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

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Dear Secretary

### **Franchising Code of Conduct**

The Law Institute of Victoria (LIV) represents approximately 15000 professional members, with many specialist practitioners in competition and trade law. A growing number of our members represent small and medium enterprises operating in franchised business structures.

Through long standing experience, our members and their clients find the substance of franchise regulation in Australia lacking a number of important protective components to ensure "good faith" is required in franchise commercial relationships.

Whilst we have maintained an interest in the current Parliamentary inquiry, we have not had sufficient time to meet the submission deadline of 12 September 2008.

### **Summary**

In summary, the LIV supports the need for the regulation of franchises in a way which is fair and which provides for a dispute resolution system which is timely, accessible and cost-effective. In particular, the LIV is concerned about the ability of franchisors to unfairly treat franchisees in respect of the renewal of franchises.

The LIV supports the following reforms to the Franchising Code:

- Requiring franchisors to explicitly advise prospective franchisees about their rights to renew or extend their franchise agreements and to disclose what payments may accrue to the franchisees for the value of their business upon exiting the system;
- Recognising existing practice that franchisees will be renewed on expiry unless there is a good reason for non renewal.

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- Requiring franchisors to give a minimum 6 months notice period of the terms of the new franchise agreement on renewal, or that they do not intend to renew an operative franchise agreement;
- Recognition of the requirement to act in "good faith" which is defined in terms of honesty, reasonableness, and behaviour which goes to better the interests of the franchise business;
- Reviewing the mediation model to ensure a dispute resolution system which is timely, accessible and cost-effective for franchisees. The appropriate model will need to be carefully considered but could involve mediation followed by binding arbitration.

### **Dispute Resolution Provisions under Part 4 of the Franchising Code**

We are aware of the existing remedies available to franchisors, however are concerned that franchisees can often be significantly disadvantaged in a franchise commercial relationship. The Code provides for mediation through the Office of Mediation Adviser (**OMA**) to resolve disputes between parties to a franchise agreement. However, under this dispute resolution process, franchising disputes can escalate quickly, often resulting in expensive litigation. As a result, this dispute resolution process is often not viable for franchisees with limited resources, facing closure of their business.

Accordingly, a deal of uncertainty to the entire franchise relationship creates unsound economic conditions in a market environment which needs greater certainty. The LIV is concerned that inadequate protection for those most vulnerable in the franchise relationship will result in more disputes and collapses. Obviously, this has substantial flow down effect to the broader economy and employment opportunities, many of which are in rural and regional Australia.

Therefore, the LIV supports the recommendation made by the Australian Competition and Consumer Commission that the mediation model should be reviewed to ensure a dispute resolution system which is timely, accessible and cost-effective for franchisees. The appropriate model will need to be carefully considered to ensure that it works fairly for both franchisees and franchisors but could involve a mediation process which, if unsuccessful, is followed by binding arbitration.

### **Franchising Code of Conduct – Conduct Standards and "Good Faith"**

In 1997, the Reid Committee Inquiry into franchising recommended a mandatory code of conduct governing the relationship of franchised parties. In 1998, the TPA was amended to establish the Code which imposes certain conduct mandatory on franchise parties. However, we believe the Code does not cover some of the most important issues arising between franchise participants in the emerging commercial market.

For example, an obligation to act in "good faith" where the franchisor and franchisee intend to exercise any power or rights arising under, or in relation to a franchise renewal should be inserted into the Code. Currently section 51AC(4)(k) of the TPA provides that in determining whether an acquirer has acted unconscionably in connection with the acquisition of goods or services from a small business supplier, the Court may have regard to "the extent to which the acquirer and the small business supplier acted in good faith". However, this limited obligation to act in "good faith" should be extended to the exercise of all powers and rights arising under a franchise agreement. It is important that any regulated conduct regarding the issue of "good faith" dealing be defined in terms of honesty, reasonableness, and behavior which goes to better the interests of the franchise business.

