliance oriented initiatives, including seminars and compliance measurement and training tools that will link directly in to insurance products and possibly banking accreditation.

19.3 Membership

The FCA currently represents the majority of major franchise systems. However the FCA intends to focus substantial energies and resources upon membership growth and development. Several initiatives are likely to drive membership growth, including:

- the FCA's *"Don't Sign Without This Sign"* campaign, aimed at educating the public about the values of FCA membership and the additional safeguards of dealing with FCA members as a result of the introduction of the FCA Member Standards;

- the FCA's Member Advantage program;

- new insurance products designed specifically for the franchise sector, including liability insurance available only to FCA members with additional benefits linked to the existence of strong compliance systems; and

- further educational and other events available only to FCA members, or available at substantial discounts to FCA members.

19.4 FCA Member Standards

The FCA has introduced Member Standards with effect from July 1 2005 to further enhance perceptions of the credibility of franchising, and ensure that ethical behaviour in the sector remains high. The FCA aims to ensure that people do not enter the sector attempting to trade off the goodwill and reputation of franchising without honouring the expected standards of conduct.

The FCA Member Standards supplement the TPA regulatory framework by providing further detail as to the forms of conduct unacceptable for those involved in franchising. Importantly the FCA Member Standards impose new obligations on consultants and service providers in areas such as disclosure, conflicts of interest and professional behaviour.

A copy of the FCA Member Standards is included in this report at Appendix 3.

20. Future trends in Australian franchising

The success of franchising in Australia is well chronicled, and the growth of franchising in Australia shows no signs of abating. However one of the key determinants of long-term success will be how well franchise systems cope with the franchising mega-trends. The FCA has identified some of the likely mega-trends in Australian franchising, and the challenges these trends pose for franchise networks.

<u>Internationalisation</u> is already a feature of Australian franchising, with over $220 million in export earnings derived in 2002. More and more Australian systems will expand internationally, buoyed by the success to date of systems as diverse as Cartridge World, Gloria Jeans Coffee, Aussie Pooch Mobile, Cash Converters, Expense Reduction Analysts, Pirtek, Dome, Boost Juice and numerous others. The Australian market, with its logistical and geographic challenges, highly competitive marketplace and strong and effective regulatory framework prepares Australian systems well for international expansion.

<u>Aggregation</u> is a feature of competition in all markets. In Australia we are likely to see either a reduction in the number of franchise systems, as smaller systems merge with others to achieve economies of scale, or a gap emerge between those franchise systems that can achieve superior economies and efficiencies, and those that cannot. Currently there are around 850 franchise systems, which means Australia has around 3 times as many franchise systems per head of population as the USA. However in the US the number of franchisees per franchise system is much higher than in Australia, with many systems having more than 1000 franchisees.

Concomitant with this aggregation is the development of the <u>super franchisee</u>. The single unit franchisee that has been a feature of Australian franchising will be progressively superseded by franchisees that are bigger, stronger, own multiple franchises and have their own resources. They may even have franchises from different non-competing co-branded outlets and raise their own venture capital. These franchisees will be totally focused on, and expert in, operational matters. The challenge for the franchisor is to deliver brand and systems value that justifies the royalty cheque from the super-franchisee. This has been the trend in the US, and there are in fact several publicly listed franchisees, and intense competition between franchise systems to attract the franchisee heavyweights.

<u>Corporate competition</u> has already increased substantially in recent years. Franchise systems have taken market share from the large corporations by developing specialty retail niches, but the corporations are fighting back. Franchise systems will experience even greater competition from department stores, supermarkets, international chains and even other beefed up franchise networks that have added capital or other networks to their stable to achieve greater economies of scale. That said, franchise systems have proven in the past to be far too agile and innovative for large corporations. Provided franchise systems continue to adapt their product or service to the needs of consumers, use their franchisees to communicate those needs, and deliver exceptional customer service, franchise systems will continue to enjoy a competitive advantage over their corporate colleagues.

Greater sophistication is essential for franchise systems wishing to attract the best franchisees. Franchisors need to focus on brand and system development, and purchasing economies rather than just providing a range of operational services of minimal value to the discerning franchisee. Franchisors will also need to become more sophisticated in their brand promotion, communications, marketing, management, business methods, use of technology and systems. As super-franchisees deliver superior returns to the unit franchisee, franchisors will need to be sophisticated to be able compete for these franchisees.

The US trend that has seen the corporatisation of franchisors will be repeated in Australia. We will see more and more franchise companies move from private companies owned and operated by the founder, to corporations where management and ownership are separate. Corporatisation will raise capital to fund future expansion and facilitate exits for founders. Features of the new corporate franchisors will include management with specialist skills in brand building and systems development, and expert boards of directors appointed by shareholders.

Increased regulation is a feature of all western economies. There is likely to be new legislation in areas affecting franchising, such as employment law, occupational health and safety, consumer protection and taxation. In industries where rationalisation may occur, such as pharmacy, there may be a temptation to introduce franchise legislation to address industry issues. Although franchisee failure levels are very low, there is always a franchisor on hand to be blamed. In the face of circumstances of economic downturn or substantial occupancy cost increases, there may be calls for further regulation of the sector. The growth of franchising in the mobile or service field is likely to face threats from Government in the form of the extension of employee taxation regimes, although the Federal Liberal Government at present is proposing Commonwealth legislation to protect those areas from the encroachment by industrial relations legislation.

Appendix 1

List of Members of Franchise Council of Australia

http://www.franchise.org.au/index.cfm?fuseaction=list

FCA Membership List

123 Express Pty Ltd
1800 ONHOLD
1-800-GOT-JUNK? LLC
24seven
3D Paint Store Holdings Ltd
7 Eleven Stores Pty Ltd
A Balloon And Party Centre Pty Ltd
A.T.S Franchising
ABS - Auto Brake Service
Ace Body Corporate Management
Action International
Advanced Hair Studios
Advanced National Services
AGL Retail Energy Limited
AHL Investments Pty Ltd
Ali Baba Lebanese Cuisine Pty Ltd
All City Cleaning
All That And More
Allens Arthur Robinson
Amber Group Australia Ltd
AMC Commercial Cleaning
Andrew Benefield
ANZ Banking Group Ltd T/A ANZ Mortgage Solutions
ANZ Franchise Team
APCO Service Stations
Appetitos Franchise Systems Pty Ltd
Approveit Home Loans Pty Ltd
Aquatic Achievers (Douglas Family Trust T/A)
Aroma Café
Attache Sofware Australia P/L
Auset Pty Ltd
Aussie Pooch Mobile
Austrade
Australasian Pool Services Pty Ltd
Australia Pacific Computer Consultants Limited
Australia Post Head Office
Australian Exhibition Services
Australian Franchising Systems
Australian Independent Vendors Pty Ltd
Australian Money Exchange Pty Ltd
Australian Pharmaceutical Industries
Australian Private Realty Pty Ltd
Auto Leaders All Car Servicing
Auto Masters Australia Pty Ltd
Autobarn Pty Ltd
Avatar Consulting Pty Ltd
B Capital Pty Ltd
Back in Motion Physiotherapy Pty Ltd
Baker & McKenzie
Bakers Delight Holdings Pty Ltd
Bamboozle

Just Cuts Canberra
Just Cuts Franchising
Just Fingerfoods pty ltd
Kelly & Co
Kelly Sports Franchising
Kemp Strang Lawyers
KenKleen Window Cleaners
Kick Juice Bars Pty Ltd
Kieran Liston & Co
Kings Swim Centre
Kiss Cafe Franchising Pty Ltd
Kleenmaid Pty Ltd
Kleins Franchising Pty Ltd
Knight Frank Licencing Pty Ltd
Kwik Fix International
Kwik Kopy
Kwik Kopy (T/A Errington Business Systems Pty Ltd)
La Porchetta Pizza & Pasta Restaurant
Lancione Partners Lawyers
Laser Group Management Pty Ltd
Lavis Melin Taylor
Le Cornu Furniture
Ledgers Franchising Pty Ltd
Lenard's Pty Ltd
Lifetime Franchise Pty Ltd (The Book People)
Link Business Australia Pty Ltd
Little Images Pty Ltd
LJ Hooker Swan Hill
Local Lenders
Logie-Smith Lanyon
Lotteries Commission of Western Australia
Macedone Christie Willis
Macpherson & Kelley Solicitors
MACT Franchise Pty Limited
Made Easy Financial Group pty ltd
Magnetite
Mannings AV Services
MapInfo Australia
Mars Venus Coaching Pty Ltd
Marshalls & Dent
Mason Sier Turnbull
Master Feng Institute Pty Ltd
Matchbox Franchising Pty Ltd
Matthews Folbigg
McInnes Wilson Lawyers
McLaughlins
McLean Delmo & Partners
McMahon Fearnley
Meerkin & Apel Lawyers
Megasealed Bathrooms Franchising Aust. Pty Ltd
Mercury Management Systems Services

Bamboozle
Bank of Queensland
Bank of Queensland Limited
BankWest
Barbeques Galore Ltd
Bargain Wheels Car Rentals (Australasia) Pty Ltd
Barry Plant Doherty
Barry's, The Home Improvers (PEACS Pty Ltd)
Bartercard Australia Pty Ltd
Bathroom Werx Australia Pty Ltd
Battery World Australia
Baybridge Lawyers
BBX Management Ltd
BCI Business Brokers
Beacon Lighting
Bean Bar Franchising Pty Ltd
Beaumont Tiles (R J Beaumont & Co Pty Ltd T/A)
BedShed Franchisors Pty Ltd
Beechworth Bakery
Belgravia Formalwear
Bennett & Philp Solicitors
Betta Stores Limited
Big Dad's Pies
Big Fun Franchises Pty Limited
Bill Buddy Pty Ltd
Bing Lee Pty Ltd
Bio-Lab Australia
BNI Australia Pty Ltd (T/A Business Network International)
Bob Jane Corporation Pty Ltd
Boost Juice Bars Pty Ltd
Boots Great Outdoors Pty Ltd
Boss Hogs Hot Dogs Pty Ltd.
Bowler Geotechnical
BP Australia
Brad's Test & Tag
Brady Australia Pty Ltd
Bramalco Group (T/A Modern Group of Companies)
Bright Eyes Pty Ltd
Bristol Banner Group Pty Ltd
Brown Wright Stein
Brumby's Bakeries Ltd
Buchanan Law
Business Growth Strategies Pty Ltd
Busy Bookkeeping Pty Ltd
Bywaters Timms
Cabot Square Pty Ltd
Cafe2U Pty Ltd
Calair Pipe Systems (Calair Systems Pty Ltd T/A)
Caltex Australia Ltd
Card Connection
Cargroomers Pty Ltd
Cartridge World
Cash Converters International
Cash Loan Money Centres Pty Ltd
Catmax International
Mercury Management Systems Services
Metro Modelling Academy Pty Ltd ATF The Metro Trust
Meyer & Associates
Michel's Patisserie Pty Ltd
Midas Asia Pacific Pty Ltd
Middletons Lawyers Melbourne
MINC Services
Mini Maestros Operations Pty Ltd
Mini-Tankers Australia
Minter Ellison Lawyers
Minuteman Press International Inc
Miss Maud
Mister Minit
Mister Plywood Management Pty Ltd (Mister Ply & Wood T/A)
Mobil Gosford Area Service Stations
Mobitow Geraldton
Modern Streamline Roller Shutters
Mokum International Trading Pty Ltd
Money Depot Franchising Pty Ltd
Mortgage Choice Group
Moss Financial Services
Mountain Designs/Kolumbin Retail (Wild Gear Pty Ltd T/A)
Mr Antenna Pty Ltd
Mr Carports Licensing Pty Ltd
Mr Colin McCosker
Mr Globologist Pty Ltd
Mr Meticulous Pty Limited
Mr Rentals Franchising Pty Ltd
Mrs Fields Bakehouse
Mrs Flannery's
My Virtual Home Pty Ltd
Nandos Australia Pty Ltd
Narellan Pools Pty Ltd
National Australia Bank
National Business Sales
National Recruitment Pty Ltd
Natra Pty Ltd
Nedai Pty Ltd
New Level Personal Training Studio's
New Price Retail
New Zealand Natural Pty Ltd
Nextra Australia Pty Ltd
Nicol Robinson Halletts
NightOwl Convenience Stores
NJF Electrics Pty Ltd
Nutshack Franchise Group Pty Ltd
O2V Austalasia PTY LTD T/A Open2view
Office Choice Pty Ltd
One Water Naturally Pty Ltd
OneSteel Ltd
Oporto Portuguese Style Chicken Pty Ltd
Opposite Lock
OPSM
Optus Administration
Ovenclean Enterprises Pty Ltd
Ovenu
OZ Bin Cleaning Pty Ltd
Oz Design Furniture

Cavalier Homes Australia Pty Ltd
Central Coast Business Lawyers
Central Park Limousines
Chakram Pty Limited
Charter Resources Group
Chemtura Australia Pty Ltd
Chick n Feed Group-Joemnik
Chicken Express Systems P/L
Chocolate Orange
Choice Hotels Australasia
Chooks Fresh & Tasty Pty Ltd
Cibo Espresso Australia Pty Ltd
City Farmers Franchising Pty Ltd
City Pacific Finance Pty Ltd
City Pacific Law Firm Pty Ltd
Clark Rubber Franchising Pty Ltd
CleanTastic Pty Ltd
Coffee Ezy (Patsa Pty Ltd T/A)
Cold Rock
Coldwell Banker NSW/ACT
Coleman & Greig
Commonwealth Bank of Australia
communikate et al pty ltd
Concrete Taxi Pty Ltd
Contours Express (Australasia Franchise Group Pty Ltd trading as)
Cookie Man Pty Ltd
Coolabah Tree Cafe
Cost Less Plants Pty Ltd
Coulton Isaac Barber
Coverall Queensland Pty Ltd
CPR Complete Property Rejuvenation
CRA Cost Reduction Analysts NSW
Creative Home Decor Pty Ltd
Creative Marketing and Design
Crown & Gleeson Business Finance Pty Ltd
Cullen Babington Hughes
Cummings Flavel McCormack
Curwoods Lawyers
Custom Car Care Australasia
Cutler Hughes & Harris
Dairy Farmers Pty Ltd Vendor Number 110842
Daly International
DANARU PTY LTD
Danlaid Contracting Brisbane (Stevenson Contracting Pty Ltd)
Danlaid Contracting Pty Ltd
Darriwill Farm Franchising Pty Ltd
David Reid Homes
Davies Knox Maynards Chartered Accountants
DCM - Coffee & Donuts
Deacons
Deacons Consulting
Deloitte
Deloitte Growth Solutions Pty Ltd
Destiny Financial Solutions
DIA ORO JEWELLERY PTY LTD
Dibbs Abbott Stillman
Direct Pest Control Admin Pty Ltd
Oz-Cover Building Design Pty Ltd
Ozspy Pty Ltd
Ozzy Tyres
Pacific Internet
Pack & Send Systems Pty Ltd
Paddy Pallin
PaintRight Ltd
Paramount Franchise Services
Parasol Emt Pty Limited
Parker Enzed Australia Pty Ltd
Parmalat Australia Ltd
PARRAFINE
PBM Fitness Pty Ltd
PC Masters International Pty Ltd
Pedders Shock Absorber Services
Pet Mobile Pty Ltd
Petstock Pty Ltd
PFA Chartered Accountants
Phillips Fox
Phone Central Pty Ltd
Picton Printing
Pie Face Pty Ltd
Pilot Nexia Pty Ltd
Pirtek Fluid Systems Pty Ltd
Pizza Haven
PKF Australia
Plenty Trak Systems (Vimex Pty Ltd T/A)
PNF Management Pty Ltd T/A Pure & Natural
Poolwater Services
PoolWerx Corporation Pty Ltd
POS Displays Pty. Limited
Power Loan
Powertec Telecommunications Pty Ltd
PRD Nationwide Pty Ltd
PricewaterhouseCoopers
Priority Management Systems P/L
Pro Klean Systems
Professional Advantage
Prosell Franchising Pty Ltd
Protect-A-Window Australia Pty Ltd
Protex Australia
QB Securities
Quest Apartments
Quest Apartments WA Pty Ltd
Quick Fit Tyre Service
Quick Sign Shops Franchising Pty Ltd T/A
Quick Colourprint.com.au
R.W Corrie & Co
Rams Finance Pty Ltd
Ranger Camping & Outdoors
Recruitment Vision Pty Ltd
Red Rooster
Reed Business Information
Refund Home Loans
Resi Mortgage Corporation Ltd
Resumes For Results
Retail Brands Group Pty Ltd
Retail Food Group (Australia)
RetireInvest Pty Ltd
Riaz Jeena
Richard Solomon & Associates

Dixon Systems
DMAW Lawyers
Doggy Wash (Flea Stoppers Pty Ltd T/A)
Dominion Printing
Domino's Pizza Australia New Zealand Limited
Donaldson Walsh
donbelinder pty ltd T/A healthy habits
Don't Fret Pet Franchising Pty Ltd
Downings Legal
Dymocks Group of Companies
Eagle Boy's Dial-A-Pizza Pty Ltd
Ecomist Australia Pty Ltd
Ecowash Mobile Pty Ltd
Edwards Global Services
Edworks Active Learning
Ekinci & Hardy Management P/L
Elite Fitness Equipment Pty Ltd
Elite Maintenance Services Pty Ltd
EmbroidMe
Endota Spa
Energie Fitness Clubs Ltd
Enzed (Parker Enzed Technology Pty Ltd)
Espresso Mobile Cafe
Ettamogah Franchising Systems
Eurolight
Executive Property Maintenance
Exhibitions & Promotions Pty Ltd
Expense Reduction Analysts
Express GST Accounting
Extragreen Travel Franchises Pty Ltd
Extrastaff Pty Ltd
Fastway Couriers (Aust) (Australian Couriers Pty Ltd t/as)
Ferguson Plarre Bakehouses Pty Ltd
Fernwood Fitness
Fernwood Womens Health Clubs Pty Ltd
Fibrecare Australia Group Pty Ltd
FiltaFry
Fire Hydrant Systems (Australia) P/L
First Class Accounts
First Class Accounts (Sydney) Pty Ltd
First Food Group Pty Ltd
Fisher & Paykel Appliances Australia P/L
Flight Centre Limited
Flippin' Fresh Seafood
FluidMasters International Pty Ltd
Foam Factory
Formalwear Express Franchising Pty Ltd
FORTE fitout logistics Pty ltd
Forte School of Music
Forty Winks Franchising Pty Ltd
FRANCH-EYES Pty Ltd
Franchise Alliance Pty Ltd
Franchise Careers
Franchise Central
Franchise Control Systems
Franchise Council of Australia
Franchise Developments Management Consulting
Franchise Link

Riordan Hume
Rivergum Furniture 1939 Pty Ltd
Roadside Auto Care
Robbins Watson
Robert James Lawyers
Ryco Hose
S2M2 Franchising Pty Ltd
Safetyquip (Australia) Pty Ltd
Save Time Services
Scoop News & Lotto Pty Ltd
Scott Alexander Pty Ltd
Sea Tow Services Australia Pty Ltd
Secretary.com.au Pty Ltd
Select Information Pty Ltd
Sensis Pty Ltd
Sign-A-Rama
Signwave Australia Pty Ltd
Sky Blue Coffees Pty Ltd
Sleepy's Pty Ltd
Slurp
Small Myers Hughes
Smart Saver
SmartCare (Franchising) Pty Ltd
Snap Franchising Ltd
Snap-on Tools (Australia) Pty Ltd
Snowgum
Software Quality Assurance Centre
South Coast Bakeries P/L
Spanline Weatherstrong Building
Spectrum Analysis Australia Pty Ltd
Spinners Holdings Pty Ltd
Sport For Life
Sportskeep Pty Ltd
Sportzing Court Care Pty Ltd
Spotless Services Ltd
ST Software Pty Ltd
Stacks of Snacks
Stain Busters Cleaning Systems ACT
Stephens Lawyers & Consultants
Stewart Germann Law Office
STORAGE KING PTY LTD
Strathfield Group Limited
Stretch-n-Grow Australia Pty Ltd
Stretch-N-Grow Upper North Shore & Northern Beaches
Subway Systems Australia P/L
Sumo Salad Franchising Pty Ltd
Supergeek.com.au Pty Ltd
Superior Steel Lattice Pty Ltd
Sureslim Australia Pty Ltd
Survival First Response
Symbion Pharmacy Services
Synectico Pty Ltd
Synergy executive (south) pty limited
Tallahesse Pty Ltd
Taps 'n Toilets
Targett Retail Training Pty Ltd
Tasman Recruiting
Tasty Trucks Pty.Ltd.
Tattersalls Sweeps Pty Ltd
Tayco Petroleum

