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September 12, 2008

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services,
Department of the Senate
PO Box 6100
Parliament House, Canberra ACT 2600. Australia

Re: **Commonwealth Parliament Inquiry into the Franchising Code of Conduct**

Dear Sir:

We are writing on behalf of the International Franchise Association to share comments on our experience with mandatory franchise registration in the United States as well as to submit comments on the amendments to the Australian Franchising Code of Conduct (the "Code") which came into effect March 1, 2008.

Franchise Registration

We appreciate the opportunity to comment on this matter. It is our view that meaningful pre-sale disclosure is the most effective and efficient method of protecting potential franchise investors. By comparison, decades of practical experience with state franchise registration and review requirements has shown that these regulations are burdensome for franchise companies and state governments while conveying little or no protection for franchisees. In fact, we are aware of no data in the United States that shows that franchise investors in states with registration requirements are more adequately protected from sales fraud than investors in states without registration.

In the United States, franchising is business model regulated by the federal government as well as under various state laws. For nearly thirty years, the United States Federal Trade Commission ("FTC") Trade Regulation Rule on Franchising (the "FTC Franchise Rule," 16 C.F.R. Part 436), has required extensive pre-sale disclosure of information about any franchise investment. Many states have adopted laws that mirror the FTC Franchise Rule. These disclosure documents make comprehensive information available to prospective franchisees. Franchise companies are required to disclose their litigation and bankruptcy history and that of their officers and directors; the initial investment, royalty, advertising fund and other fees; the rights and

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obligations of both the franchisor and franchisee; the conditions under which the franchise can be transferred, terminated or not renewed; the restrictions on what the franchisee may sell or is required to purchase from the franchisor; and much other similar information.

It is important to note that there is no federal franchise registration requirement. At the outset of federal franchise regulation, the Federal Trade Commission determined that reviewing and approving franchise registrations would not be a prudent use of agency resources.

Fourteen states, however, have laws requiring some manner of franchise sales registration. In general, all of these requirements pre-date the establishment of the FTC's Franchise Rule in 1979. California enacted their Franchise Investment Law in 1970, and almost all state legislation on registration, disclosure and post-sale relationship issues in franchising was enacted between 1970 and 1979. Since the FTC Franchise Rule become effective, there has been a steady shift away from franchise registration by states. Indiana, Michigan, and Wisconsin all amended their registration laws in the 1980s and 1990s to change the process from policies requiring registration approval to a system requiring a simple notice filing. A similar change was enacted in South Dakota earlier this year, and other states are considering following suit.

Registration imposes a significant cost on franchisors. The IFA estimates that it costs $500 to $3,000 per state annually to register a franchise offering in a state or make any contractual or other changes required by the state. In states with the most stringent registration reviews, delays are common and franchisors can spend $5,000 or more in legal fees to register. Once again, there is no data showing that franchise investors are better protected in these states than others.

Registration also imposes unnecessary costs on state governments. In fact, regulators in states that have opted to discontinue review of registrations often cite as justification for the change the insufficient evidence supporting registration as an effective means of protecting the public interest. In an article published in 2000 in the American Bar Association's *The Franchise Lawyer*, for example, Wisconsin regulators James Conohan and Patricia Struck are quoted as noting that "the vast majority of filings passed muster anyway" and franchisee complaints did not increase following the change in policy. Similarly, in Indiana, the State Securities Commissioner, Bradley Skolnick, opted to abandon full registration review so that the agency's resources could be better utilized dealing with investment fraud issues and post-sale enforcement.

In conclusion, it has been the consistent view of the IFA that an effective federal regime based on pre-sale disclosure is the best regulatory scheme for franchising. By comparison, the IFA considers mandatory registration to be archaic, costly and burdensome for both franchisors and government while providing no measurable public policy benefit to prospective franchisees

Comments Regarding the Removal of the Foreign Franchisor Exemption

In addition to our comments above, we would like to use this opportunity to submit views on the removal of the foreign franchisor exemption. This change has had a profound and burdensome impact on many U.S. franchisors.

As you know, one of the amendments to the Australian Franchising Code of Conduct (the "Code") which came into effect March 1, 2008 was the removal of the exemption to the application of the Code to a franchise in circumstances where the franchisor was resident, domiciled or incorporated outside of Australia, and where the franchisor only granted one franchise or master franchise to be operated in Australia. One effect of this amendment is that U.S. franchisors are now required to provide disclosure documentation to their Australian franchisees which complies with the requirements under the Code. Further, U.S. franchisors who had granted single master franchises in Australia will now be required to comply with the disclosure obligations under the Code not only with respect to the grant, renewal or extension of the master franchisee, but also with respect to each unit franchise granted, renewed or extended by that master franchisee. Section 6B(2) of the Code provides that both a franchisor and their master franchisee must provide disclosure documentation to a prospective unit franchisee. It should be noted that this section does permit the disclosure information in respect of the franchisor and the master franchisee to be consolidated within a joint document. In addition to the requirement to provide disclosure to prospective franchisees and existing franchisees on renewal and extension, there are other ongoing disclosure obligations under the Code which will now apply to U.S. franchisors in respect of their Australian franchisees. These obligations can be summarized as follows:

- Updated disclosure documentation - Other than updates necessary prior to the issue of a franchise agreement, franchisors must update their disclosure documentation at least annually within 4 months of the end of their financial year. This is important even if the franchisor has not granted any new franchises within a given year because any existing franchisee has the right under section 19 of the Code to request an updated form of the disclosure documentation at any time, provided that this right can only be exercised by each franchisee once in every 12 month period. If such a

request is made, the franchisor must provide the updated documentation to the franchisee within 14 days.

- Materially relevant facts - Section 18 of the Code requires all franchisors to disclose certain events to existing franchisees within a reasonable time (not being more than 14 days) following their occurrence. Such events will include proceedings being issued against the franchisor or one of its directors; a judgment being entered against the franchisor; the franchisor becoming an externally-administered body corporate; a change in the intellectual property relevant to the franchise, or ownership or control of the same; and the existence of any undertakings made by the franchisor under section 87B of the Trade Practices Act (usually resulting from a claim by the Australian Competition and Consumer Commission).

The removal of the "single grant" exemption from the Code has created a significant burden for those U.S. franchisors which had been operating in Australia through a master franchisee. Those franchisors will now need to work much more closely with their Australian master franchisees and ensure that they are able to fulfill the disclosure requirements not only on any grant, renewal or extension by the master franchisee, but also with respect to disclosure documentation updates and ongoing disclosure of materially relevant facts. The extension of these regulatory requirements to all U.S. franchisors of systems operating in Australia has resulted in additional administrative and legal costs which must be taken into account by franchisors looking to enter the Australian market. In particular, this obligation is highly burdensome for franchise systems that are not engaged in current sales activity in Australia. In effect, the removal of the exemption requires many foreign franchise systems to prepare annual disclosure documents for which there is simply no relevant audience, and we strongly encourage you to consider restoring the exemption.

Thank you for the opportunity to share the views of the International Franchise Association regarding the ongoing inquiry. We hope this information is useful, and please feel free to contact us if you have any additional questions.

Sincerely,

Matthey Shay
President and CEO

David French
Vice President, Government Relations