There is no doubt that franchisors require certain scope to their allowable discretionary powers when dealing with franchisees. This applies equally to the benefit of franchisees with overall benefit to the commercial relationship. The LIV believes that the law requires greater reform to provide a minimum set of conduct standards in the franchise relationship.

Additionally, the respective financial and non financial contributions made by each party to the franchise relationship must be weighted accordingly, and measured against a loss and benefit equation defined through the evolution of the franchise.

The LIV recognises the uniqueness of franchising in commercial relationships. They are based on a high degree of trust and universally accepted notions of goodwill. Therefore, it is important to balance this against the arguments not to regulate, which by their nature present an unworkable economic model which assumes all franchise relationships have equal power balance and remedies to resolve disputes cost effectively. This is simply not the reality in our emerging commercial markets.

The addition of a statutory obligation on franchisors to act in "good faith" is not out of step with the approach by some courts. For example, the court implied a term of "good faith" in *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187. Although there is currently some uncertainty about the exact extent of the content of an obligation of "good faith", the insertion of a statutory obligation will allow the courts to flexibly apply the concept to individual factual circumstances.

## **Renewal of Franchise Agreements**

The LIV is particularly concerned about the ability of franchisors to unfairly treat franchisees in respect of the renewal of franchises, given that franchisees will have spent money, time and effort building up a valuable business during the course of the franchise agreement.

Due to the unique nature of franchising, unlike retail leasing for example, the franchisee cannot take its business elsewhere once the franchise agreement expires. Restraints of trade upon the franchisee also place limits on the franchisee's future business options.

The LIV believes that the Code should deal expressly with the renewal issue, to resolve uncertainties that currently exist between the established practice where almost all franchises are renewed on expiry, and the fact that most contracts are silent in relation to questions of renewal. .

At a minimum, the LIV supports the inclusion of a more substantial disclosure requirement in the Code. For example, the LIV supports the introduction of a requirement that franchisors explicitly advise prospective franchisees about their rights to renew or extend their franchise agreements and to disclose whether a payment may accrue to the franchisee to represent the value of the business upon exiting the system.

More importantly the LIV supports the codification of the existing practice by an express provision in the Code. This would provide reassurance to all franchisees that they will not have their businesses taken away by the franchisor, due to a non-renewal, unless some good reason exists. This may be also be important for franchisees who have borrowed money against the value of their businesses.

The LIV also believes a minimum "six month notice" should be required of franchisors to advise franchisees about the terms of the renewal, or to advise that they intend not to renew an operative franchise agreement.

That six month period would also allow both parties to consider their options where the franchisor intends to make a substantial change to the operative conditions of the franchise agreement.

It is also important to ensure that the proposed doctrine of "good faith" be included as a requirement of the parties in putting forward any variation of the franchise agreement to apply upon a renewal. This ensures that a commercially realistic obligation is imposed on the entire franchise relationship, eliminating the so called "back door" method of diluting the value of a franchise operation.

The LIV believes that where a franchisor or franchisee fails to serve notice of their intention in relation to the renewal of a franchise agreement, then by default, a "six month notification" period should commence from the time a notice is given either proposing new terms for the renewal or notifying an intention not to renew the agreement.

## **Conclusion**

The LIV believes the Code should be amended to include a standard of conduct which imposes obligations on the parties to a franchise relationship to act in "good faith" and not engage in "unfair conduct". The numerous examples found in the common law provide adequate model terms which could be used as a basis to amend the Code and energise the franchising market to even greater transparency and fairness. This has overwhelmingly positive economic benefit and works to the promotion of franchising as a superior business model in Australia.

Parameters defining the conduct and limitations of parties to a franchise relationship add to the commercial certainty of this business model and thus the credit worthiness risk for lenders.

Please do not hesitate to contact either myself or Michael Hayes, LIV Commercial Lawyer on 03 9607 9382 if you require any further particulars.

Yours sincerely

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

**Danny Barlow**  
Acting President  
Law Institute of Victoria