Franchise New Zealand Magazine (Franchise NZ Marketing Ltd T/A)
Franchise Point
Franchise Relationships Institute
Franchise Systems Group
Franchise Technology Solutions
Franchise Works Australia
Franchising Solutions Pty Ltd
Freedom Group Limited
Frenchams
Futureworld Drama Pty Ltd
Gadens Lawyers
Gallery 360
Gametraders Franchising Pty Ltd
Gauci Franchising Pty Ltd
Gaze Burt Solicitors
GE Commercial Corporation (Australia) Pty Ltd
Gelare International PtyLtd
Gelatissimo
Glass Art Australia
Glenwood Homes Pty Ltd
Global Art Australia Pty Ltd
Global Enterprises (t/as Salon Express Australia)
Global Living Furniture and Homewares Group Pty Ltd
Globepro's Australia Pty Ltd
Gloria Jean's Coffees
Go Gecko
Go Sushi Management
Golden Casket Lottery Corporation Ltd
Golden Circle Limited
goldenwest usa
Goodyear Auto Service Centre
Got One Pty Ltd
Grant Thornton Melbourne
Grey Army Management
Grill'd Pty Ltd
Grinners Catering (Australia) Pty Ltd
H&L Australia
Haarsmas Lawyers
Hairhouse Warehouse Pty Ltd
Hall & Wilcox
Hallas Trading (Ella Bache)
Handi Ghandi Franchising Pty Ltd
Han's Cafe PTY LTD
Harry's Cafe de Wheels (Holdings) Pty Ltd
Harvey World Travel Franchises Pty Ltd
Healthline Health Care Systems Australia Pty Ltd
Healthy Habits Australia Pty. Ltd.
Healthy Life Pty Ltd
Helen O'Grady International Pty Ltd
High Plains Trading (Rep. Action International)
Hill Mayoh
Hind Fort Pty Ltd
Hire A Hubby NSW Pty Ltd
Hire for Baby Pty Ltd
Hire Intelligence
TCM Consulting and TCM Franchising
Teamwork Finance
Telco In A Box
Telefonix Technology Group Pty Ltd
Termi-Mesh Australia
Test Sponsor
Testel Australia Pty Ltd
Thai Express Australia
The Ad Company P/L
The Athlete's Foot Australia P/L
The Award Bookkeeping Company Pty Ltd
The Business Card Shop
The Cheesecake Shop (Hodmac Holdings t/a)
The Coaches Consortium Pty Ltd
The Coffee Club Franchising
The Computer Market Pty Ltd
The Concrete Cutter (Franchising) Pty Ltd
The Confectionery Party Shop
The Crêpe Cafe Development PTY LTD
The Duster Dollies Pty Ltd
The Edge Corporate Strategies
The Iceberg Corporation
THE KEBAB CO
The Loan Doctor Pty Ltd
The Lucky Charm
The Mortgage Bureau Pty Ltd
The Mortgage Gallery
The Natural Source
The Natural Way
The Outdoor Furniture Warehouse Pty Ltd
The Quantum Organization Pty Ltd
The Real Learning Experience
The Realise Group Pty Ltd
The Retail Doctor
The Safety Shop Pty Ltd
The Shed Company Franchising P/L
The Storage Space Company Pty Ltd
The Touch Up Guys Pty Ltd
The Tyre Factory
The Waterboys Pty Ltd
Thomson Playford
Thrifty Car Rental
Thymac Admin Pty Ltd
Tilecraft Ceramics
Timberland Furniture Franchise Systems
Tint a Car
Tobacco Station Group
Tom's Trash Paks Pty Ltd
Toni & Guy Australia Pty Ltd
Toohey Reid Pty Ltd
Total Building Maintenance
Trampoline Franchising P/L
Travelworld
Trios Pty Ltd
True Choice Home Loans Pty Ltd
Ultra Tune (S A) Pty Ltd
Ultra Tune Australia Pty Ltd
Uncle Tony's Kebabs
University of New South Wales
Urban Burger (S2M PTY LTD t/as)

Hire Intelligence North Sydney
Hobbysew
Hocking Stuart
Hog's Breath Cafe - Mackay
Holding Redlich
Holistic Group Pty Ltd
Holy Sheet! Homewares
Home Entertainment Express Pty Ltd
Home Wilkinson Lowry
Honda Australia MPE
Horizon Franchising Pty Ltd
Horizon Media Pty Ltd
Horseland Saddlery Pty Ltd
Horwath
Hosemasters International Pty Ltd
Hotkey Internet Services
Hotkey Internet Services Pty Ltd
Hotondo Building Pty Ltd
Howards Storage World
Hudsons Coffee
Hungry Jack's Gold Coast
Hungry Jack's Pty Ltd
Hunt & Hunt Lawyers
Hydrodog
I.L Wollermann
Icon Business Solutions
IFX International Inc.
Imagine Essential Services Limited
Ink On the Run
iNSIGHT Home Loans (GSR Corporation Pty Ltd T/A)
Insite Data Solutions
Insurance Australia Group
Intelink Franchise Services Pty Ltd
Inut Inut Pty Ltd
Investor Finance Pty Ltd
ISS Facility Services
Jackson McDonald
James Home Services
Jani-King (Aust) Pty Ltd
Jarima Holdings Pty Ltd
Jaymak Australia Pty Ltd
Jesters Jaffle Pie Company
Jetset Travel World
Jim's Corp Limited
John Brennan Franchising
John Cully Pty Ltd
John Danks & Son Pty Ltd
Jones Condon
Jumping J-Jays Franchises Pty Ltd
Just Better Care Franchising Pty Ltd
Vaby's Franchising Pty Ltd
Van Go Australia
Vatman Group
Vaughan Barnes
Versatile Buildings TA Totalspan Australia
Victory Curtains & Blinds
VIP Australia Pty Ltd (VIP Home Services)
Viva Life Photography
Walk on Wheels Franchise Systems Pty Ltd
Walker Wayland WA Pty Ltd
Waterco (Swimart)
Webresource Testing Company
Wengor Pty Ltd t/a City Pacific Finance - Business Solutions
Westpac Banking Corporation
Wet-seal Management Pty Limited
Whirlwind Print
WHK Greenwoods
WHK Greenwoods
William Buck
WISE Employment Ltd
WiseOnes Australia Pty Ltd
Wisewoulds Lawyers
Wok in a Box Pty Ltd
Wood Rot Doctor
WordWerx Pty Ltd t/a Franchise Advisory Centre
Workforce Services Pty Ltd
Worldwide Online Printing Aust/NZ Pty Ltd
Worldwide Refinishing Systems (Aust) Pty Ltd
Wozzie Trading Pty Ltd t/as Chooks Fresh & Tasty - Byford - Coolbellup - Maddington
Wrappings Pty Ltd
Xpresso Delight Pty Ltd
Xpresso Mobile Coffee Bar Pty Ltd
Yates Security
Yum Restaurants International
Zarraffa's Franchising Pty Ltd
Zebra Interactive Pty Ltd
ZUVELA LAWYERS

Appendix 2

FCA Member Standards

http://www.franchise.org.au/content/?id=205

Franchise Council of Australia - Member Standards

To lodge a complaint please direct to:

The Complaints Officer
Franchise Council of Australia
PO Box 2195
Malvern East VIC 3145

Email: complaintsofficer@francise.org.au

(i) The new member standards promoting excellence in franchising

One of the hallmarks of a reputable industry sector is a commitment to high standards of personal and professional conduct. This enhances public perceptions of franchising, helps safeguard the investments of franchisors and the businesses of franchisees, protects franchise networks from unfair or unethical attack and provides guidance for those seeking to commence their franchising journey.

The Franchise Council of Australia (FCA) encourages its members to maintain standards of conduct worthy of franchise sector professionals. The Member Standards are designed to provide members of the FCA with an authoritative guide on acceptable standards of conduct.

The FCA believes the Australian franchise sector to be well regulated with the Franchise Code of Conduct (the Code) allowing for adequate dispute resolution procedures and disclosure provisions to assist and guide the sector. It also considers that the franchise relationship between the franchisor and franchisee can be developed even further with best practice guidelines in the form of Member Standards.

It is the FCA's view a member gains significant market benefit in identifying themselves with FCA membership and as such the business practice and activities of members should work towards franchise best practice.

The Member Standards and Best Practice are not intended to anticipate each and every occurrence of a franchise relationship, but rather, articulate the values upon which the members of the FCA can structure their franchise relationships and strive to conduct their businesses.

If a member does not comply with the requirements of the Member Standards then investigation and disciplinary procedures are in place to handle the matter. It is not intended that breach of the Member Standards have any legal consequences other than potentially in relation to membership of the FCA. Clause 2.10(1)(b) of the Constitution of the FCA empowers the FCA Board by three-quarter majority to censure, suspend or expel from the FCA a member who fails to comply with any Standards of Conduct applying to them.

The FCA will respond to any complaint alleging breach of the Member Standards by a member, but does not have sufficient resources to vet documentation, audit behaviour or generally police compliance. Use by a member of the FCA logo does not carry any endorsement or certify compliance, and the FCA accepts no liability to any person in relation to any breach of these Member Standards.

Franchising Activities
All Franchise Council of Australia members are expected to conduct their franchising activities professionally and in accordance with Australian law. They are expected to comply with agreed minimum

standards of conduct.

The FCA considers the following standards to be relevant to Members:-

- Members of the FCA shall abide by all relevant State and Federal laws including in particular the Franchising Code of Conduct and the Trade Practices Act. A member shall within 14 days of written request by the FCA furnish to the FCA a copy of its current disclosure document, franchise agreement and any other documentation or advertising material used in connection with the appointment of a franchisee.
- No member shall imitate the trade mark, trade name, corporate name, slogan, or other mark of identification of another member of business in any manner or form that would have the tendency or capacity to mislead or deceive.
- Members will become familiar with the content of these Member Standards and draw them to the attention of clients as appropriate from time to time.
- A Member, be they franchisor, vendor franchisee, franchise broker, or representative of a franchise system should not sell a franchise if at the time the franchisor or vendor franchisee knew or ought to know that a reasonably competent franchisee would be unlikely to be able to successfully operate the franchise.
- Members are expected to behave professionally and refrain from illegal, unethical or improper dealings or otherwise act contrary to the image of franchising or the FCA.

Relating to a franchisor and franchisee

- A franchisor shall as part of its franchisee recruitment process make reasonable investigation to assess whether a prospective franchisee appears to possess the basic skills and resources to adequately perform and fulfil the needs and requirements of the franchise.
- The franchisor shall have training and support processes as applicable to the franchise system to help franchisees improve their abilities to conduct their franchises. Franchisees will endeavour to apply and adapt all learning to their operation
- A franchisor and franchisees should be reasonably accessible and responsive to communications, and provide a mechanism by which ideas may be exchanged and areas of concern discussed for the purpose of improving mutual understanding and reaffirming mutuality of interest.
- Franchisors and franchisees shall endeavour to resolve complaints, grievances and disputes through direct communications and negotiation. Failing this, consideration should be given to mediation or arbitration.
- Franchisors and franchisees should in their dealings with one another avoid the following conduct, where such conduct would cause significant detriment to either party's business:
  (a) substantial and unreasonable overvaluation of fees and prices; and
  (b) unnecessary and unreasonable conduct beyond that desirable for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

Relating to a Supplier Member

- A Member who is a lawyer, accountant, consultant or other supplier or service provider ("Supplier Member") should behave in a manner consistent with these guidelines.
- Respect the integrity of established franchise systems and not seek to inflame any dispute, incite litigation, generate media coverage or otherwise act in any way which is unprofessional or may create a misleading impression of the system.
- Provide a client or prospective client on request with a written resume or profile of any relevant qualifications of the supplier together with true representations of the supplier's franchising education and experience;
- Respect the confidentiality of all information received concerning a client's business which is not in the public domain and will not disclose or permit disclosure of any such information without the client's prior permission in writing;
- Not advise any franchisee or prospective franchisee in relation to any franchise

opportunity offered by any franchisor for whom the adviser has acted, without full disclosure of relevant circumstances;

- Disclose to a client or prospective client any personal or financial interests or other material circumstances which may create a conflict of interest in respect of that client and in particular, without derogating from the generality of the foregoing:
  - any directorship or significant interest in any business which competes with the client;
  - any financial interest in goods or services recommended by the Adviser for use by the client;
  - any personal relationship with any individual in the client's employment;
- Not undertake work for which they are not appropriately licensed, qualified and experienced.

Appendix 2

FCA Submission to the Parliament of South Australia Economic and Finance Committee Inquiry into Franchises

PROUD MEMBER OF
FCA
FRANCHISE COUNCIL OF AUSTRALIA

Parliament of South Australia Economic and Finance Committee Inquiry into Franchises

Submission from

FRANCHISE COUNCIL OF AUSTRALIA

21 January 2008

Suite 6
307 Wattletree Road
Malvern East
Victoria 3145

Stephen Giles
Director – Industry and Government Relations
Steve Wright
Executive Director
1300 669 030
stephen.giles@franchise.org.au
steve.wright@franchise.org.au

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Appendices

21. Executive Summary

As the peak industry body representing franchisors, franchisees, service providers and suppliers involved in franchising the Franchise Council of Australia welcomes the opportunity to provide input to this Inquiry.

Industry statistics confirm that franchising continues to prosper throughout Australia, including in South Australia. The FCA does not believe there are any endemic problems in franchising, a view confirmed by the recent Federal review of the Franchising Code of Conduct. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public.

All participants in the franchise sector acknowledge that the current Federal regulatory framework is working well. The *New Deal Fair Deal* Reforms were introduced in 1998 with bi-partisan support, and the Government's legislative response which takes effect March 1, 2008 also has bi-partisan approval. The Mathews Committee Report on the operation of the Franchising Code of Conduct noted as follows:-

> "*Strong support for the Code has been registered throughout the review process. It is widely seen as pivotal to the continued success of the franchising industry".*[58]

The FCA has been strongly supportive of the current Federal regulatory framework, including the recent reforms which will provide additional protection for prospective franchisees. The FCA believes the current regulatory environment creates a fair balance between the need for effective regulation supported by a strong and well resourced regulator, and the importance of minimising compliance costs for this entrepreneurial sector. A summary of the current regulatory regime is included in section 5 of this submission, as the extent of existing protection available is often not understood by critics or the media.

The FCA is concerned to ensure that the franchise sector operates efficiently and fairly, and there is a strong positive perception of franchising in South Australia. Based on information collected by the FCA as part of its franchisee forums and in policing the FCA Member Standards the FCA does not believe there are any endemic problems in franchising that are not addressed by current regulation. However the FCA remains open minded to any suggestions that will improve Australian franchising, and the understanding of franchising by Governments, the media and the general public. The FCA is not privy to the detail of complaints received by members of the Inquiry. We have endeavoured to anticipate some of the matters that might be raised, and would be pleased to provide further comment on any specific issues.

The broad position of the FCA in relation to the terms of reference for the inquiry can be summarised as follows:-

(1) The FCA does not believe that current laws disadvantage franchisees. Indeed the laws provide strong protection for franchisees. Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of that framework are discussed in detail in paragraph 4.3, and can be summarised as follows:-

- (i) the Franchising Code of Conduct requirement to provide a comprehensive disclosure document prior to a franchisee signing a franchise agreement;
- (ii) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;
- (iii) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for

[58] Foreword by Graeme Mathews, p4, Review of the Disclosure Provisions of the Franchising Code of Conduct.

termination and establishing a mediation based dispute resolution process;

(iv) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to prove it had reasonable grounds for making any representation as to a future event;

(v) the prohibition on unconscionable conduct in s51AC of the TPA; and

(vi) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

(2) A disclosure document prepared in accordance with the comprehensive requirements of the Franchising Code of Conduct provides sufficient information to assist a prospective franchisee to make an informed decision in relation to the franchise. The disclosure process has been further strengthened by the recent amendments to the Code which take effect March 1, 2008;

(3) The current disclosure process seems to be working well:-

(a) The FCA is not aware of any endemic problem with information quality in disclosure documentation. The Code is highly prescriptive as to the information required, the format and layout and even the headings to be used, so any deficiencies in information are readily apparent. The provision of inaccurate information would either be a breach of the Code or a breach of the Trade Practices Act. Strong sanctions apply in the event of breach, and the ACCC is a vigilant and effective regulator;

(b) The disclosure document is not intended to be the sole or authoritative source of all information. It is a starting point for the franchisee's due diligence.[59]

(4) The mediation based dispute resolution procedure set out in the Code has been extremely successful, with over 80% of disputes being successfully resolved. The cost of mediation is minimal, and far less than even the simplest court or tribunal procedure;

(5) Any aggrieved franchisee can, at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act. The ACCC is well resourced, is duty bound to investigate all claims where there is a breach of the Code or the TPA, and has a strong track record of taking enforcement action where necessary.[60]

(6) The FCA is strongly supportive of the current Federal regulatory environment. The FCA is opposed to State regulation of franchising, as franchising is essentially a national activity and there would be no issue in franchising in South Australia that would not apply across State borders.

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[59] The Code expressly notes in clause 6A the purpose of the disclosure document, being to give to a prospective franchisee "<u>information</u> from the franchisor to <u>help</u> the franchisee make a reasonably informed decision about the franchise". On the front page of every disclosure document as a mandatory requirement is a detailed statement advising that the disclosure document contains "<u>some</u> of the information you need in order to make an informed decision", and telling prospective franchisees "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>" (Underlining added to demonstrate key points.)

[60] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

22. The Franchise Council of Australia

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers involved in franchising in Australia. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. Details of the activities of the FCA can be found at www.franchise.org.au Additional information on the FCA and a list of current members of the FCA are set out in the Report on the Current State of Australian Franchising in Appendix 1.

The FCA has as its core aim the promotion of the growth and development of franchising in Australia. The FCA believes collaboration (as opposed to an adversarial relationship) between franchisors and franchisees has been one of the reasons for the success of the Australian franchise sector, and remains critical to its future success. The FCA represents franchising, and the joint and separate interests of all stakeholders, as opposed to the interests of one component of the sector over another component.

The Parliament of South Australia has indicated it wishes to consider existing laws in terms of whether they disadvantage franchisees or provide insufficient protection for franchisees. Press reports have quoted instances of alleged inappropriate behaviour by franchisors as the cause of failure of some franchisees, although no specific detail has been provided. These are important issues for the franchising community. The FCA would like to work with the members of the Inquiry to better understand the nature of the issues that have been raised with them, and provide input into the best manner of resolving any identified problems. The FCA can also play an important role in helping the Inquiry to verify the accuracy of representations made to the Inquiry, as in our experience there can often be a divergence between assertions and fact. Some of the franchising matters that have received extensive media publicity are being promoted by people with an often undisclosed self-interest in fermenting discontent and an adversarial approach to franchising. The FCA can help the Inquiry to sift through to the real facts.

The FCA has always been very concerned at any allegations of inappropriate conduct in franchising. As a result, in its submission to the recent Federal Government Inquiry into franchising, the FCA made several recommendations to improve the Franchising Code of Conduct and provide additional information and protection to franchisees. The FCA supported the legislative amendments to the Code made by the Federal Government (with bi-partisan support) and which take effect March 1, 2008. Further, the FCA has introduced its own Member Standards to provide additional guidance to FCA members on what is required of franchisors, franchisees and service providers to ensure responsible franchising. The Member Standards are supported by educational programs and a complaints process that enables the FCA to remain in touch with the issues causing concern in the franchising community.

The FCA is actively seeking information from its franchisee community as to the issues relevant to its franchisee stakeholders, including matters before this Inquiry. It has already conducted franchisee forums around the country, and this submission has drawn from that input. More broadly the FCA board has identified franchisee inclusiveness as one of its top priorities for the ensuing year. To give effect to this priority franchisee representatives have been appointed in each State, and Gloria Jeans franchisee Tony Melhem has been appointed to the FCA board to specifically represent the franchisee interests in view of the recent retirement of long time franchisee director John Longmire.

The FCA looks forward to working with the Inquiry and the South Australian Government to assist them to meet the objectives of the Inquiry and more broadly to foster the growth and development of franchising in South Australia.

23. The Development of Australian Franchising

The franchise sector in Australia makes a very substantial contribution to the Australian economy. Industry turnover is estimated at $111.5 Billion, or 3.2% of Australian Gross Domestic Product. The sector has around 1,000 franchise systems, 60,000 units and employs 600,000 people. The indirect impact of franchising is estimated at 1.5 times these figures.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. Since 1998 the sector has not only grown, but matured and developed into one of the primary engines for economic growth in Australia. We have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world' best practice.

The FCA is a strong supporter of the regulatory framework established by the Federal Government in 1998. It considers the *New Deal Fair Deal* reforms have made a very important contribution to the success of Australian franchising. The FCA believes that Australia's regulatory framework represents world's best practice in terms of striking a balance between strong and effective regulation and the fundamental principles of free enterprise. It features the comprehensive Franchising Code of Conduct requirements, which are administered by the ACCC. In addition to the Code, the Commonwealth Trade Practices Act's prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions.

The FCA believes that franchisors that break the law must be strongly punished, as their conduct affects the general reputation of the sector and the value of the assets of reputable franchisors and franchisees. The FCA has been supportive of ACCC enforcement action. The ACCC has moved quickly, such that there has not often been a need for civil action by franchisees. Interestingly, in the vast majority of cases where either a franchisee or the ACCC have taken court action they have been successful. Importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA does not pretend that franchising is perfect, and indeed has been at pains to ensure that potential franchisees are not lured to the sector by a belief in the infallibility of a franchised business. The FCA, and more recently the ACCC, have emphasised that franchising not only requires responsible franchisor behaviour, but proper franchisee due diligence. Many of the problems the FCA sees in franchising would not have arisen had the potential franchisee sought appropriate specialist legal and business advice and undertaken proper due diligence prior to purchasing the franchise. This remains probably the biggest ongoing challenge for the sector.

24. The Current Regulatory Environment

24.1 Balancing contractual freedom and regulation

The FCA is strongly supportive of the current regulatory environment. In our view it strikes an ideal balance between contractual freedom and flexibility that encourages growth and entrepreneurial behaviour, and regulatory intervention to support the contractual process and ensure informed and fair bargains are made.

The FCA believes that the two key principles that underlie effective franchising are responsible franchisor behaviour, and proper franchisee due diligence and risk awareness. The Code and the TPA prohibitions on misleading or deceptive conduct and unconscionable conduct support these principles, and do not undermine the important principle of freedom of contract. The Code requires responsible and lawful franchisor behaviour through a comprehensive disclosure regime, mandatory mediation based dispute resolution, constraints on restricting transfer and controls on termination. The Code facilitates proper franchisee due diligence and risk awareness by providing extensive information and franchisee contact details in the disclosure document, and creating a framework for franchisees to obtain independent advice and then sign (with the protection of the 14 day disclosure period and the 7 day cooling off period) without undue haste.

The FCA believes the Franchising Code of Conduct and the Trade Practices Act provide important protection for franchisees, and the ACCC has been a highly effective industry regulator. Australia's level of disputation, at just over 1%, is substantially lower than the US, which is estimated by the International Franchise Association at around 6%. Further, over 80% of disputes in Australia are successful resolved by mediation, whereas in the US arbitration and litigation are the more dispute resolution common methods. Another encouraging statistic is that the level of franchising complaints to the ACCC continue to fall, and is at historically low levels notwithstanding the substantially increased high profile of the ACCC. As a consequence the FCA considers Australian franchising is world's best practice.

The regulatory framework has only recently been comprehensively reviewed at a Federal level. The FCA supported the review of the Code conducted in 2006, and the Federal Government's response. These amendments take effect March 1, 2008. Obviously any review by this Inquiry needs to take into consideration the fact that these reforms, which include additional disclosure requirements in areas such as rebates and former franchisee information, have yet to take effect. Fundamentally the FCA believes the recently improved disclosure provisions in the Code are adequate and work well for the market.

The danger with any review is that regulatory change will be recommended without proper analysis of the nature and extent of any problem or assessment of the regulatory impact and cost. Given the objective evidence available as to the overall healthy state of the sector any recommendations should only be made after very careful analysis, properly tested evidence and having regard to the impact and cost of any proposed change.

24.2 State regulation of franchising

Although the FCA welcomes the interest shown by the South Australian Government in franchising, and is appreciative of the opportunity to discuss franchising issues with the Inquiry, the FCA is strongly supportive of the regulation of franchising solely at a national level.

There would be no issues in franchising in South Australia that would be unique to the South Australian market. Over 95% of franchisors are small businesses, and they have limited capacity to absorb the costs of excessive regulation. Most franchise systems operate, or at the very least intend to operate, across State boundaries. State regulation of franchising would create unnecessary duplication and cost at a time when all Governments are championing a reduction in regulatory red tape.

On this point, and although only generally relevant, we note that the costs of regulatory duplication have been independently recognised quite recently. In early December the Productivity Commission released a report that estimated that the concurrent regulation of consumer affairs at Federal and State level cost an estimated $4.9 billion above the cost of a unified Federal scheme. The franchise sector cannot afford even a fraction of this additional cost, and the FCA and its members would strongly resist any attempt to regulate at a State level given the existence of the current Federal regime.

It is also useful to consider the US experience, where they do have concurrent Federal and State regulation. According to the International Franchise Association the consequence of inappropriate State legislation is not only substantial extra compliance cost, but often that franchise systems simply withdraw from business activities in that State. For example the damage to the State of Iowa due to the introduction of its franchise legislation has been significant, with 135 companies reducing or halting expansion in Iowa, with a consequent cost of $207 million in lost sales and 7,500 jobs. 27 US States have since rejected Iowa type laws, and the legislation has been broadly condemned.

24.3 Understanding the current regulatory environment

Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of that framework are:-

(1) the Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. In addition to typical requirements to disclose the franchisor's business background, relevant financial information, previous litigation and solvency history and other relevant matters the Code uniquely requires the franchisor to:

   (a) include a list and contact details of existing franchisees, which facilitates contact with those parties as part of due diligence. As of March 1, 2008 franchisors will also have to disclose details of former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence; and

   (b) requires a director to certify the solvency of the franchisor as at the end of the last financial year, which provides considerable additional comfort to prospective franchisees.

(2) the Code requirement for franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice;

(3) various Code requirements governing the operation of marketing funds, prescribing a process for transfer, limiting the grounds for termination and establishing a mediation based dispute resolution process;

(4) the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act, and supplemented by 51A, which ensures that a franchisor must be able to prove it had reasonable grounds for making any representation as to a future event;

(5) the prohibition on unconscionable conduct in s51AC of the TPA; and

(6) a well-resourced regulator – the ACCC – with extensive powers of investigation and prosecution to oversee the industry and act on any complaints.

The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct.

The history of litigation in franchising shows that this protection is meaningful and effective. In the vast majority of cases where either a franchisee or the ACCC has taken court action they have been successful.[61] More importantly, and perhaps as a result of the strength of the franchisee's legal position, the low cost mediation based dispute resolution procedure set out in the Code has been phenomenally successful, with the Office of Mediation Adviser reporting that over 80% of disputes are being successfully resolved via mediation.

The FCA contends that these statistics clearly demonstrate that franchisees are not disadvantaged by current laws, and that current laws provide strong protection against franchisors that act unlawfully. The dispute resolution mechanisms are world's best practice in terms of success and cost effectiveness, and franchisees have ready access to low cost remedies such as mediation. The ACCC is an active, expert and well-resourced regulator that is duty bound to investigate, at no cost to a franchisee, any allegation that a franchisor has breached the Code or the TPA.

The FCA has enacted its own Member Standards to supplement these statutory remedies, and provide some additional remedies. Again there is no cost to a complainant.

24.4 Disclosure as part of the contractual process

The Code not only facilitates the provision of extensive information through the disclosure document, but does so as part of a process that is designed to ensure as far as is reasonably possible that a prospective franchisee makes an informed decision to purchase the franchise. The information to be disclosed includes a list with contact details of existing franchisees, which enables a prospective franchisee to make contact with those actually involved in the business to verify any information provided by the franchisor. From March 1, 2008 this requirement is extended to include a list of former franchisees. The disclosure document must be provided at least 14 days prior to signing the franchise agreement, which allows ample time to obtain advice and avoids the risk of high pressure selling. Even then there is a mandatory 7 day cooling off period, so that a franchisee can essentially change its mind and exit the arrangement without penalty.

Importantly disclosure is intended only as part of the franchisee's due diligence process. The Code expressly notes in clause 6A the purpose of the disclosure document, being to give to a prospective franchisee "<u>information</u> from the franchisor to <u>help</u> the franchisee make a reasonably informed decision about the franchise". On the front page of every disclosure document as a mandatory requirement is a detailed statement advising that the disclosure document contains "<u>some</u> of the information you need in order to make an informed decision", and telling prospective franchisees "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

The advice process established by the Code is intended to reinforce the disclosure process by endeavouring to ensure the disclosure document and other information is not only read and understood by the franchisee, but considered by an independent legal, business and accounting adviser. A franchisor must receive from a prospective franchisee before signing the franchise agreement a certificate that the franchisee has either obtained advice, or been told that the advice should be sought but has decided not to seek it. It is hard to imagine a more comprehensive process. Indeed no other regulatory regime in Australia, and probably in the world, combines the concepts of disclosure, advice and pre-contractual certification so comprehensively. The concepts of cooling off, legal and business advice and disclosure of former franchisees are uniquely Australian.

24.5 Disclosure and compliance costs

There are currently over 250 separate pieces of information to be included in the disclosure document, which must be in a prescribed order and layout. No doubt there are other pieces of information that could be included. However any change to the current format will result in compliance costs not just in making changes to the document, but in accessing the necessary information and recording information for future documents. Depending on the nature of the information franchisors may not have kept records on the matter, so information may need to be accessed from archives or other records, at substantial cost. Any additional disclosure obligations must be considered in the context of

[61] See for example ACCC v Simply No-Knead (Franchising) Pty Ltd; re Cheap as Chips Pty Ltd; ACCC v Kwik Fix International Pty Ltd, re Suffolke Park Pty Ltd and ACCC v Arnolds Ribs & Pizza Australia Pty Ltd.

the relevant compliance costs. This issue is particularly relevant given the stated purpose of the Code, being to provide "some" of the relevant information, as opposed to "all" relevant information.

24.6 Current complaints

Current research and anecdotal evidence from those associated with franchise complaints confirms that the level of complaints is low. Statistically franchisee non-compliance with the system has in fact been identified as the most significant cause of disputes. Anecdotally there also appears to be a strong correlation between complaints and a failure on the part of the franchisee to conduct due diligence and obtain independent legal, accounting and business advice.

As mentioned above, the FCA has itself received complaints from various parties involved in franchising since the launch of its Member Standards in 2005. On investigation many of the allegations of franchisor misconduct, including those that have achieved significant press coverage, have not in fact been substantiated. Further, where misconduct may have occurred, existing legal remedies were already available and appeared adequate. Interestingly, on a cursory analysis, few of the apparent root causes for the complaint appeared to relate to inadequate disclosure, but rather:-

- unwise investment decisions where a franchisee failed to undertake due diligence or seek independent legal, business and accounting advice prior to entering into the commercial arrangements;
- differences of commercial opinion as part of the ongoing franchise relationship;
- conduct by a franchisor that would appear to be illegal by virtue either of the Code or s52 of the Trade Practices Act;
- conduct of third parties such as landlords;
- mismatched expectations of business success or an underestimation of the amount of work required to achieve success;
- cost overruns in establishment costs or underestimation of start-up costs including working capital.

The FCA recognises that there have been in recent times a handful of quite public allegations of inappropriate business conduct in franchising. No doubt there are instances of inappropriate behaviour that have not come to our attention. However these complaints need to be considered in the context of the 60,000 franchisees and almost 1,000 franchise systems. Given the size of the market and the interdependent and long-term nature of the franchise relationship, often described as a business marriage, the divorce statistics in franchising are remarkably low.

24.7 Consultation and member input

The FCA submission was prepared after extensive consultation with its membership and is intended to compliment and provide background for the formal meetings with the Inquiry. It provides an overview of the sector and will identify many of the issues before the market at the moment and will also suggest some of the weaknesses in the current system.

The FCA has included with this submission some additional material providing background, or addressing specific issues. Although these documents have been prepared for other purposes it was felt that their inclusion was appropriate to assist the Inquiry in its deliberations and enable the Inquiry to gain a greater understanding of the issues before the sector. These important appendices include:

- An industry report on the current state of Australian franchising; and
- The FCA Member Standards and complaint process

We have also provided in section 5 below a commentary on the existing disclosure provisions to help the Inquiry in its deliberations.

We would welcome the opportunity to address any queries arising from our submission, or to respond to matters raised by any other submissions. We would also welcome the opportunity to provide input form the perspective of practising franchisors and franchisees to any proposed recommendations of the Inquiry to Government. Our position, and indeed our corporate objective as an organisation, is that we will support any initiative that is in the best interests of Australian franchising.

25. Disclosure Under the Franchising Code of Conduct

25.1 Introduction

The Franchising Code of Conduct provides a comprehensive regime of disclosure unparalleled in the Australian legal system.

Disclosure underpins the operation and effectiveness of the Code, and supports the fundamental legal principle that whilst freedom of contract should apply, contracts should be made between informed parties. The disclosure process is supplemented by a legal advice process to further ensure the parties have the opportunity to be fully informed.

This regime is even more effective when seen in the context of the general prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act and supporting provisions. Even without the disclosure obligation contained in the Code, the prohibition on misleading or deceptive conduct as interpreted by Australian courts of itself prevents a franchisor from providing information that is false, misleading or deceptive. It also probably prevents a franchisor from withholding information that is material and relevant to the decision, as in relationships such as a franchise relationship the courts have been prepared to find that silence of itself can be misleading. This would particularly be the case given the existence of the Code – if the franchisor is in possession of any material and relevant information that contradicts or renders misleading any information contained in the disclosure document the franchisor would be exposed to a misleading conduct claim if the franchisor did not disclose it.

25.2 The Effectiveness of Disclosure

The effectiveness of the Code's disclosure process should fairly be judged against the stated purpose contained in clause 6A of the Code, which provides (paraphrased, and with emphasis added):

The purposes of a disclosure document are:-

*1.1.1.3 to give to a prospective franchisee … **information** from the franchisor to **help** the franchisee make a **reasonably informed** decision about the franchise; and*

*1.1.1.4 to give a franchisee **current information** from the franchisor that is material to the running of the franchised business.*

It is clear from an analysis of this purpose, noting in particular words that have deliberately not been used, that:-

(1) the requirement is to provide "information", which can fairly be read as meaning "some" as opposed to "all" or even "current" information. [62]

(2) The disclosure document is intended to "help", not "ensure" the franchisee makes a reasonably informed decision; and

(3) The decision is to be "reasonably informed", as opposed to "fully" informed.

In other words the Code sees the disclosure document as an aid to the decision, and a starting point for the franchisee's own due diligence. Clause 11 supports this intention by establishing an advice process aimed at ensuring prospective franchisees understand that they should obtain legal, business and accounting advice.

The disclosure document is clearly not intended to be exhaustive. Further the specific obligation to update the document annually, and for only limited continuous disclosure of materially relevant facts under clause 18 of the Code, shows it is only intended to be relatively current. The information is intended to relate to the franchise system and agreement generally and the business history and other details of the franchisor. Investment information is intended to show a range and relate to the overall

[62] The requirement in (b) for "current" information relates only to information relevant to running the business, as opposed to the decision to purchase. The generally accepted interpretation of (b) is that it is intended to provide a purpose to renewal and extension of an existing franchise, as opposed to a grant of a new franchise where (a) is relevant, and to the obligation contained in clause 19 to provide a current disclosure document to any existing franchisee on request.

nature of the business as opposed to the specific franchisee being purchased by an individual franchisee.

In evaluating the effectiveness of disclosure against the stated purposes, it is suggested that there should be two main criteria – the structure of the disclosure requirements, and the substance of disclosure. Each factor is considered below.

25.3 The Structure of Disclosure

The requirement to provide a disclosure document and make ongoing disclosure of certain materially relevant facts is similar to disclosure regimes applying under the Corporations Act in the fundraising and financial services arena. However the franchising disclosure regime is supplemented by a requirement for advice before entering into a franchise agreement that is unique in Australia, and indeed in the world. This system is further supplemented by a 7 day cooling off process that enables the franchisee to terminate the franchise agreement without cause.

Conceptually it is difficult to see how the structure of the disclosure arrangements could be improved:-

- The disclosure document is in writing, the format and layout of the document is prescribed and the document is indexed, thereby facilitating ease of review and comparison with other systems. (Interestingly no such requirements apply under corporate law disclosure.)

- The disclosure process allows a mandatory 14 day period between provision of disclosure and signing, which is ample time for consideration and to obtain advice. (Again no such requirement exists under corporate disclosure.)

- The disclosure process applies not just to grants of franchises, but renewals and extensions and to the making of any non-refundable payment. It is therefore comprehensive;

- The requirement for advice extends to legal, business and accounting advice, which is all that any prospective franchisee would fairly expect to require. (By way of comparison the advice certificate process instituted by many banks, which is generally considered to be an industry best practice benchmark, relates only to legal advice. No legal advice requirement exists under corporate law disclosure.)

- Although the franchisor is entitled to enter into a franchise agreement if advice is not obtained, it is only able to do so if the franchisee confirms in writing that the franchisee has been told that the particular kind of advice should be sought, “but has elected not to seek it.” This places a strong obligation on the franchisor to “tell” the franchisee advice “should be sought”, and is a clear warning to prospective franchisees. Arguably any prospective franchisee that proceeds without getting advice could legitimately be expected to accept responsibility for such a decision.

The only area for possible structural improvement would be to remove the discretion for a franchisee to elect not to seek advice. The proposal to make the obtaining of advice a mandatory requirement is supported by the FCA because the FCA believes that this would in fact actually reduce even further the opportunity for mismatched expectations. However the FCA considers that some due diligence responsibility must be accepted by prospective franchisees. Arguably this responsibility should apply to a franchisee that elects at the franchisee’s peril not to seek advice despite being told to do so.

25.4 The Substance of Disclosure

The franchisor and franchisee are entering into a written contractual relationship. The fundamental rights and obligations of the parties will be set out in the contract, and the parties are free to include in the contract such provisions as they shall consider appropriate, subject to law and the specific requirements of the Code. The principle of freedom of contract underpins all business dealings, and is recognised by the nature of the disclosure obligations under the Code.

The Code also acknowledges that the principles of privity of contract are relevant to disclosure. For the most part disclosure needs to focus on the intended party to the franchise agreement, being the franchisor. Any departure from this principle needs to be justifiable in terms of relevance to the overall relationship or the decision to purchase the franchise.

25.5 The prescriptive nature of disclosure

Annexure 1 to the Code sets out the substantive disclosure requirements. The disclosure document must be in the form and order and using the headings set out in Annexure 1. The following comments are offered in the context of considering the substance of disclosure:

1. First page

The mandatory preamble reinforces the intent that the decision is "**a serious undertaking"** and "**legally binding"**, the disclosure document contains "**some"** of the information you need and the decision should be "**informed"**.

The preamble specifically advises franchisees to **"read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with the requirements of a franchised business."**

The franchisor contact detail, signature and preparation date requirements are non-controversial and sensible.

2. Franchisor details

These requirements are relatively standard internationally. They provide information on the franchisor and all associates. Further information could be obtained by company and other searches as part of due diligence if relevant.

3. Business experience

Again these requirements are relatively standard internationally. They provide information on the business experience of the people likely to be involved in the business. Further information could be obtained if desired as part of due diligence by seeking references, asking questions to the franchisor or via industry associations.

It may be useful to extend clause 3.2(b) beyond just the franchisor to at least associated companies if not associated individuals as well.

4. Litigation

These requirements are relatively standard internationally. They provide information on the franchisor. Further information could be obtained by company, court record and other searches as part of due diligence if relevant. The nature of proceedings to be disclosed is extensive and would appear to cover any claim likely to be relevant to a franchisor.

At the suggestion of the FCA the Federal Government has extended (with effect from March 1, 2008) the obligations in clause 4.1 beyond just the franchisor to franchisor directors, enhancing disclosure.

5. Payments to agents

The FCA suggested to the Mathews Committee that it may be appropriate to add the words "and the nature or purpose of the payment" at the end of the sentence concerning disclosure to agents. This is not known to be an area of great concern for prospective franchisees, and was not either recommended by the Mathews Committee or implemented by the Government.

6. Existing franchisees

This is a comprehensive and important provision that supports and facilitates the exhortation contained in clause 1 for the prospective franchisee to contact existing franchisees.

The FCA suggested to the Mathews Committee that clause 6.4 may be able to be improved, as the categories are somewhat ambiguous and overlapping. There is some argument that the substance of disclosure could be improved in this area. To assist franchisors complete this section accurately perhaps additional guidance could be provided, and franchisor's encouraged to choose the primary category. However compliance costs need to be considered, as franchisor's current recordkeeping systems will be structured around the existing categories and some adjustment time would be required should any changes be made.

The FCA supports the Government's changes (effective March 1, 2008) to include a requirement for the franchisor to disclose contact details of former franchisees as well as existing franchisees.

7. Intellectual property

This section is comprehensive and important. We are not aware of any compliance issues.

8. Franchise site or territory

This section is comprehensive and important. We are not aware of any compliance issues.

9. Supply of goods or services to a franchisee

Disclosure in this section is comprehensive and important. It links in to other sections of the Trade Practices Act, in that admissions made in answer to what are very specific questions can immediately alert advisors or indeed any investigating regulator to any potential breaches of the law. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

The March 2008 Code changes will further tighten the requirements concerning disclosure of rebates to require disclosure of the name of the business providing the rebate.

The FCA's view is that the Trade Practices Act has a comprehensive and powerful array of remedies relating to exclusive dealing, third line forcing, resale price maintenance, price fixing and unconscionable conduct to address pricing and supply issues. Franchising is no different to other forms of commerce, and no further action is required in this area.

10. Supply of goods or services by a franchisee

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

11. Sites or territories

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

12. Marketing or other cooperative funds

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

13. Payments

13.1 Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

13.2 As above.

13.3 The difficulty with disclosure in this area is that the disclosure is an overarching document intended to apply to every franchise granted. It is not intended to provide exact or specific information on the particular franchise involved, as to do so would be impossible. The information provided is a "range", and is intended only as a guide. Prospective franchisees and their advisors would secure more than enough initial information to make their own calculations and seek any additional information. Although at first glance there is potential for a prospective franchisee to be misled as to actual costs in relation to their particular investment, the s52 prohibition on misleading or deceptive conduct would provide a more than adequate remedy. The Code provides an excellent starting point, and the categories are comprehensive.

13.4 See above.

13.5 See above.

13.6 See above.

13.7 See above.

13.8 See above

14. Financing

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

15. Franchisor's obligations

A copy of the franchise agreement must be provided with the disclosure document. The franchise agreement is normally already indexed, and it is a legitimate expectation of the franchisor that the prospective franchisee will read the agreement before signing.

16. Franchisee's obligations

See 15 above.

17. Summary of other conditions of agreement

See 15 above.

18. Obligations to sign related agreements

Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

19. Earnings information

This clause largely repeats existing law, and fundamentally serves as a reminder to franchisors in the context of potential claims under s52 and s51A of the Trade Practices Act. Any breach of this section of the Code would almost certainly be a breach of s52 or s51A. Disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

20. Financial details

20.1 This is an important and often overlooked additional protection provided to franchisees, as it is in effect an annual solvency warranty. It goes far beyond disclosure, and gives franchisees substantial additional legal rights.

20.2 Although there are practical problems sometimes encountered under this section, for the purposes of the current disclosure review disclosure is extensive and more than adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

20.3 See above.

21. Updates

Disclosure is adequate in the context of the purposes of the Code or any reasonable requirements of a prospective franchisee.

22. Other relevant disclosure information

This clause is procedural and self-explanatory.

23. Receipt

This clause is procedural and self-explanatory.

26. General remarks and observations

The FCA has learnt from past experience that a number of matters are consistently raised by people who make representation to franchising inquiries. We felt it may assist the Inquiry if we provided our comments on some of these issues in anticipation. We would of course be prepared to expand upon our comments at any time.

The substance of previous inquiries into franchising.	The Howard Government in 1998 introduced the New Deal Fair Deal reform package, which was focused on improving trading conditions for small business. This followed a comprehensive Parliamentary Inquiry into the franchise sector. This Inquiry took evidence from all major cities and recorded over two hundred submissions. The Mathews Committee review of the Franchising Code of Conduct commenced in late 2006, and the Government's legislative response will take effect March 1, 2008. The Code amendments have bi-partisan support, and are well accepted in the franchise sector.
Disputation in franchising	Disputation is low by world standards. Research indicates a significant drop in disputation and an increase in mediation services to resolve franchise disputes as forecasted by the Parliamentary Committee when it recommended such action. Griffith University research indicates that disputes are less than 1%, with 30% of that 1% being listed as action taken by the franchisor for lack of system compliance by the franchisee. This means that the majority of disputes happen when franchisees do not follow the prescribed system, the very essence of franchising.
Good faith should apply on termination of a franchise agreement	There is currently a dispute between a major franchisee of KFC restaurants and franchisor Yum brands that has been a significant reason behind the establishment of the WA inquiry into franchising. In summary, the franchisee (which is a very substantial corporation) is arguing that Yum should have to negotiate with it at the end of a franchise term to either grant a further term, or pay compensation including goodwill if the franchisor wishes to take over the sites. It is being suggested that Government legislate to create a specific statutory good faith obligation to negotiate at the end of term for a renewal. The High Court of Australia has ruled on this issue, and the law is clear – once a franchise term ends, it ends. This level of certainty enables all those involved in franchising to understand their legal rights, and negotiate accordingly. The FCA strongly opposes any move to create a statutory right that would thereby advantage one party to a contract over another. The FCA understands that this is not a significant issue in the eyes of the SA Inquiry. If it is, the FCA would be pleased to expand upon its views.
Media coverage of alleged problems	In recent times, amongst the overwhelmingly positive coverage the franchise sector has received, some media commentators have reported alleged problems within the franchise sector. A number of major franchise systems have been named as having ongoing franchise disputes, but little has been provided by way of specifics. The FCA has seen little factual support for these claims. Indeed to date the FCA has been satisfied with all explanations provided when it contacted the franchise systems in question for their comment. It would appear that there has been a rather orchestrated and consistent email campaign from a small group of disgruntled former franchisees, and encouraged by journalists keen to publish unsubstantiated assertions rather than investigate the facts.

Some media commentators have questioned the Code, without conducting any real analysis of indeed demonstrating any real understanding of how the Code operates, and called in a very non-specific way for reform. Others have criticised the ACCC, and challenged the effectiveness of the mediation system.

This is legitimate media behaviour, and to some extent a consequence of the many success stories in franchising. Journalists feel the need to try and balance the ledger. However media reports should not be the basis of policy changes. The FCA accepts that media comment may have played a part in the convening of the Inquiry, but it should play no part in its recommendations or the action Government takes in response to the Inquiries recommendations.

Questions on the effectiveness of the ACCC

The ACCC has been active in taking action against franchisors that have breached the law, having undertaken around 20 effective prosecutions. Complainants who challenge the effectiveness of the ACCC seem to treat this number as proof of the ACCC's inaction, when in the FCA's opinion it is reflective of the generally excellent standards of behaviour within the sector. The ACCC has moved very quickly in all cases, and set clear precedent in the areas of Code compliance and unconscionable conduct that benefit all in the franchise sector.

The ACCC has recently instituted a process for providing a more transparent record of its enforcement activity. To some extent this was driven by a desire to correct misinformation being publicly circulated about the ACCC's activities, and the behaviour of franchisors entities under investigation. A review of this section of the ACCC website will show that the ACCC has been thorough and professional in its activities. The ACCC has also commented publicly that there have been significant differences between assertions of fact published in the media in relation to various companies, and the facts as established by ACCC investigations.

Since 2002 the ACCC has provided leadership on the management of the Code with regular meetings with the franchise sector with its Franchise Consultative Committee. This Committee meets twice a year to discuss issues pertaining to the sector. From these meetings there have been a number of initiatives have been instigated. The FCA Member Standards were introduced to endeavour to further improve industry behaviour and address matters that, whilst not breaches of the law, might benefit from some form of third party intervention. The ACCC has recently introduced its Franchisee Start Up Checklist, and there are various educational initiatives in progress.

Is there sufficient pre-entry education of franchisees?

No. Education has been determined to be critically important for the future development of the sector, in particular education of pre-entry franchisees. The FCA has proposed many initiatives, but funding has not been made available. The FCA focuses upon educating our franchisor members about best practice, and those initiatives are ongoing. We, the ACCC and others have also focused on providing extensive information to prospective franchisees via our participation at franchise exhibitions, our FCA website and our publications. Prospective franchisees these days are as a result much better informed than has ever been the case, a fact verified by our franchisor members in industry forums. With full employment, franchisee recruitment is a competitive business and standards are continually rising not to meet compliance obligations, but to secure the best franchisees by providing the best returns and security of investment.

Do existing laws prevent "churning" in franchising.

Yes they do. Prior to 1998 there were allegations of "churning" in franchising in Australia. What was happening, in a small number of franchise systems, was that franchisors were in essence selling franchises that were not viable. When the franchisee failed, the franchisor in essence resold the same franchise. This happened in particular in the service sector, where the costs of the franchise were relatively low and there were not premises or other complications. Although franchisees lost money, and would have had a pretty good legal claim under s52 of the Trade Practices Act, the cost of legal action to recover perhaps $20,000 - $30,000 was somewhat prohibitive, particularly as the franchisors themselves were often marginal in terms of asset backing.

The Government quite rightly addressed these issues in the New Deal Fair Deal reforms, which included the Franchising Code of Conduct but also featured a new prohibition on unconscionable conduct and provided increased funding for the ACCC to regulate the sector. The Franchise Council of Australia also acted, including a specific prohibition in their Member Standards on selling a franchise when there was no reasonable prospect of it being profitable.

The reforms in 1998 have strengthened the law and protected franchisees in the following specific areas:-

- the mere introduction of the Code, backed by the ACCC's careful supervisory eye, has introduced barriers to entry for franchise systems that keep out most of the marginal operators;
- any allegation of "churning" in Australia post 1998 would constitute a clear breach of not just the Code, but s52 of the TPA and probably s51AC (unconscionable conduct). The ACCC would therefore have to become involved on receipt of any complaint;
- the ACCC has done an excellent job of enforcement. As soon as the ACCC receives a complaint alleging breach of the law they act promptly and professionally.
- the Code requires specific disclosure of the history of a particular premises or site. This has been augmented by the most recent reforms;
- the franchisor has to provide substantial information concerning its financial history, in fact over 250 separate pieces of information;
- the Code requires specific disclosure of franchisee exits. This has been further augmented by the most recent reforms, which in effect enable a prospective franchisee to contact all recent previous franchisees including those who may have departed the system.

The commercial reality is that franchise systems get no financial or other joy from the business failure of a franchisee. Invariably the franchisors lose money as well, through unpaid royalties, the costs of operating the business while a solution is sought, the costs of recruiting and training a new franchisee, the cost of concessions given to any new franchisee to get the business back up and running etc.

Systematic failure, or unsolvable problems?

The Inquiry will no doubt receive submissions from various parties asserting that the current regulatory framework is inadequate. The real issue to determine is whether, in the context of the stated objectives of the Code, there is a systemic problem within the sector that requires change to a successful regulatory structure. The FCA is not privy to all submissions, so cannot provide a pre-determined response. However our own experiences with the FCA Member Standards provides some insight into the likely nature of submissions you will receive. To the extent that they are of commercial substance they are likely in the main to relate to matters already covered within the Code, to matters that would be a breach of existing law such as the Trade Practices Act, to conduct of third parties such as landlords, to matters that resulted from poor franchisee due diligence or to matters for which it would be almost impossible to provide any legislative protection.

Any change will create costs

It should be recognised the cost of compliance is already quite high, and any changes at all will add to the cost. The FCA and its members would strongly resist any proposal which increased compliance cost in a sector already burdened with comprehensive Federal Government compliance.

"Franchisor does not fully disclose"

The Code requires franchisors to disclose more than 250 items as a starting point to the franchisee's due diligence. The disclosure document is not intended to be an exhaustive source of all information – as stated on the front page it provide "<u>some</u>" of the information required to make an informed decision. Franchisees must accept responsibility for the investment decision. They cannot simply assert that the franchisor did not "fully disclose." Franchisees are clearly warned to "<u>take your time, read all documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with requirements of the franchised business</u>". Franchisees are also advised to "<u>make your own enquiries, … get independent legal, accounting and business advice, … prepare a business plan and projections for profit and cash flow … and consider educational courses, particularly if you have not operated a business before.</u>"

Further,s52 of the TPA applies to disclosure. Irrespective of the Code requirements, if a franchisor provides a compliance disclosure document but fails to disclosure a material fact that would have altered the franchisee's decision to proceed the franchisor is likely to have breached s52 of the TPA. The Code does not provide a defence to a s52 claim – that claim is judged on its separate merits.

The Code provides for the franchisee to seek legal, business and accounting advice. If advice is obtained any non-disclosure would be apparent to the relevant expert, and therefore the franchisee.

"Franchisor does not disclose trading figures"

Many franchise systems do provide historical trading figures as a matter of course, whilst others will provide them on request. There is no obligation on a franchisor to do so, and considerable risk in the context of a potential s52 claim should the franchisor provide any financial information. Such an obligation could not be mandated in the Code, as it would expose franchisors to unreasonable compliance costs and liability. A prospective franchisee has access to existing franchisees, and can thereby obtain much of this information other than via the franchisor. Ultimately this is a factor for the franchisee to consider when making an informed decision – if figures can not be substantiated, the franchisee should not proceed.

The franchisor is restricted in providing income projections by the Code and is restricted to historical information unless the franchisor wishes to take on the additional liability for projections contained in s51A of the TPA. Some franchisors provide a variety of trading actuals from franchisees within the system. Others provide full disclosure of all franchisees trading. Others provide nothing fearing the implications of Section 51A and 52 of the Trade Practices Act.

"Poor advice received"

Such an assertion should be treated with caution. It is true that the quality of understanding of franchising outside the franchise sector, and indeed possibly within it, is variable. However most advisers would have professional indemnity cover should poor advise be provided.

A far bigger problem is franchisees failing to seek advice.

There is an argument that franchise advice and education should be mandatory prior to entry into a franchise system however this then becomes a philosophical question which raises issues of government control in the economic structure of the country. Education is vital but should it be mandatory?

The FCA is currently establishing an accreditation system for those providing advice to franchisees, and is broadening its educational activities to legal and accounting professional bodies. The FCA considers no other action is necessary.

"the Franchisor has too much power"

The relationship between the franchisor and the franchisee is a contractual relationship akin to a commercial partnership. It is not a relationship of equals. The franchisor generally has more risk and money invested, has developed the brand and requires trading consistency within the market. Therefore the franchise business format model requires the franchisor to control aspects of the franchisee's behaviour that are relevant to the brand and the performance of the network. Decisions may need to be made that could affect the franchisee. This is the nature of franchising, and is clearly outlined within the franchise agreement. It should not be a surprise if a franchisee has undertaken appropriate due diligence.

Understanding the franchise relationship and the rights the franchisee has is a vital element within the relationship and this is why the Government advised franchisees to seek advice prior to entering the agreement. If a franchisee does not seek advice and then disputes the franchise agreement and the Disclosure document - is this the franchisor's responsibility of the franchisee's?

Retail Leasing Issues

As identified in the Fair Trading Inquiry in 1997, the practice of the landlords in major shopping centres continues to impact upon the relationship between the franchisor and the franchisee. The Landlord has monopolistic powers within standalone shopping centres and although most state legislation seems adequate the manipulative powers of the landlord prevails.

State legislation does not address the three major issues:

- excessive rent reviews;
- inadequate tenure and lease terms; and
- unequal information and bargaining power.

Issues of lease renewal and other tenancy matters can impact upon a franchisee and they can remain captive to a site because of the power the landlord has which therefore impacts upon the Franchising Code of Conduct provisions and the relationship between the franchisor and franchisee.

In its submission to the Mathews Committee the FCA recommended that the Federal Government review the retail leasing market and introduce a Code of Conduct for Shopping Centre management. This Code should provide that:

(1) landlords cannot increase rent beyond a specified multiple, say 15%, without providing clear written justification and being subject to an appeal process to ensure franchisors and franchisees are not held to ransom in their captive market;

(2) lease terms must be such as to ensure an adequate return or investment for a tenant;

(3) landlords must provide on request all available rental information in a shopping centre in the event of any rental dispute.

Appendices

3. FCA Industry Report

(Please note that the information, statistics and list of members in this Industry Report were accurate as at May 2006. Some aspects of the Report are no longer current. The FCA Chairman is now Mr John O'Brien, and some of the statistics have been superseded by the statistics contained in the body of this submission. However the essence of the Report remains relevant.)

4. FCA Member Standards

Appendix 1

FCA Industry Report

PROUD MEMBER OF

FCA

FRANCHISE COUNCIL OF AUSTRALIA

FRANCHISE COUNCIL OF AUSTRALIA REPORT ON THE CURRENT STATE OF AUSTRALIAN FRANCHISING

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27. The Franchise Council of Australia

The Franchise Council of Australia (FCA) was formed in 1983 and is the peak industry body in Australia, with responsibility for representing all sectors of the franchise community. It is a not-for-profit membership based association, and does not receive ongoing government funding.

As franchising is a global activity, the FCA is affiliated with franchise associations around the world and was a founding member of the Asia Pacific Franchise Confederation. It is also an active member of the World Franchise Council. This enables the FCA to have access to the latest global information on franchising, and to receive information on any franchising trends that may have relevance to the Australian market. The international links are also intended to assist Australian systems to enter foreign markets.

The FCA has excellent relations with the Australian Competition & Consumer Commission (ACCC), the Office of Small Business, Austrade and other industry bodies. The FCA meets regularly with the ACCC and is a key member of the ACCC Franchising Consultative Committee.

Membership of the FCA is open to individuals and organisations that are involved in franchising. There are several membership categories designed to accommodate franchisors, franchisees, advisors and service providers. A list of current members of the FCA is included at Appendix 1.

The FCA is structured to enable the organisation's professional management team to access the collective intellect of its members to supplement the skills and experience they bring to the FCA. Chief Executive Richard Evans, a former Federal parliamentarian with extensive franchising and small business experience, has day-to-day responsibility for the operations of the FCA, with his personal focus being the interface between the franchise sector and other stakeholders such as Government and the public. Other FCA employees have specific skills in education, event management and member services.

At a strategic level, a board of ten directors manages the FCA. Five directors are State Chapter Presidents, who each preside over a State Chapter Committee and are elected by the respective state chapter members. The other five directors are elected on a national basis at the Annual General Meeting. At least three of the five nationally elected directors must be either a franchisor or franchisee. There are State chapters in New South Wales, Queensland, South Australia, Victoria and Western Australia, with a National Secretariat based in Melbourne.

A list of current directors and senior executives of the FCA is set out in the table below. A brief summary of their franchising experience has been included to illustrate the skills and experience available to the FCA.

Chief Executive Officer	Richard Evans	A former franchisee who entered Federal politics as the Member for Cowan in 1993. Richard served on the House of Representatives Committee that handed down the landmark Fair Trading Report, which resulted in the introduction of the Franchising Code of Conduct and other reforms.
Chairman	Stephen Giles	Partner with Deacons and generally acknowledged as Australia's leading franchising lawyer. Author of numerous publications including Franchising Law & Practice, The Franchisor's Manual and Going International – A Guide for Australian Franchise Systems.
Deputy Chairman	John O'Brien	Managing Director and owner of Poolwerx Corporation, John O'Brien (PoolWerx Corporation) has the unique distinction of having been an Australian Franchise Council Franchisee of the Year (Queensland), inaugural Australian Master Franchisor of the Year, Franchisor of the Year (services category – twice), and current Australian Franchisor of the Year outright. His experience in the franchising sector spans more than 20 years.
Victorian President & Finance Director	George Yammouni	George Yammouni, B.Bus., Director, George Yammouni, B.Bus., Director, George is the CEO of the Bathroom Werx Group (which includes Mend-A-Bathroom) - a National Franchise System which specialises in bathroom restorations and renovations. Having started life as a Franchisee in 1986, he acquired the Australian Franchise in 1988 and then began franchising in 1990. Serving on Victorian Chapter Committee since 1993 and is currently Chair of the FCA Board Finance Committee.
NSW President	Ken Roseberry	Ken Roseberry is Chief Executive Office of Fastway Couriers, a position he has held since 2002. Fastway was established in Australia in 1993, boasts nearly 500 franchisees Australia-wide, and is a previous winner of the FCA's 'Franchise System of The Year'. Fastway now operates in 12 countries. Ken's other career highlights include being the CEO of; Australian Geographic, Qantas Holidays, Tourism Queensland, the Gold Coast Indycar Grand Prix, and promoter of the 1988 Bicentennial First Fleet Re-Enactment. Ken holds an MBA and has served on the FCA NSW Chapter for the past two years, being elected as Vice President in 2005.
Qld President	Philip Ciniglio	Philip has over 30 years of business, sales and marketing experience through his involvement with large global corporate organisations such as Bridgestone, Century Yuasa Batteries and Retail Food Group, having held senior positions in General Management, marketing, sales management and franchising. Philip has been associated for over 20 years with the Franchise Council of Australia and is currently a Director on the National Board and President for the Queensland Chapter.
WA President	Steve Hansen	Stephen is the Managing Director of the fast food chicken chain "Chooks Fresh & Tasty", formerly River Rooster. Steve started his career in banking, spending 4 years in PNG and many branches in the West. Steve started in franchising in 1983 as a franchisee, becoming a franchisor in 1991 with the River Rooster Brand. Steve has been involved with the FCA WA chapter for over 8 years and is passionate about franchising.
SA President	Steve Butler	Steve Butler is the National Franchise Manager for Beaumont Tiles, who are the largest distributor of ceramic wall and floor tiles in Australia. He has been in this position for 5 years. Prior to this he owned 3 South Australian Beaumont Tiles franchise outlets for a period of 15 years and has been in this industry for just under 30 years. He has served on the committee of the FCA in South Australia for 3 years, Vice President last year and recently taking on the role of President.
	Chris Malcolm	Chris Malcolm has been active in franchising for over 15 years. Initially with Solomon's carpets, he has more recently been involved with the Clark Rubber brand and has reinvented it as a vibrant modern retail network. Chris had a 2-year chairmanship of the Franchise Council of Australia during the mid 1990s and guided the Association through a restructuring process that resulted in a reinvigorated organisation with a national focus. Chris served for 5 years on the national board of the FCA, and is an active participant in the franchising debate.
	John Longmire	John owns five Just Cuts salons in the ACT and employs 80 staff. Prior to entering franchising John worked in government for 15 years. He started in franchising in June 1994 with the first Just Cuts salon outside of Sydney and is now part of an Australia-wide network of 120 salons. John was Highly Commended Franchisee of the Year in 1995 and 1996, the NSW/ACT Franchisee of the Year in 1998, and 1999 and the National Franchisee of the Year in 1999.
	Noel Carroll	Noel Carroll co-founded Michel's Patisserie, a multi-award winning franchise system he built to over 350 outlets. Michel's was Franchise System of the Year in 2003 and 2004. Noel has recently also taken an interest in two emerging franchise systems in the health and hairdressing field. Prior to Michel's, Noel's 15 year corporate career included senior management roles with S.A. Frozen Foods, R.M. Gow Frozen Food Division, McCain Foods, Sara Lee and Defiance Milling.

28. Executive Summary

The Franchise Council of Australia is the peak industry body for the franchise sector. The FCA represents the vast majority of franchisors, franchisees, advisors and suppliers to the franchise sector. The FCA represents the sector in discussions with Government, and conducts extensive educational and networking activities throughout Australia. A list of current members of the FCA is set out in Appendix 1.

The franchise sector in Australia makes a very substantial contribution to the Australian economy. Industry turnover is estimated at $111.5 Billion, or 3.2% of Australian Gross Domestic Product. The sector has around 900 franchise systems, 53,500 units and employs 550,000. The indirect impact of franchising is estimated at 1.5 times these figures.

Once seen predominantly as a growth strategy for small business that had difficulty accessing capital, franchising is now seen as a business method that delivers enduring competitive advantage to both franchisors and franchisees. Franchising is the dominant business method in many business segments, including motor vehicle distribution; automotive retail, servicing and repair; bulky goods retail; specialty retail; quick service restaurants; convenience stores; real estate; travel; finance and mortgage lending; petrol retail; hairdressing; fitness, health and beauty; pharmacy; and home services. Franchising is used by small business and large corporations alike, and the benefits of franchising are now universally recognised.

Franchising has changed in recent years, with the sector maturing substantially since 1998 both in terms of size and conduct. Franchising has always been seen as having many benefits, and reputable franchise systems prospered in a way that benefited both franchisors and franchisees. However the nature of the franchise relationship was open to exploitation prior to 1998 in Australia, when franchising operated in a de-regulated environment. As a consequence the public perception of franchising was tarnished to some extent by several high profile franchise failures and a somewhat cavalier attitude by some franchisors to the franchise relationship. Behaviour in the sector was not universally appropriate, and franchisees had far less investment security. The predecessor body to the FCA, the Franchisors Association of Australia, was fundamentally a franchisor networking group, and was described in Federal Parliament as unrepresentative and “controlled by a small cabal of franchisors”. This is a far cry from the multi-representative and highly professional industry body the FCA is today.

The regulatory framework established by the Federal Government in 1998 has made a very important contribution to the success of Australian franchising. It provides strong regulatory protection for franchisees through the Franchising Code of Conduct, which is administered by the Australian Competition and Consumer Commission. A copy of the Franchising Code of Conduct is in Appendix 2. In addition to the Code, the Commonwealth Trade Practices Act’s prohibitions on misleading or deceptive conduct and unconscionable conduct apply to franchising transactions. As a consequence we have seen genuine behavioural change from franchisors, who have embraced the regulatory framework and developed franchise systems that are world’ best practices.

The FCA worked closely with the Government in preparing the Franchising Code of Conduct. This work continues today to ensure there is ongoing review and amendment of the Code as required. There is also a strong ongoing collaborative relationship with the Australian Competition and Consumer Commission in regard to the Code, and the application of the Trade Practices Act within franchising.

The current regulatory environment finds the correct balance, providing a strong regulatory framework without unnecessarily impeding the flair of franchising entrepreneurs. Mr. Peter Reith, Federal Minister for Workplace Relations & Small Business, in his Foreword to the Franchising Code of Conduct commented as follows:

> *"Franchising is one of the fastest growing business sectors in Australia. Franchising is a unique way of doing business, built on mutual trust. The growth and development of franchise systems is dependent upon the relationship between the franchisor and its franchisees…. The Commonwealth Government is strongly committed to the growth and prosperity of the franchising sector."*

Although growth slowed for a very short period while the sector came to grips with the new compliance obligations, growth has continued since 1999 at similar rates to the pre-Code period. Importantly the regulatory framework has dramatically reduced the levels of disputation and enhanced the public perceptions of franchising. Largely as a result of the mediation based dispute resolution process contained in the Code, strong enforcement oversight by the ACCC and pro-active educational activities conducted by the FCA, disputation in Australian franchising is now extremely low. The Franchising Australia 2004 Survey estimates that around only 1% of franchisees are in “substantial dispute”, with “substantial dispute” being very broadly defined beyond just litigation to include anything involving a solicitors letter or above. This compares extremely favourably with the United States, where the level of disputes is estimated at around 6% and many disputes are resolved in the courts. The Code’s mediation based dispute resolution process has been an outstanding success, with around 75% of all franchise disputes in Australia resolved by mediation.

The FCA has further strengthened the franchise sector framework by introducing its Member Standards of Conduct. The Member Standards do not impose new legal obligations on franchisors, but they provide greater detail in terms of typical expectations of franchisors and service providers and introduce additional mechanisms for the FCA to be able to monitor behaviour and intervene pro-actively to ensure disputes are resolved quickly and cost effectively. A copy of the FCA Member Standards is in Appendix 3. Most franchise complaints today do not involve breaches of the law, but rather mismatched expectations. By taking control of the complaints process, the FCA aims to ensure such mismatched expectations do not escalate into court cases or media field days that harm the hard earned good reputation of Australian franchising.

With the prospect of an enhanced compliance process, and widespread adoption of comprehensive risk management systems, business risk for franchisees and franchisors is likely to further reduce. New developments in the area of specific franchise insurance products and further innovations in franchise sector lending are likely to drive further growth and development of the sector. Franchise systems are well placed to surf the wave of industry mega-trends, and meet the increasingly demanding needs of customers due to the unique relationship of the franchisor and franchisee. Franchisors can focus on branding, systems design and compliance management, while franchisees can concentrate on the customer relationship, delivering superior customer service and providing the coalface information needed to drive innovation and system improvements.

29. The Economic Impact of Franchising in Australia

29.1 Franchising Australia 2002

The FCA has commissioned regular independent surveys of the franchise sector. All paint a similar picture of growth, development and business success. One of the most relevant remains *Franchising Australia 2002, the Commonwealth Bank Franchising Survey*, released in August 2002. The survey was undertaken by Griffith University and sponsored by the Commonwealth Bank, and provided one of the most comprehensive reports on the status of the franchising sector in Australia. Much of the information remains relevant today.

The report confirmed the continued growth and increasing maturity of franchising in Australia. It also provided an insight into the economic contribution, development, trends and concerns of the sector. Speaking at the FCA national conference, FCA Chairman Stephen Giles welcomed the survey as further evidence of the value of the franchise sector to the Australia economy:

> *"It is now beyond rational argument that franchising delivers competitive advantage to the franchisors and franchisees that embrace best practice franchising principles in their business. The franchise sector delivers $80 billion in annual turnover, employs 500,000 people, has around 420,000 permanent employees, generates $292 million in annual export earnings, and has 90% of its business owners earning profits beyond wages. These are stunning figures."*

The FCA Chairman went on to note that the survey confirmed, contrary to some perceptions, that there is a very low level of disputes in franchising.

> *"It is pleasing to see that less than 1% of franchisees were involved in a "substantial dispute" with their franchisor, meaning a dispute involving litigation, mediation or correspondence with a solicitor. 81% of franchisors recorded no substantial disputes at all in their system in the past 12 months. These are important statistics for those thinking of buying a franchise, and further signs of the increased maturity of the sector."*

The key points of the Franchising Australia 2002 Survey, which was the first of its kind since 1999, were summarised as follows:

- There were approximately 700 franchise systems in Australia, or 3 times as many per head of population as in the USA. (This figure has now risen to around 900 according to Franchising Australia 2004 and the IBISWorld Report.) Over 90% of these systems were home grown. On average, Australian franchisors have been operating for 15 years, and franchising for 9 years.

- There were almost 50,000 franchised outlets. (This figure has now risen to around 60,000.) The number of franchised units had grown by 8.5% since 1999. An indicator of the success of franchising, and indeed the increasing maturity of the sector, was that the average number of franchised units per franchise units had grown by 100% since 1999.

- Franchising was big business in terms or export earnings, much bigger than had previously been appreciated. $292 million per annum was generated from overseas operations of Australian franchisors in 2001. 25% of Australian franchisors had expanded overseas, with 62% indicating an intention to do so in the next 3 years. This was up from 22% in 1999. New Zealand was the most popular destination (74%) followed by the UK (36%), USA (34%), Singapore (34%), South Africa (26%) and Europe (26%).

- The sector employed approximately 500,000 people, with permanent employment having risen dramatically to 83.5% of the workforce. This figure is now estimated at around 600,000.

- The level of disputation in franchising continued to fall, with less than 1% of franchisees in serious dispute with their franchisor. As with the 1999 survey, the top causes of substantial disputes were lack of compliance with the system (27%) and payment of fees (15%). Franchise re-sales provided further evidence of the strength of the sector, with 74% of franchisee exits resulting from sale of their business. Where the exit was due to franchisor or franchisee termination, lack of suitability to franchising and personal/family reasons were the main exit reasons identified.

- Franchised businesses remained affordable, with average start up costs being $62,500 for mobile and $208, 000 for fixed location franchisees (excluding GST).

- Although there is risk attaching to every business, 90% of franchisees were reported as earning profits beyond employee wages. This figure compared extremely favourably with the small business sector generally.

- Although the Franchising Code of Conduct had improved franchisor/franchisee relationships (53%), been beneficial to the sector (79%) and required franchisors to keep more detailed records (62%), there remained issues to be addressed to improve the effectiveness of the Code. The embryonic nature of the franchise mediation was demonstrated by the survey finding that, despite the requirements of the Code to attempt to resolve disputes through mediation, more disputes were in fact resolved through litigation (23%) than mediation (17%). It is important to note that this figure has now changed very dramatically, with most franchising disputes referred to mediation, and mediation achieving success in around 75% of cases.

- Cost of compliance, difficulty and uncertainty in compliance, excessive disclosure requirements and the ACCC influence over the sector rated highly as concerns in the regulatory area. These concerns have largely evaporated.

- Lack of suitable franchisees and insurance cover and cost were rated the most critical business issues by franchisors.

29.2 Franchising Australia 2004

The results of the Franchising Australia 2004 Survey conducted by Griffith University confirmed the continued growth in franchising in Australia and revealed that franchising techniques were in use in most industry sectors.

The research identified a total of 850 business format franchisors in Australia. The sector comprised 50,600 franchised outlets, together with around 3,400 company owned outlets. The growth from 1994 had been substantial, as the Australian Bureau of Statistics reported a total of only 24,500 franchised outlets in 1994. The growth in franchised outlets was 14 percent per annum from 1991 to 1994 (ABS) and 15.5 percent from 1989 to 1991, confirming a decade of strong performance.

Probably as a result of compliance responsibilities associated with the introduction of the Franchising Code of Conduct, the growth in 1999 reduced to around 6%. However, between 2002 and 2004 growth increased again to 14%.

The 1998 Survey revealed that the total turnover of business format franchised outlets was $22.4 billion, with $14.1 billion in turnover for company outlets, yielding a combined total of $36.5 billion. Motor vehicle and automotive fuel retailers were not included in these figures. If these groups are added, the estimated turnover is in excess of $80 billion. The total number of people employed in business format franchise systems (including motor vehicle retail franchises and automotive fuel retail franchises) at the time of the 2004 survey was around 600,000. 33% were permanent full-time employees, 50% permanent part-time and 17% casual employees.

29.3 Other relevant statistics

The various franchising surveys have provided the following additional information on franchising in Australia:-

- 10% of franchises are owned by couples, 74% are owned by men and 9% by women. A significant proportion (43%) of those owners are in the 41-50 years age group. Single unit franchise ownership is the norm in Australia, although the number of multi-unit franchise owners continues to grow. Master franchising and sub-franchising are common expansion methods, particularly for mobile or service franchise systems.

- Franchising continues to expand through all regions of Australia. New South Wales and Australian Capital Territory (31%) have the greatest concentration of outlets, similar to the population distribution. However, Queensland (22%) and Western Australia (13%) continue to exhibit a greater acceptance of franchise systems in that they host noticeably larger proportions than their populations.

- Of the total franchise systems in Australia, 95% were business format franchise systems, 0.4% were motor vehicle franchise systems and 0.1% were major auto fuel retail franchise systems.

- Australia is the most franchised nation per head of population in the world. That is, there are more franchise systems in Australia compared to our population than any other country, and Australia has at least three times as many franchise systems per head of population than the United States.

- The average length of time that current franchise systems have been franchising is 8 years.

- Franchising enjoys a small business success rate more than 2 and a ½ times greater than stand-alone small business. Each year, only 1% of franchisees leave their businesses.

- In 2002 24% of Australian franchise systems operated overseas, with a further 27% of systems planning to commence foreign operations within the next 3 years.

29.4 IBISWorld Report information

The IBISWorld Industry Report of 3 February 2006, which is the most recent industry report, confirmed the substantial contribution of franchising to the Australia economy. IBISWorld estimated that in 2004/05:

- the sector generated gross revenue of $111.5 billion;

- gross domestic product was $27.3 billion, or 3.2% of total Australian GDP;

- this turnover was an increase of 9.7% on 2003/04;

- there were 53,500 units;

- there were 900 franchise systems; and

- the sector employed 550,000 people, for a total wage bill of $15.9 billion.

Strong growth had been experienced in previous years, with turnover growth rates of 16.1%, 11.0% and 9.7% in the past 3 years. In the same period the number of franchise units had grown by 5.1%, 8.5% and 5.7% and the number of franchise systems by 10.7%, 9.7% and 5.9%. Employment had grown by 15.8%, 12.7% and 8.4%, and total wages by 18.3%, 12.4% and 8.1%.

The IBISWorld Industry Report determined food retailing to be the leading segment at 31.0%, with non-food retailing (furniture, books, whitegoods and clothing) at 30.0% and property and business services (real estate, finance, building) at 24.0% and other including education, training, domestic services, automotive and childcare) at 15.0%. It noted that financial services and retail food had experienced the strongest growth in recent years, but every area of commercial activity had been subject to some growth via franchising.

The distribution of franchise units amongst the States and Territories was generally consistent with population levels and availability of suitable premises. New South Wales had 31% of franchise units, followed by Queensland and Victoria at 22% each, Western Australia at 9%, South Australia at 8%, Tasmania at 4% and ACT and Northern Territory at 2% each.

In the 5 years to 2004/05:
- the sector experienced average revenue growth of 5.5%;
- gross domestic product grew by 4.0% per annum; and

- the number of systems grew by an average of 5.8%.

Turning to the future, IBIS World offered the following predictions:

	Revenue	Growth	GDP	Growth
2005	$111.5 Billion	9.7%	$27.3 Billion	8.3%
2006	119.3 Billion	7.8%	$29 Billion	6.0%
2007	$125.3 Billion	5.0%	$30.3 Billion	4.5%
2008	$132.8 Billion	6.0%	$31.9 Billion	5.5%
2009	$139.4 Billion	5.0%	$33.6 Billion	5.2%
2010	$145.7 Billion	4.5%	$35.2 Billion	4.8%

This yields an average annual growth of 5.5% in revenue, and 5.2% in GDP, which compares favourably to the predicted growth in Australian GDP of 3.5% over the same period.

IBISWorld concludes that the sector will transcend from the growth to mature stage of its lifecycle, but notes that "there is still room for the domestic growth in the franchising sector as low failure rates and low levels of disputation along with the relative security and stability of the sector attract small business investors. Investors are increasingly looking for new expansion opportunities internationally….as much future industry growth will come from offshore opportunities" (p39). BRW (June 23-29, 2005) predicts that the sector is set to continue experiencing strong growth, and IBIS World quotes PriceWaterhouseCoopers as predicting that the sector will double in the next 15 years and account for around 24.0% of Australian GDP.

29.5 Indirect impact of franchising

The International Franchise Association released a report on the direct and indirect impact of franchising in the United States by PriceWaterhouseCoopers. PWC determined that the direct and indirect impact of franchising in the US economy was approximately 1.5 times the direct impact. Although no similar report has been conducted in Australia, there are such strong similarities between US and Australian franchising that the indirect impact of franchising in Australia is likely to also be around 1.5 times the direct impact.

29.6 International statistics

The growth and development of franchising has been a global mega trend. The following information extracted from statistics provided by the World Franchise Council in 2004 indicate the penetration of franchising into many developed economies.

Country	Franchise Brands	Total Outlets	Sector Turnover (Billions)	Sector Employment	Total Population
EUROPE					
Austria	330	4,700	EU 3.00	60,000	8,174,000
Belgium	100	3,500	US 2.80	30,000	10,348,000
Czech Rep.	90	300			10,246,000
Denmark	128		US 0.07	22,316	5,413,000
Finland	177	3,666	EU 4.88	46,000	5,214,000
France	835	62,981	EU 94.78	400,000	60,424,000
Germany	845	45,200	EU 28.00	406,000	82,424,000

Great Britain	718	31,300	EU 13.30	327,000	60,270,000
Greece	430	6,540			10,647,000
Hungary	300				10,032,000
Italy	708	44,426	EU 16.90	117,783	58,057,000
Latvia	8				2,306,000
Netherlands	453	19,600	EU 18.80	187,000	16,318,000
Poland	210	13,500	EU 1.10		38,626,000
Portugal	489	8,500	US 3.40	53,000	10,524,000
Russia	95	1,850			143,782,000
Slovenia	106	980			2,011,000
Spain	650	42,554	EU 14.00	186,000	40,280,000
Sweden	300	9,600	EU 8.42	67,000	8,986,000
Switzerland	180				7,450,000
Canada	850	80,000	US 90.00	1,000,000	32,507,000
USA	1500	760,000	US 1,500.00	9,700,000	293,027,000
LATIN AMERICA					
Argentina	300	10,000	US 2.00	180,000	39,144,000
Brazil	814	59,028	US 1.00	531,000	184,101,000
Columbia	120	4,667		35,000	42,310,000
Mexico (year 2005)	720	462,000	US 50.00	500,000	104,959,000
ASIA					
PPR China	2,100	120,000	US 29.60	2,400,000	1,298,847,000
Hong Kong	92	3,000			6,855,000
India	850	48,000	US 3.80	300,000	1,065,070,000
Japan	1,100	220,000	US 170.00	2,000,000	127,333,000
Malaysia				500,000	23,522,000
Philippines (year 2003)	850	68,000		1,000,000	86,241,000
Singapore	380	3,000	US 2.00		4,353,000
PACIFIC					

Australia		720	US 62.00	600,000	19,913,000
New Zealand	350				3,993,000
AFRICA					
Egypt					76,117,000
South Africa	391	22,895	US 19.90	285,000	42,718,000

30. History of franchise regulation in Australia

30.1 The Current Regulatory Regime

The franchise sector in Australia is regulated by the Franchising Code of Conduct, which was introduced with effect from October 1 1998, as part of a range of Federal Government initiatives called the *New Deal: Fair Deal* reforms.

The Franchising Code of Conduct is a mandatory industry code prescribed by regulations under the Trade Practices Act (TPA) Pt IVB. The Franchising Code of Conduct was introduced by the Trade Practices Amendment (Fair Trading) Act 1998 in response to strong criticisms of business conduct in the franchising sector, in a report to the Federal Government known generally as the Fair Trading Report. At the same time the Federal government also introduced section 51AC of the TPA, which prohibits unconscionable conduct in small business transactions. Although not specifically targeted at franchising, section 51AC, in tandem with the broad and general prohibition of misleading or deceptive conduct under section 52 of the TPA, confers significant additional protection on franchisees.

The Franchising Code of Conduct is an important development for the Australian franchising sector. It imposes significant obligations on franchisors in relation to prior disclosure, substantive obligations and dispute resolution. The Code was modelled on the previous voluntary Franchising Code of Practice, but evolved considerably in scope and application during the exposure draft stage. During this stage the Franchising Policy Council, appointed to advise the government on its initial content and ongoing review, consulted widely with the sector. As a result some of the clauses in the draft Code which dealt with relationship or conduct issues, such as those which imposed obligations to pay compensation on termination of a franchise in certain circumstances, were removed.

The introduction of the Code does not limit the operation of the general law, which continues to govern the formation and general operation of franchising relationships. The main areas of law influencing franchising are contract, restrictive trade practices, intellectual property, consumer protection, fair trading, and revenue laws, in addition to retail leasing. Franchising is also subject to the TPA, which focuses upon competition and consumer protection. Of particular relevance to franchising is the prohibition on “misleading or deceptive conduct” contained in section 52.

30.2 The Origins of the Franchising Code of Conduct

The debate on the difficult issue of whether franchising should be subjected to a specific regulatory regime, commenced shortly after the introduction of business format franchising in Australia in the early 1970s.

Since 1981 the franchising sector in Australia has been subjected to a variety of regulatory regimes. Initially there was no regulation except under the general law (pre-1981). Then, in effect by accident, the sector was subject to quasi-regulation under the “prescribed interest” or “investment security” provisions of the Corporations Law (1981-87), to deregulation (1987-93), and to self-regulation pursuant to a voluntary Code of Practice (1993-96).

Until 1981 franchising was regulated only by the general laws governing all commercial relationships. The only exception was the regulation imposed on retail petroleum franchising through the *Petroleum Retail Marketing Franchise Act 1980* (Cth). However this changed when the Supreme Court of Western Australia held in *Commissioner for Corporate Affairs v Casnot Pty Ltd* (1981) ACLC 40-704, that an advertisement for a cleaning franchise was subject to regulation under the “prescribed interest” provisions of the then *Companies Act 1981*. These provisions dealt with the offering to the public of certain “investment schemes”.

This decision subjected franchising to an inappropriate regime more applicable to company securities and shares. This was compounded by the decision in *Commissioner for Corporate Affairs v Casnot Pty Ltd*, which allowed the National Companies and Securities Commission (NCSC) to assume jurisdiction for franchising, requiring franchisors to comply with a number of statutory requirements.

The Corporations Law provisions prohibited a company from issuing a “prescribed interest” unless the company:

- was a public company;
- had issued a prospectus;
- had in place an approved trust deed; and
- had appointed an approved trustee.

The promoter and relevant employees were required to hold security dealers and dealers' representatives licences. The legislation went on to specify quite significant requirements to be inserted in the documentation. Compliance with these requirements imposed a substantial cost upon a franchisor. Significant civil and criminal sanctions applied to any breach of those requirements.

The problems created for the franchising sector were ameliorated by the governing body (then the NCSC, and now known as the Australian Securities and Investments Commission), which had the power to exempt a company from compliance. The NCSC accepted arguments that a franchisee was seeking a business opportunity rather than making a passive investment, and hence it was appropriate for there to be less protection. The acquisition of a franchise was known to carry certain risks, which a franchisee was better equipped to assume, and indeed influence, than a passive investor. Accordingly the NCSC issued a formal release (Policy Statement 118) which provided that franchisors would be exempt if they complied with certain less onerous requirements. The exemption was available if the franchisor was a company, whether private or public, and the franchise agreement contained certain provisions, relating inter alia to:

- the use of a trust fund;
- the consent to assignment;
- a cooling-off period; and
- an obligation of disclosure.

The regime saw the first disclosure document requirement, which was conceptually a precursor to the disclosure document that is central plank of the Franchising Code of Conduct.

The NCSC was required to approve the franchise agreement and disclosure document before the exemption could apply.

Whatever the problems that resulted from the absence of regulation, they were not resolved by the arbitrary, complex, onerous and inappropriate regulation pursuant to the “prescribed interest provisions”. Between 1981 and 1987 the interest provisions imposed a regime not specifically structured for franchising. By the mid-1980s the situation had become unworkable. National Companies and Securities Commission Policy Statement 118 requirements were less onerous, but nevertheless inappropriate for franchising. The requirements only applied when the prescribed interest was offered to the public, which led one commentator to advise that, “the sure way to avoid the Companies Act regime is to avoid advertising franchise opportunities to the public”. Additionally, where it is considered necessary to advertise it was thought that it may be possible to structure the advertisement so that it merely provides a broad and vague outline of the proposal, and invites the reader to apply for information. However, a more basic problem was the emerging judicial divergence of opinion among State Supreme Courts as to whether the sale of franchises actually constituted prescribed interests.

The quasi-regulated era was brought to an end by the removal of franchising from the scope of the Companies Act by legislative amendment in 1987. Franchising then operated in a deregulated era, governed only by the general laws regulating all commercial activity until 1993.

A Franchising Task Force was established in 1990 to “examine impediments to the growth and efficiency of the franchising sector” and to “examine and report on the potential of self-regulatory codes for countering marketing failure in franchising, focussing on Business Format Franchising”. The Task Force recommended a self regulatory Code of Practice administered and maintained by a council of representatives from all areas of the franchising sector. The recommendations were accepted by the Commonwealth, state and territory governments and the Code of Practice came into operation on 1 February 1993. The Code of Practice was authorised by the Trade Practices Commission on the basis of public benefit; it attempted to raise standards in the sector and to apply these nationally and uniformly across a diverse range of industries. Additionally, as an alternative to government legislation, the Code would avoid the attendant costs of implementation and enforcement.

There were 5 editions of the Code during its short life, primarily in the nature of improvements and clarifications than changes of major significance.

Voluntary compliance with the Code was sought from franchisors, advisers and service providers. They were encouraged to register and thereby certify that they agreed to comply with those provisions of the Code that applied to them. The main Code provisions affected franchisors, and dealt with prior disclosure, cooling off periods, dispute resolution, certification and standards of conduct. Registration was voluntary. Non-compliance led to deregistration, but did not prevent that franchisor from operating as such .

The main features of the Code were:

- Disclosure — Franchisors were required to provide a standard form of disclosure document to prospective franchisees at least 7 days prior to signing a franchise agreement. The disclosure document need to be updated annually and was available to existing franchisees upon request. A disclosure document also had to be provided by a vendor franchisee and its franchisor to a purchaser of that franchisee's business.
- Cooling off — Franchisees were to be provided with a 7-day cooling-off period following execution of the franchise agreement. A franchisee who exercised the “cooling-off” option was to be refunded all fees paid less reasonable expenses specified in the franchise agreement.
- Dispute resolution — The Code laid down an alternative dispute resolution procedure with which the parties had to comply.
- Certification — Prior to the execution of the franchise agreement the franchisor had to require the franchisee to produce a certificate from a solicitor certifying that the solicitor had explained the franchise agreement to the franchisee, or have the franchisee sign a statement that the franchise agreement has been explained by a solicitor.

In line with the Task Force's recommendations, the Code imposed no specific requirements in relation to termination, intellectual property rights, tenure, assignment, approvals or other terms and conditions of the franchise agreement, including goodwill.

The Code nevertheless provided in paragraph 12 that franchisors and franchisees:

(3) will not participate in unconscionable conduct, in relation to franchise arrangements; and

(4) should act in an ethical, honest and lawful manner, and endeavour to pursue best franchise business practice on the time and place. They should in their dealings with one another at least avoid the following conduct, where such conduct would cause significant detriment to either party's business:

  (a) substantial and unreasonable overvaluation of fees and prices;

  (b) conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party; and

  (c) conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

However, the body entrusted with the administration and enforcement of the Code, the Franchising Code Council (FCC), had no power to deregister any party who failed to comply with paragraph 12. The standards of conduct operated as ethical standards to which participants in the franchising sector should aspire, rather than mandatory provisions to which participants had to comply under threat of deregistration.

The Franchising Task Force which recommended the introduction of the voluntary Code acknowledged in its report that its conclusions would satisfy neither those who had called for strict mandatory legislative arrangements, nor those who believed that there was nothing wrong with the sector and that no form of regulation, even voluntary self-regulation, was necessary. Nevertheless, at the time of its introduction in 1993 there was a strong hope that it would be a sufficient response to the problems affecting the franchising sector. It was described by the then Minister for Small Business as:

> *the most progressive industry/government franchising initiative undertaken in the world [which has attracted] strong interest in its development from the franchising community overseas. This*

> *Code of Practice and the self-regulatory regime which will support it, provides an excellent model for how the business community and government can work in partnership to promote business development.*

However, the reality did not match the hyperbole. Fourteen months into its 2 year trial period, the government, prompted by increasing concerns as to the effectiveness of the Code, initiated an independent review of its operation and effectiveness. The Gardini Report was submitted in October 1994 and released in March 1995. It identified two major weaknesses in the Code: its lack of coverage across the franchise sector, and failure of the “standards of conduct” provisions to address serious franchise problems.

The Code eventually “died” with the demise of the FCC in December 1996 as a result of:

- funding pressures (the outgoing government's promise of government funding fell victim to cost-cutting measures of the new government elected in March 1996;
- concerns among members of the FCC regarding their vulnerability to defamation actions brought by franchisors whom the FCC threatened to deregister; and
- disputes among franchisor and franchisee members of the FCC as to the role, viability and integrity of the Code and the self-regulatory regime.

The Code lapsed with the demise of the FCC. Australia was again returned to a deregulated environment, where franchising was regulated only by the general laws that regulated all commercial activity. It was obvious that the unregulated environment would be a temporary stage which lasted only until the new government determined its policy for the franchising sector.

30.3 The *New Deal: Fair Deal* Reforms

In June 1996 the Government appointed the House of Representatives Standing Committee on Industry, Science and Technology with wide terms of reference to report on business conduct issues in fair trading in general, and franchising in particular. In May 1997 the Committee handed down its Report. This Report, *Finding a Balance — Towards Fair Trading in Australia* was highly critical of some practices within the franchising sector.

The Report found that the problems had considerable economic and social costs, in that they contributed significantly to business failure. The social costs identified by the Committee included stress, marriage breakdown, poor health and suicide. The economic costs of the business conduct issues raised with the Committee included an inability of small firms to gain a return on sunk costs, and market inefficiencies arising out of exploitative conduct.

Faced with an orchestrated media campaign highlighting unfair conduct issues, the accumulated experience of over 20 reports over the last two decades, and the harsh criticisms and unanimous recommendations of a backbench committee of both government and opposition members, the government was left with no option but to act quickly and decisively.

Its *New Deal: Fair Deal* reform package released in September 1997 contained initiatives of great significance to the franchising sector. These included the enactment of a “business unconscionability” provision modelled on the “consumer unconscionability” provision of section 51AB of the TPA, and the introduction of a mandatory Franchising Code of Conduct . These regulations were proscribed under the TPA pursuant to a new Pt IVB which provided the legislative infrastructure for Codes of Conduct.

Two Exposure Drafts of the Code were released for public comment — the first modelled closely on the voluntary Franchising Code of Practice, and the second a more comprehensive document moving significantly beyond prior disclosure obligations to regulation of the franchisor/franchisee relationship. The final form of the Code prescribed by regulations came into effect in stages on 1 July 1998 and 1 October 1998.

The package contained a number of measures including:

- new protection for small business in the TPA, through prohibiting unconscionable conduct in terms similar to the strong protection already provided for consumers;
- new protection for small business franchisees through a mandatory and stronger Franchising Code of Conduct underpinned by the TPA;

- a safety net of minimum legislative standards for protection of retail tenants to be negotiated through State and Territory legislation;
- stronger enforcement by the ACCC of small business' fair trading rights, including representative legal actions on behalf of small business, small business commissioners, a Codes of Conduct Enforcement Unit and funding for test cases;
- support for alternative dispute resolution to provide small business with quicker, less costly and more efficient remedies than traditional court litigation; and
- support for the development of information packages on fair trading.

A feature of the reforms was that they comprised of an integrated package, which the government argued was designed, "to induce behavioural change on the part of big business towards smaller business, and to provide to small businesses, that are unfairly treated, adequate means of redress". Additionally, the Government accepted the Committee's conclusions, and acted on each of the seven areas of reform identified - unfair conduct, retail tenancy, franchising, misuse of market power, small business finance, access to justice and education .

The Trade Practices Amendment (Fair Trading) Act 1998 which came into effect on 1 July 1998 enacted the "business unconscionability" provision (s51AC) and the legislative framework for the prescription, by regulations, of codes of conduct. The first mandatory industry code, the Franchising Code of Conduct, came fully into effect on 1 October 1998.

30.4 The Franchising Code of Conduct

The Franchising Code of Conduct is a mandatory industry code prescribed under section 51AE of the *Trade Practices Act 1974*. Section 51AD of the TPA makes it an offence to contravene a prescribed industry code. The Code became fully operational on 1 October 1998 and was amended by the *Trade Practices (Industry Code – Franchising Amendment) Regulations 2001*, which came into effect on 1 October 2001. The ACCC administers the Code.

The purpose of the Code is to regulate the conduct of participants in franchising, particularly the conduct of franchisors. A particular focus is on ensuring prospective franchisees are able to make an informed business decision about whether or not to enter into a franchise agreement. The Code also regulates the content of certain conditions to be included in franchise agreements, and dictates a procedure for dispute resolution.

The Code applies to franchise agreements entered into, renewed or extended after October 1998. Section 4(1) defines a "franchise agreement" as:

(1) a written, oral or implied agreement;

(2) involving the grant of a right to carry on business of offering, supplying or distributing goods or services;

(3) under a trade mark, advertising or commercial symbol;

(4) using a system or marketing plan substantially determined by the franchisor; and

(5) requiring the payment of an initial fee.

Motor vehicle dealership agreements are specifically declared to be franchise agreements and certain relationships such as co-operatives and partnerships are excluded. There are also some limited exceptions where a franchisor is resident outside Australia, or where the goods or services supplied under the agreement are likely to account for no more than 20% of the franchisee's gross turnover.

The definition of a franchise agreement is quite broad and has the potential to capture a wide range of licensing, distribution and agency arrangements not traditionally considered to be strictly franchise arrangements. Consequently, the definition has tended to be read down by the courts with a focus on ensuring that there is a system or marketing plan actually being imposed by the alleged franchisor before the Code will be applied.

There are comprehensive disclosure obligations on the part of a franchisor intending to enter into, extend or renew a franchise agreement covered by the Code. A franchisor must provide a detailed disclosure document to a prospective franchisee at least 14 days prior to signing a franchise agreement. The franchisor must also provide a copy of the Code and a copy of the franchise agreement to the franchisee. In the case of a sub-franchise situation, both the sub-franchisor (master franchisee) and the franchisor are required to prepare a disclosure document. This may be done either jointly or individually.

The disclosure document requires the franchisor to provide approximately 250 items of information listed under 23 categories. The disclosure document must be in the form, order and numbering prescribed by the Code. It must also use the prescribed headings and have an indexed table of contents. The information required to be disclosed includes details of the franchisor, the business experience of those involved in the franchise system, litigation history, existing franchisee contact particulars, intellectual property ownership, territorial or supply restrictions, marketing or other cooperative funds, and a range of costs and payments relevant to the franchise and the franchisor's financial position.

There is provision for a short form disclosure document where a franchised business has an expected annual turnover of less than $50,000. The benefit of this exemption is compromised by the fact that a franchisor is still required to provide all the information in the long form disclosure document if requested by the franchisee. As a consequence this form of disclosure document is virtually never used.

A disclosure document must be updated within three months of the end of each financial year, regardless of whether the franchisor is recruiting new franchisees or not. The content of a disclosure document must be carefully monitored to ensure that it contains no misleading or deceptive information. Similarly, a franchisor must be careful about the information regarding pricing and supply conduct, to ensure it does not fall foul of the anti-competitive conduct provisions of the TPA.

A franchisor must advise a prospective franchisee to obtain professional legal, business and accounting advice before entering into the franchise agreement. The franchisee must sign a statement to the effect that he or she has received such advice, or been told to receive such advice but elected not to.

The Code dictates how the following issues are regulated in a franchise agreement:

(6) Cooling Off Period - a franchisee is entitled to terminate the franchise agreement and recover all fees paid under the agreement if it does so within 7 days of entering the agreement;

(7) Marketing Funds - if a franchisee is required to contribute to a marketing fund, then the franchisor must prepare an annual financial statement in respect of the fund and have the statement audited;

(8) Transfer - a franchisor must not unreasonably withhold consent to the transfer of a franchised business to a new franchisee;

(9) Termination - if a franchisee has breached the franchise agreement, then the franchisee must be informed of the breach, and given a reasonable time to remedy it. If it cannot be, or is not remedied, then the franchisor can only terminate on reasonable notice. Similarly, if the franchisee is relying on a power of termination in the agreement (other than for breach), reasonable notice must be given. There is no definitive answer of what will constitute reasonable notice as it depends on individual circumstances;

(10) Liability disclaimer – a franchise agreement cannot require the franchisee to give a general release from liability.

The Code requires parties to give a notice of dispute in the event of disagreement. If the matter cannot be resolved between the parties according to the internal complaint handling procedure, then the dispute should proceed to mediation. The mediation must be conducted in Australia and attended by someone with the power to settle the dispute on behalf of each party.

A breach of the Code will allow for the application of the TPA remedies, including damages, injunctions, specific performance, termination, and variation of agreements entered into. Where there has been a serious breach of the Code, such as a failure to provide a disclosure document, the court may declare all the franchise agreements entered into by the franchisor void, and order the franchisor to refund all the money paid by the franchisees under these agreements. As a part of any remedy for a breach of the TPA, it is common for the court to order that a franchisor adopt a trade practices compliance program which can itself be an expensive exercise.

The Code is merely the starting point of a franchisor's legal obligations. Franchisors have specific obligations under an array of different laws. Other laws, such as the TPA itself, the Corporations Law, Occupational Health & Safety laws and retail tenancies legislation in each State apply to franchising in the same way as they apply to other businesses. The general law of contract also applies to franchising, as franchising is essentially a contractual relationship.

31. The role of the FCA in the past and future growth and development of franchising in Australia

31.1 Representation

The FCA has played a key role in the development of franchising in Australia. When it became obvious that some form of franchise regulation was necessary to curb some of the excesses of the free market dealings, and restore the reputation of franchising as a credible business method, the FCA embraced the need for regulation. The FCA worked collaboratively with the Federal Government to develop a regulatory framework that addressed the perceived weaknesses of a de-regulated environment, yet did not unnecessarily restrict the entrepreneurial flair of franchisors or important principles of freedom of contract. The outcome was a regulatory framework that enhanced the contractual process by providing a comprehensive disclosure document to assist prospective franchisees to make an informed decision, and introducing a requirement for franchisor's to encourage franchisees to seek independent legal and business advice prior to signing the franchise agreement.

The Franchising Code of Conduct addressed important issues such as transfer, termination and dispute resolution, providing additional certainty for franchisors and franchisees alike. In many ways the disclosure requirements have reduced the risk of application of the section 52 TPA prohibition on misleading or deceptive conduct.

The FCA then combined with the Australian Competition and Consumer Commission to educate the franchise sector on the Code and the new regulatory requirements via national seminar roadshow. The FCA also conducts regular training as part of its Diploma of Franchising program, and produces a variety of publications to assist franchisors with compliance.

The FCA has also represented the sector in discussions concerning the Goods and Services Tax, TPA, retail tenancies , and red tape reforms, industrial relations issues and a range of other small business matters. To date the focus has been fundamentally on matters that have a specific impact on franchising, but in more recent times that representation role has widened.

The primary focus of the FCA will continue to be political representation, as that is the area most important to its members. In 2003 as part of a deliberate strategy to enhance its capacity to effectively represent the franchising community, the FCA appointed former Federal politician Richard Evans as its Chief Executive Officer. The FCA is now an active member of various Governmental committees, including the ACCC Franchising Consultative Committee.

It is likely that the FCA's representative role will extend beyond franchising into the general small business sector. The FCA is deliberately positioning itself as being representative of successful small businesses, with the aim of helping to harness the political influence of the sector for constructive purposes. The FCA believes that small business is currently very poorly represented, with many so-called small business groups being very narrowly focused or unrepresentative of the genuine needs of the sector. The vast majority of franchisors and franchisees are small business people, and the success rates of franchising justifies the FCA taking a broader role in small business policy issues.

The FCA represents the whole franchising community – franchisors, franchisees, service providers and suppliers. The FCA sees this as an important role, as this collaborative approach is culturally consistent with the mutual interdependence of the franchisor and franchisee relationship. The FCA has vigorously opposed the formation of organisations purporting to represent franchisees, but in reality being self-interested organisations intent on fermenting discontent and litigation.

The FCA believes that by representing franchising, as opposed to franchisors or franchisees alone, the FCA is helping to create a truly a collaborative approach to franchising in Australia. As a business method franchising is a team game, and it is important for the FCA to foster teamwork and collaboration, not an adversarial framework.

To effectively represent the whole community the FCA realises that it will need to develop initiatives that appeal to the separate interests of its constituents. The representative efforts in relation to retail tenancies have been important for franchisees, as have the Franchisee of the Year Awards. In recent times franchisee specific seminars and events have been scheduled, and more are likely. It is also likely that the FCA will take some of its activities, particularly franchisee events, into regional locations.

31.2 Education

The FCA has been very active in franchise sector education, its activities including:

- educating the franchise sector upon introduction of the Franchising Code of Conduct and related reforms, including conducting with the ACCC a national roadshow, producing a range of compliance materials and generally assisting with sector education concerning the Code;
- educating the franchise sector upon introduction of the Goods and Services Tax, conducting a national roadshow, producing a compliance video, producing a Franchisors Guide and a Franchisees Guides and generally assisting with sector education concerning the GST;
- developing an Accredited Franchise Executive program, later superseded by the Diploma of Franchising, which is a portable qualification recognised under the Federal Government's educational competencies;
- conducting national and State conferences on franchise sector issues, together with a range of special interest seminars, workshops, training modules and educational events;
- running monthly breakfasts or similar events in each State as a forum for information exchange, practical continuing education and networking;
- sponsoring franchise exhibitions, and conducting public education forums to enhance the understanding of franchising by the general public; and
- producing general information, press releases, newsletters and other material and making the information available to journalists, Federal and State Parliamentarians and the public via a range of means including the FCA website (www.franchise.org.au).

Future educational initiatives are likely to include specific compliance oriented initiatives, including seminars and compliance measurement and training tools that will link directly in to insurance products and possibly banking accreditation.

31.3 Membership

The FCA currently represents the majority of major franchise systems. However the FCA intends to focus substantial energies and resources upon membership growth and development. Several initiatives are likely to drive membership growth, including:

- the FCA's *"Don't Sign Without This Sign"* campaign, aimed at educating the public about the values of FCA membership and the additional safeguards of dealing with FCA members as a result of the introduction of the FCA Member Standards;
- the FCA's Member Advantage program;
- new insurance products designed specifically for the franchise sector, including liability insurance available only to FCA members with additional benefits linked to the existence of strong compliance systems; and
- further educational and other events available only to FCA members, or available at substantial discounts to FCA members.

31.4 FCA Member Standards

The FCA has introduced Member Standards with effect from July 1 2005 to further enhance perceptions of the credibility of franchising, and ensure that ethical behaviour in the sector remains high. The FCA aims to ensure that people do not enter the sector attempting to trade off the goodwill and reputation of franchising without honouring the expected standards of conduct.

The FCA Member Standards supplement the TPA regulatory framework by providing further detail as to the forms of conduct unacceptable for those involved in franchising. Importantly the FCA Member Standards impose new obligations on consultants and service providers in areas such as disclosure, conflicts of interest and professional behaviour.

A copy of the FCA Member Standards is included in this report at Appendix 3.

32. Future trends in Australian franchising

The success of franchising in Australia is well chronicled, and the growth of franchising in Australia shows no signs of abating. However one of the key determinants of long-term success will be how well franchise systems cope with the franchising mega-trends. The FCA has identified some of the likely mega-trends in Australian franchising, and the challenges these trends pose for franchise networks.

<u>Internationalisation</u> is already a feature of Australian franchising, with over $220 million in export earnings derived in 2002. More and more Australian systems will expand internationally, buoyed by the success to date of systems as diverse as Cartridge World, Gloria Jeans Coffee, Aussie Pooch Mobile, Cash Converters, Expense Reduction Analysts, Pirtek, Dome, Boost Juice and numerous others. The Australian market, with its logistical and geographic challenges, highly competitive marketplace and strong and effective regulatory framework prepares Australian systems well for international expansion.

<u>Aggregation</u> is a feature of competition in all markets. In Australia we are likely to see either a reduction in the number of franchise systems, as smaller systems merge with others to achieve economies of scale, or a gap emerge between those franchise systems that can achieve superior economies and efficiencies, and those that cannot. Currently there are around 850 franchise systems, which means Australia has around 3 times as many franchise systems per head of population as the USA. However in the US the number of franchisees per franchise system is much higher than in Australia, with many systems having more than 1000 franchisees.

Concomitant with this aggregation is the development of the <u>super franchisee</u>. The single unit franchisee that has been a feature of Australian franchising will be progressively superseded by franchisees that are bigger, stronger, own multiple franchises and have their own resources. They may even have franchises from different non-competing co-branded outlets and raise their own venture capital. These franchisees will be totally focused on, and expert in, operational matters. The challenge for the franchisor is to deliver brand and systems value that justifies the royalty cheque from the super-franchisee. This has been the trend in the US, and there are in fact several publicly listed franchisees, and intense competition between franchise systems to attract the franchisee heavyweights.

<u>Corporate competition</u> has already increased substantially in recent years. Franchise systems have taken market share from the large corporations by developing specialty retail niches, but the corporations are fighting back. Franchise systems will experience even greater competition from department stores, supermarkets, international chains and even other beefed up franchise networks that have added capital or other networks to their stable to achieve greater economies of scale. That said, franchise systems have proven in the past to be far too agile and innovative for large corporations. Provided franchise systems continue to adapt their product or service to the needs of consumers, use their franchisees to communicate those needs, and deliver exceptional customer service, franchise systems will continue to enjoy a competitive advantage over their corporate colleagues.

Greater sophistication is essential for franchise systems wishing to attract the best franchisees. Franchisors need to focus on brand and system development, and purchasing economies rather than just providing a range of operational services of minimal value to the discerning franchisee. Franchisors will also need to become more sophisticated in their brand promotion, communications, marketing, management, business methods, use of technology and systems. As super-franchisees deliver superior returns to the unit franchisee, franchisors will need to be sophisticated to be able compete for these franchisees.

The US trend that has seen the corporatisation of franchisors will be repeated in Australia. We will see more and more franchise companies move from private companies owned and operated by the founder, to corporations where management and ownership are separate. Corporatisation will raise capital to fund future expansion and facilitate exits for founders. Features of the new corporate franchisors will include management with specialist skills in brand building and systems development, and expert boards of directors appointed by shareholders.

Increased regulation is a feature of all western economies. There is likely to be new legislation in areas affecting franchising, such as employment law, occupational health and safety, consumer protection and taxation. In industries where rationalisation may occur, such as pharmacy, there may be a temptation to introduce franchise legislation to address industry issues. Although franchisee failure levels are very low, there is always a franchisor on hand to be blamed. In the face of circumstances of economic downturn or substantial occupancy cost increases, there may be calls for further regulation of the sector. The growth of franchising in the mobile or service field is likely to face threats from Government in the form of the extension of employee taxation regimes, although the Federal Liberal Government at present is proposing Commonwealth legislation to protect those areas from the encroachment by industrial relations legislation.

Appendix 1

List of Members of Franchise Council of Australia

http://www.franchise.org.au/index.cfm?fuseaction=list

FCA Membership List

123 Express Pty Ltd
1800 ONHOLD
1-800-GOT-JUNK? LLC
24seven
3D Paint Store Holdings Ltd
7 Eleven Stores Pty Ltd
A Balloon And Party Centre Pty Ltd
A.T.S Franchising
ABS - Auto Brake Service
Ace Body Corporate Management
Action International
Advanced Hair Studios
Advanced National Services
AGL Retail Energy Limited
AHL Investments Pty Ltd
Ali Baba Lebanese Cuisine Pty Ltd
All City Cleaning
All That And More
Allens Arthur Robinson
Amber Group Australia Ltd
AMC Commercial Cleaning
Andrew Benefield
ANZ Banking Group Ltd T/A ANZ Mortgage Solutions
ANZ Franchise Team
APCO Service Stations
Appetitos Franchise Systems Pty Ltd
Approveit Home Loans Pty Ltd
Aquatic Achievers (Douglas Family Trust T/A)
Aroma Café
Attache Sofware Australia P/L
Auset Pty Ltd
Aussie Pooch Mobile
Austrade
Australasian Pool Services Pty Ltd
Australia Pacific Computer Consultants Limited
Australia Post Head Office
Australian Exhibition Services
Australian Franchising Systems
Australian Independent Vendors Pty Ltd
Australian Money Exchange Pty Ltd
Australian Pharmaceutical Industries
Australian Private Realty Pty Ltd
Auto Leaders All Car Servicing
Auto Masters Australia Pty Ltd
Autobarn Pty Ltd
Avatar Consulting Pty Ltd
B Capital Pty Ltd
Back in Motion Physiotherapy Pty Ltd
Baker & McKenzie
Bakers Delight Holdings Pty Ltd
Bamboozle
Just Cuts Canberra
Just Cuts Franchising
Just Fingerfoods pty ltd
Kelly & Co
Kelly Sports Franchising
Kemp Strang Lawyers
KenKleen Window Cleaners
Kick Juice Bars Pty Ltd
Kieran Liston & Co
Kings Swim Centre
Kiss Cafe Franchising Pty Ltd
Kleenmaid Pty Ltd
Kleins Franchising Pty Ltd
Knight Frank Licencing Pty Ltd
Kwik Fix International
Kwik Kopy
Kwik Kopy (T/A Errington Business Systems Pty Ltd)
La Porchetta Pizza & Pasta Restaurant
Lancione Partners Lawyers
Laser Group Management Pty Ltd
Lavis Melin Taylor
Le Cornu Furniture
Ledgers Franchising Pty Ltd
Lenard's Pty Ltd
Lifetime Franchise Pty Ltd (The Book People)
Link Business Australia Pty Ltd
Little Images Pty Ltd
LJ Hooker Swan Hill
Local Lenders
Logie-Smith Lanyon
Lotteries Commission of Western Australia
Macedone Christie Willis
Macpherson & Kelley Solicitors
MACT Franchise Pty Limited
Made Easy Financial Group pty ltd
Magnetite
Mannings AV Services
MapInfo Australia
Mars Venus Coaching Pty Ltd
Marshalls & Dent
Mason Sier Turnbull
Master Feng Institute Pty Ltd
Matchbox Franchising Pty Ltd
Matthews Folbigg
McInnes Wilson Lawyers
McLaughlins
McLean Delmo & Partners
McMahon Fearnley
Meerkin & Apel Lawyers
Megasealed Bathrooms Franchising Aust. Pty Ltd
Mercury Management Systems Services

Bamboozle
Bank of Queensland
Bank of Queensland Limited
BankWest
Barbeques Galore Ltd
Bargain Wheels Car Rentals (Australasia) Pty Ltd
Barry Plant Doherty
Barry's, The Home Improvers (PEACS Pty Ltd)
Bartercard Australia Pty Ltd
Bathroom Werx Australia Pty Ltd
Battery World Australia
Baybridge Lawyers
BBX Management Ltd
BCI Business Brokers
Beacon Lighting
Bean Bar Franchising Pty Ltd
Beaumont Tiles (R J Beaumont & Co Pty Ltd T/A)
BedShed Franchisors Pty Ltd
Beechworth Bakery
Belgravia Formalwear
Bennett & Philp Solicitors
Betta Stores Limited
Big Dad's Pies
Big Fun Franchises Pty Limited
Bill Buddy Pty Ltd
Bing Lee Pty Ltd
Bio-Lab Australia
BNI Australia Pty Ltd (T/A Business Network International)
Bob Jane Corporation Pty Ltd
Boost Juice Bars Pty Ltd
Boots Great Outdoors Pty Ltd
Boss Hogs Hot Dogs Pty Ltd.
Bowler Geotechnical
BP Australia
Brad's Test & Tag
Brady Australia Pty Ltd
Bramalco Group (T/A Modern Group of Companies)
Bright Eyes Pty Ltd
Bristol Banner Group Pty Ltd
Brown Wright Stein
Brumby's Bakeries Ltd
Buchanan Law
Business Growth Strategies Pty Ltd
Busy Bookkeeping Pty Ltd
Bywaters Timms
Cabot Square Pty Ltd
Cafe2U Pty Ltd
Calair Pipe Systems (Calair Systems Pty Ltd T/A)
Caltex Australia Ltd
Card Connection
Cargroomers Pty Ltd
Cartridge World
Cash Converters International
Cash Loan Money Centres Pty Ltd
Catmax International
Mercury Management Systems Services
Metro Modelling Academy Pty Ltd ATF The Metro Trust
Meyer & Associates
Michel's Patisserie Pty Ltd
Midas Asia Pacific Pty Ltd
Middletons Lawyers Melbourne
MINC Services
Mini Maestros Operations Pty Ltd
Mini-Tankers Australia
Minter Ellison Lawyers
Minuteman Press International Inc
Miss Maud
Mister Minit
Mister Plywood Management Pty Ltd (Mister Ply & Wood T/A)
Mobil Gosford Area Service Stations
Mobitow Geraldton
Modern Streamline Roller Shutters
Mokum International Trading Pty Ltd
Money Depot Franchising Pty Ltd
Mortgage Choice Group
Moss Financial Services
Mountain Designs/Kolumbin Retail (Wild Gear Pty Ltd T/A)
Mr Antenna Pty Ltd
Mr Carports Licensing Pty Ltd
Mr Colin McCosker
Mr Globologist Pty Ltd
Mr Meticulous Pty Limited
Mr Rentals Franchising Pty Ltd
Mrs Fields Bakehouse
Mrs Flannery's
My Virtual Home Pty Ltd
Nandos Australia Pty Ltd
Narellan Pools Pty Ltd
National Australia Bank
National Business Sales
National Recruitment Pty Ltd
Natra Pty Ltd
Nedai Pty Ltd
New Level Personal Training Studio's
New Price Retail
New Zealand Natural Pty Ltd
Nextra Australia Pty Ltd
Nicol Robinson Halletts
NightOwl Convenience Stores
NJF Electrics Pty Ltd
Nutshack Franchise Group Pty Ltd
O2V Austalasia PTY LTD T/A Open2view
Office Choice Pty Ltd
One Water Naturally Pty Ltd
OneSteel Ltd
Oporto Portuguese Style Chicken Pty Ltd
Opposite Lock
OPSM
Optus Administration
Ovenclean Enterprises Pty Ltd
Ovenu
OZ Bin Cleaning Pty Ltd
Oz Design Furniture

Cavalier Homes Australia Pty Ltd
Central Coast Business Lawyers
Central Park Limousines
Chakram Pty Limited
Charter Resources Group
Chemtura Australia Pty Ltd
Chick n Feed Group-Joemnik
Chicken Express Systems P/L
Chocolate Orange
Choice Hotels Australasia
Chooks Fresh & Tasty Pty Ltd
Cibo Espresso Australia Pty Ltd
City Farmers Franchising Pty Ltd
City Pacific Finance Pty Ltd
City Pacific Law Firm Pty Ltd
Clark Rubber Franchising Pty Ltd
CleanTastic Pty Ltd
Coffee Ezy (Patsa Pty Ltd T/A)
Cold Rock
Coldwell Banker NSW/ACT
Coleman & Greig
Commonwealth Bank of Australia
communikate et al pty ltd
Concrete Taxi Pty Ltd
Contours Express (Australasia Franchise Group Pty Ltd trading as)
Cookie Man Pty Ltd
Coolabah Tree Cafe
Cost Less Plants Pty Ltd
Coulton Isaac Barber
Coverall Queensland Pty Ltd
CPR Complete Property Rejuvenation
CRA Cost Reduction Analysts NSW
Creative Home Decor Pty Ltd
Creative Marketing and Design
Crown & Gleeson Business Finance Pty Ltd
Cullen Babington Hughes
Cummings Flavel McCormack
Curwoods Lawyers
Custom Car Care Australasia
Cutler Hughes & Harris
Dairy Farmers Pty Ltd Vendor Number 110842
Daly International
DANARU PTY LTD
Danlaid Contracting Brisbane (Stevenson Contracting Pty Ltd)
Danlaid Contracting Pty Ltd
Darriwill Farm Franchising Pty Ltd
David Reid Homes
Davies Knox Maynards Chartered Accountants
DCM - Coffee & Donuts
Deacons
Deacons Consulting
Deloitte
Deloitte Growth Solutions Pty Ltd
Destiny Financial Solutions
DIA ORO JEWELLERY PTY LTD
Dibbs Abbott Stillman
Direct Pest Control Admin Pty Ltd
Oz-Cover Building Design Pty Ltd
Ozspy Pty Ltd
Ozzy Tyres
Pacific Internet
Pack & Send Systems Pty Ltd
Paddy Pallin
PaintRight Ltd
Paramount Franchise Services
Parasol Emt Pty Limited
Parker Enzed Australia Pty Ltd
Parmalat Australia Ltd
PARRAFINE
PBM Fitness Pty Ltd
PC Masters International Pty Ltd
Pedders Shock Absorber Services
Pet Mobile Pty Ltd
Petstock Pty Ltd
PFA Chartered Accountants
Phillips Fox
Phone Central Pty Ltd
Picton Printing
Pie Face Pty Ltd
Pilot Nexia Pty Ltd
Pirtek Fluid Systems Pty Ltd
Pizza Haven
PKF Australia
Plenty Trak Systems (Vimex Pty Ltd T/A)
PNF Management Pty Ltd T/A Pure & Natural
Poolwater Services
PoolWerx Corporation Pty Ltd
POS Displays Pty. Limited
Power Loan
Powertec Telecommunications Pty Ltd
PRD Nationwide Pty Ltd
PricewaterhouseCoopers
Priority Management Systems P/L
Pro Klean Systems
Professional Advantage
Prosell Franchising Pty Ltd
Protect-A-Window Australia Pty Ltd
Protex Australia
QB Securities
Quest Apartments
Quest Apartments WA Pty Ltd
Quick Fit Tyre Service
Quick Sign Shops Franchising Pty Ltd T/A
Quick Colourprint.com.au
R.W Corrie & Co
Rams Finance Pty Ltd
Ranger Camping & Outdoors
Recruitment Vision Pty Ltd
Red Rooster
Reed Business Information
Refund Home Loans
Resi Mortgage Corporation Ltd
Resumes For Results
Retail Brands Group Pty Ltd
Retail Food Group (Australia)
RetireInvest Pty Ltd
Riaz Jeena
Richard Solomon & Associates

Dixon Systems
DMAW Lawyers
Doggy Wash (Flea Stoppers Pty Ltd T/A)
Dominion Printing
Domino's Pizza Australia New Zealand Limited
Donaldson Walsh
donbelinder pty ltd T/A healthy habits
Don't Fret Pet Franchising Pty Ltd
Downings Legal
Dymocks Group of Companies
Eagle Boy's Dial-A-Pizza Pty Ltd
Ecomist Australia Pty Ltd
Ecowash Mobile Pty Ltd
Edwards Global Services
Edworks Active Learning
Ekinci & Hardy Management P/L
Elite Fitness Equipment Pty Ltd
Elite Maintenance Services Pty Ltd
EmbroidMe
Endota Spa
Energie Fitness Clubs Ltd
Enzed (Parker Enzed Technology Pty Ltd)
Espresso Mobile Cafe
Ettamogah Franchising Systems
Eurolight
Executive Property Maintenance
Exhibitions & Promotions Pty Ltd
Expense Reduction Analysts
Express GST Accounting
Extragreen Travel Franchises Pty Ltd
Extrastaff Pty Ltd
Fastway Couriers (Aust) (Australian Couriers Pty Ltd t/as)
Ferguson Plarre Bakehouses Pty Ltd
Fernwood Fitness
Fernwood Womens Health Clubs Pty Ltd
Fibrecare Australia Group Pty Ltd
FiltaFry
Fire Hydrant Systems (Australia) P/L
First Class Accounts
First Class Accounts (Sydney) Pty Ltd
First Food Group Pty Ltd
Fisher & Paykel Appliances Australia P/L
Flight Centre Limited
Flippin' Fresh Seafood
FluidMasters International Pty Ltd
Foam Factory
Formalwear Express Franchising Pty Ltd
FORTE fitout logistics Pty ltd
Forte School of Music
Forty Winks Franchising Pty Ltd
FRANCH-EYES Pty Ltd
Franchise Alliance Pty Ltd
Franchise Careers
Franchise Central
Franchise Control Systems
Franchise Council of Australia
Franchise Developments Management Consulting
Franchise Link

Riordan Hume
Rivergum Furniture 1939 Pty Ltd
Roadside Auto Care
Robbins Watson
Robert James Lawyers
Ryco Hose
S2M2 Franchising Pty Ltd
Safetyquip (Australia) Pty Ltd
Save Time Services
Scoop News & Lotto Pty Ltd
Scott Alexander Pty Ltd
Sea Tow Services Australia Pty Ltd
Secretary.com.au Pty Ltd
Select Information Pty Ltd
Sensis Pty Ltd
Sign-A-Rama
Signwave Australia Pty Ltd
Sky Blue Coffees Pty Ltd
Sleepy's Pty Ltd
Slurp
Small Myers Hughes
Smart Saver
SmartCare (Franchising) Pty Ltd
Snap Franchising Ltd
Snap-on Tools (Australia) Pty Ltd
Snowgum
Software Quality Assurance Centre
South Coast Bakeries P/L
Spanline Weatherstrong Building
Spectrum Analysis Australia Pty Ltd
Spinners Holdings Pty Ltd
Sport For Life
Sportskeep Pty Ltd
Sportzing Court Care Pty Ltd
Spotless Services Ltd
ST Software Pty Ltd
Stacks of Snacks
Stain Busters Cleaning Systems ACT
Stephens Lawyers & Consultants
Stewart Germann Law Office
STORAGE KING PTY LTD
Strathfield Group Limited
Stretch-n-Grow Australia Pty Ltd
Stretch-N-Grow Upper North Shore & Northern Beaches
Subway Systems Australia P/L
Sumo Salad Franchising Pty Ltd
Supergeek.com.au Pty Ltd
Superior Steel Lattice Pty Ltd
Sureslim Australia Pty Ltd
Survival First Response
Symbion Pharmacy Services
Synectico Pty Ltd
Synergy executive (south) pty limited
Tallahesse Pty Ltd
Taps 'n Toilets
Targett Retail Training Pty Ltd
Tasman Recruiting
Tasty Trucks Pty.Ltd.
Tattersalls Sweeps Pty Ltd
Tayco Petroleum

Franchise New Zealand Magazine (Franchise NZ Marketing Ltd T/A)
Franchise Point
Franchise Relationships Institute
Franchise Systems Group
Franchise Technology Solutions
Franchise Works Australia
Franchising Solutions Pty Ltd
Freedom Group Limited
Frenchams
Futureworld Drama Pty Ltd
Gadens Lawyers
Gallery 360
Gametraders Franchising Pty Ltd
Gauci Franchising Pty Ltd
Gaze Burt Solicitors
GE Commercial Corporation (Australia) Pty Ltd
Gelare International PtyLtd
Gelatissimo
Glass Art Australia
Glenwood Homes Pty Ltd
Global Art Australia Pty Ltd
Global Enterprises (t/as Salon Express Australia)
Global Living Furniture and Homewares Group Pty Ltd
Globepro's Australia Pty Ltd
Gloria Jean's Coffees
Go Gecko
Go Sushi Management
Golden Casket Lottery Corporation Ltd
Golden Circle Limited
goldenwest usa
Goodyear Auto Service Centre
Got One Pty Ltd
Grant Thornton Melbourne
Grey Army Management
Grill'd Pty Ltd
Grinners Catering (Australia) Pty Ltd
H&L Australia
Haarsmas Lawyers
Hairhouse Warehouse Pty Ltd
Hall & Wilcox
Hallas Trading (Ella Bache)
Handi Ghandi Franchising Pty Ltd
Han's Cafe PTY LTD
Harry's Cafe de Wheels (Holdings) Pty Ltd
Harvey World Travel Franchises Pty Ltd
Healthline Health Care Systems Australia Pty Ltd
Healthy Habits Australia Pty. Ltd.
Healthy Life Pty Ltd
Helen O'Grady International Pty Ltd
High Plains Trading (Rep. Action International)
Hill Mayoh
Hind Fort Pty Ltd
Hire A Hubby NSW Pty Ltd
Hire for Baby Pty Ltd
Hire Intelligence
TCM Consulting and TCM Franchising
Teamwork Finance
Telco In A Box
Telefonix Technology Group Pty Ltd
Termi-Mesh Australia
Test Sponsor
Testel Australia Pty Ltd
Thai Express Australia
The Ad Company P/L
The Athlete's Foot Australia P/L
The Award Bookkeeping Company Pty Ltd
The Business Card Shop
The Cheesecake Shop (Hodmac Holdings t/a)
The Coaches Consortium Pty Ltd
The Coffee Club Franchising
The Computer Market Pty Ltd
The Concrete Cutter (Franchising) Pty Ltd
The Confectionery Party Shop
The Crêpe Cafe Development PTY LTD
The Duster Dollies Pty Ltd
The Edge Corporate Strategies
The Iceberg Corporation
THE KEBAB CO
The Loan Doctor Pty Ltd
The Lucky Charm
The Mortgage Bureau Pty Ltd
The Mortgage Gallery
The Natural Source
The Natural Way
The Outdoor Furniture Warehouse Pty Ltd
The Quantum Organization Pty Ltd
The Real Learning Experience
The Realise Group Pty Ltd
The Retail Doctor
The Safety Shop Pty Ltd
The Shed Company Franchising P/L
The Storage Space Company Pty Ltd
The Touch Up Guys Pty Ltd
The Tyre Factory
The Waterboys Pty Ltd
Thomson Playford
Thrifty Car Rental
Thymac Admin Pty Ltd
Tilecraft Ceramics
Timberland Furniture Franchise Systems
Tint a Car
Tobacco Station Group
Tom's Trash Paks Pty Ltd
Toni & Guy Australia Pty Ltd
Toohey Reid Pty Ltd
Total Building Maintenance
Trampoline Franchising P/L
Travelworld
Trios Pty Ltd
True Choice Home Loans Pty Ltd
Ultra Tune (S A) Pty Ltd
Ultra Tune Australia Pty Ltd
Uncle Tony's Kebabs
University of New South Wales
Urban Burger (S2M PTY LTD t/as)

Hire Intelligence North Sydney
Hobbysew
Hocking Stuart
Hog's Breath Cafe - Mackay
Holding Redlich
Holistic Group Pty Ltd
Holy Sheet! Homewares
Home Entertainment Express Pty Ltd
Home Wilkinson Lowry
Honda Australia MPE
Horizon Franchising Pty Ltd
Horizon Media Pty Ltd
Horseland Saddlery Pty Ltd
Horwath
Hosemasters International Pty Ltd
Hotkey Internet Services
Hotkey Internet Services Pty Ltd
Hotondo Building Pty Ltd
Howards Storage World
Hudsons Coffee
Hungry Jack's Gold Coast
Hungry Jack's Pty Ltd
Hunt & Hunt Lawyers
Hydrodog
I.L Wollermann
Icon Business Solutions
IFX International Inc.
Imagine Essential Services Limited
Ink On the Run
iNSIGHT Home Loans (GSR Corporation Pty Ltd T/A)
Insite Data Solutions
Insurance Australia Group
Intelink Franchise Services Pty Ltd
Inut Inut Pty Ltd
Investor Finance Pty Ltd
ISS Facility Services
Jackson McDonald
James Home Services
Jani-King (Aust) Pty Ltd
Jarima Holdings Pty Ltd
Jaymak Australia Pty Ltd
Jesters Jaffle Pie Company
Jetset Travel World
Jim's Corp Limited
John Brennan Franchising
John Cully Pty Ltd
John Danks & Son Pty Ltd
Jones Condon
Jumping J-Jays Franchises Pty Ltd
Just Better Care Franchising Pty Ltd
Vaby's Franchising Pty Ltd
Van Go Australia
Vatman Group
Vaughan Barnes
Versatile Buildings TA Totalspan Australia
Victory Curtains & Blinds
VIP Australia Pty Ltd (VIP Home Services)
Viva Life Photography
Walk on Wheels Franchise Systems Pty Ltd
Walker Wayland WA Pty Ltd
Waterco (Swimart)
Webresource Testing Company
Wengor Pty Ltd t/a City Pacific Finance - Business Solutions
Westpac Banking Corporation
Wet-seal Management Pty Limited
Whirlwind Print
WHK Greenwoods
WHK Greenwoods
William Buck
WISE Employment Ltd
WiseOnes Australia Pty Ltd
Wisewoulds Lawyers
Wok in a Box Pty Ltd
Wood Rot Doctor
WordWerx Pty Ltd t/a Franchise Advisory Centre
Workforce Services Pty Ltd
Worldwide Online Printing Aust/NZ Pty Ltd
Worldwide Refinishing Systems (Aust) Pty Ltd
Wozzie Trading Pty Ltd t/as Chooks Fresh & Tasty - Byford - Coolbellup - Maddington
Wrappings Pty Ltd
Xpresso Delight Pty Ltd
Xpresso Mobile Coffee Bar Pty Ltd
Yates Security
Yum Restaurants International
Zarraffa's Franchising Pty Ltd
Zebra Interactive Pty Ltd
ZUVELA LAWYERS

Appendix 2

FCA Member Standards

http://www.franchise.org.au/content/?id=205

Franchise Council of Australia - Member Standards

To lodge a complaint please direct to:

The Complaints Officer
Franchise Council of Australia
PO Box 2195
Malvern East VIC 3145

Email: complaintsofficer@francise.org.au

(i) The new member standards promoting excellence in franchising

One of the hallmarks of a reputable industry sector is a commitment to high standards of personal and professional conduct. This enhances public perceptions of franchising, helps safeguard the investments of franchisors and the businesses of franchisees, protects franchise networks from unfair or unethical attack and provides guidance for those seeking to commence their franchising journey.

The Franchise Council of Australia (FCA) encourages its members to maintain standards of conduct worthy of franchise sector professionals. The Member Standards are designed to provide members of the FCA with an authoritative guide on acceptable standards of conduct.

The FCA believes the Australian franchise sector to be well regulated with the Franchise Code of Conduct (the Code) allowing for adequate dispute resolution procedures and disclosure provisions to assist and guide the sector. It also considers that the franchise relationship between the franchisor and franchisee can be developed even further with best practice guidelines in the form of Member Standards.

It is the FCA's view a member gains significant market benefit in identifying themselves with FCA membership and as such the business practice and activities of members should work towards franchise best practice.

The Member Standards and Best Practice are not intended to anticipate each and every occurrence of a franchise relationship, but rather, articulate the values upon which the members of the FCA can structure their franchise relationships and strive to conduct their businesses.

If a member does not comply with the requirements of the Member Standards then investigation and disciplinary procedures are in place to handle the matter. It is not intended that breach of the Member Standards have any legal consequences other than potentially in relation to membership of the FCA. Clause 2.10(1)(b) of the Constitution of the FCA empowers the FCA Board by three-quarter majority to censure, suspend or expel from the FCA a member who fails to comply with any Standards of Conduct applying to them.

The FCA will respond to any complaint alleging breach of the Member Standards by a member, but does not have sufficient resources to vet documentation, audit behaviour or generally police compliance. Use by a member of the FCA logo does not carry any endorsement or certify compliance, and the FCA accepts no liability to any person in relation to any breach of these Member Standards.

Franchising Activities
All Franchise Council of Australia members are expected to conduct their franchising activities professionally and in accordance with Australian law. They are expected to comply with agreed minimum

standards of conduct.

The FCA considers the following standards to be relevant to Members:-

- Members of the FCA shall abide by all relevant State and Federal laws including in particular the Franchising Code of Conduct and the Trade Practices Act. A member shall within 14 days of written request by the FCA furnish to the FCA a copy of its current disclosure document, franchise agreement and any other documentation or advertising material used in connection with the appointment of a franchisee.
- No member shall imitate the trade mark, trade name, corporate name, slogan, or other mark of identification of another member of business in any manner or form that would have the tendency or capacity to mislead or deceive.
- Members will become familiar with the content of these Member Standards and draw them to the attention of clients as appropriate from time to time.
- A Member, be they franchisor, vendor franchisee, franchise broker, or representative of a franchise system should not sell a franchise if at the time the franchisor or vendor franchisee knew or ought to know that a reasonably competent franchisee would be unlikely to be able to successfully operate the franchise.
- Members are expected to behave professionally and refrain from illegal, unethical or improper dealings or otherwise act contrary to the image of franchising or the FCA.

Relating to a franchisor and franchisee

- A franchisor shall as part of its franchisee recruitment process make reasonable investigation to assess whether a prospective franchisee appears to possess the basic skills and resources to adequately perform and fulfil the needs and requirements of the franchise.
- The franchisor shall have training and support processes as applicable to the franchise system to help franchisees improve their abilities to conduct their franchises. Franchisees will endeavour to apply and adapt all learning to their operation
- A franchisor and franchisees should be reasonably accessible and responsive to communications, and provide a mechanism by which ideas may be exchanged and areas of concern discussed for the purpose of improving mutual understanding and reaffirming mutuality of interest.
- Franchisors and franchisees shall endeavour to resolve complaints, grievances and disputes through direct communications and negotiation. Failing this, consideration should be given to mediation or arbitration.
- Franchisors and franchisees should in their dealings with one another avoid the following conduct, where such conduct would cause significant detriment to either party's business:
  (a) substantial and unreasonable overvaluation of fees and prices; and
  (b) unnecessary and unreasonable conduct beyond that desirable for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

Relating to a Supplier Member

- A Member who is a lawyer, accountant, consultant or other supplier or service provider ("Supplier Member") should behave in a manner consistent with these guidelines.
- Respect the integrity of established franchise systems and not seek to inflame any dispute, incite litigation, generate media coverage or otherwise act in any way which is unprofessional or may create a misleading impression of the system.
- Provide a client or prospective client on request with a written resume or profile of any relevant qualifications of the supplier together with true representations of the supplier's franchising education and experience;
- Respect the confidentiality of all information received concerning a client's business which is not in the public domain and will not disclose or permit disclosure of any such information without the client's prior permission in writing;
- Not advise any franchisee or prospective franchisee in relation to any franchise

opportunity offered by any franchisor for whom the adviser has acted, without full disclosure of relevant circumstances;

- Disclose to a client or prospective client any personal or financial interests or other material circumstances which may create a conflict of interest in respect of that client and in particular, without derogating from the generality of the foregoing:
  - any directorship or significant interest in any business which competes with the client;
  - any financial interest in goods or services recommended by the Adviser for use by the client;
  - any personal relationship with any individual in the client's employment;
- Not undertake work for which they are not appropriately licensed, qualified and experienced.