

The Hon Paul Holloway MLC
Leader of the Government in the Legislative Council

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Mr Geoff Dawson
Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
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Dear Mr Dawson

Thank you for your letter dated 7 July 2008 concerning a submission to the Joint Committee Inquiry into the Franchising Code of Conduct.

The South Australian Parliament recently released a report prepared by the Economic and Finance Committee into Franchises. The report was based on the efficacy of current laws regulating the franchisee/franchisor relationship. The Committee sought to focus on those areas of the law that regulate the:

1. disclosure of information to potential franchisees;
2. dispute resolution processes;
3. formalities required of a franchisor who wishes to conduct a franchise; and
4. any other matter considered relevant to the committee.

A full copy of the report can be found at <http://www.parliament.sa.gov.au/Committees/Standing/HA/EconomicandFinanceCommittee/EconomicandFinanceCommittee.htm>.

In all, the Committee made 21 recommendations that relate to issues under the control of the Australian Competition and Consumer Commission (ACCC) or federal legislation. I have listed these recommendations below because I believe they warrant consideration by the Joint Committee in the interests of Franchising.

I look forward to the outcomes of the Committee's deliberations.

Yours sincerely

Paul Holloway
Leader of the Government in the Legislative Council
Minister for Mineral Resources Development
Minister for Urban Development and Planning
Minister for Small Business

RECOMMENDATIONS

Federal Issues

Registration of Documents

7.2.1. The Committee recommends the introduction of a mandatory federal registration system for franchise disclosure documents.

7.2.2. The Committee recommends that such a register be maintained by the ACCC which would ensure that all documents lodged with the register comply with Code requirements.

The Committee is of the opinion that the objects of the disclosure process – that is transparency of process and information - should be supported at each stage. The provision of comprehensive, high quality and relevant information should be mandated and the assessment of that information by independent advisors - as is required by the Code - should be aided through the provision of benchmarks, standards and comparators.

Continuous Disclosure

7.2.3 The Committee recommends that the Franchising Code of Conduct be amended to require the franchisor to provide continuous and freely accessible disclosure to current and prospective franchisees.

The Committee accepted that disclosure could be improved by making it continuous, requiring mandatory updates be provided to existing franchisees “whenever changes are proposed which may impact on the franchise or any individual site”.

Franchising Experience of Franchisor

7.2.4. The Committee recommends 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 Committee were of the opinion that the disclosure of “franchise specific” experience by a franchisor would be a helpful extension of the current disclosure requirements. Not all franchise systems are successful and franchisees should be entitled to discover whether the system they are considering investing in has a track record of success or is not proven.

Access to previous Franchisees

7.2.5. The Committee recommends that the Franchising Code of Conduct be amended to prohibit any conduct that has the effect of preventing or obstructing communication between prospective and existing franchisees.

The Committee noted a practice of inserting confidentiality clauses in franchise contracts to prevent the spread of different categories of information during subsequent disclosure processes was not uncommon among franchisors. The use of confidentiality clauses to protect information about past business operators appears to the Committee to be a clear attempt to defeat the purpose of the disclosure provisions.

Endorse Recommendation 21 of Matthews Report

7.2.6 The Committee endorses Recommendation 21 of the Matthews Inquiry and encourages its timely implementation by the Commonwealth. Recommendation 21 reads 'The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with the franchisor failure'.

The Committee noted that whilst the recommendation was accepted in principle by the previous Federal Government, there has been no subsequent action to implement it.

Remove Exception to 20.3 of the Code

7.2.7 The Committee recommends that the Franchising Code of Conduct be amended to remove the exception in item 20.3. Item 20.3 states the requirement to provide financial reports, does not apply if the franchisor provides the franchisee with a written statement confirming the franchisor's good financial standing accompanied by an independent audit within 12 months after the end of the financial year to which the statement relates.

The Committee noted that receiving a written statement of the franchisors position within 12 months after the end of the financial year represented an inappropriately long interval during which the financial standing of the franchisor, or indeed any business, could drastically change.

Disclosure of Rebates

7.2.8 The Committee recommends that the Franchising Code of Conduct be amended to introduce specific penalties for breaches of the disclosure requirements under the Code.

The Committee were told that there remained an issue over whether franchisors should disclose to franchisees the nature and volume of rebates or other payments received by them on goods or services provided by them to franchisees. In the Committee's opinion, the recent amendments to the Code with respect to rebates and other benefits, does not reflect the spirit of the disclosure process. To acknowledge the simple fact of a rebate without quantifying its value or how it was arrived at does not in itself provide a franchisee with useful information; indeed it would seem to raise more questions, which seems counter to the purpose of disclosure in the first instance.

Penalties for Breaching Code

7.2.9 The Committee recommends that the Franchising Code of Conduct be amended to introduce specific penalties for breaches of the disclosure requirements under the Code.

The Committee was told that currently the Code does not contain any penalty provisions in the case of non-compliance with disclosure requirements. The Committee was further told that non-compliance was a persistent problem.

Statutory Definition of Unconscionability

7.2.10 The Committee recommends 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 Committee is of the opinion that section 51AC of the *TPA*, as it currently stands, is not being effectively utilised because of a combination of drafting imprecision and judicial caution. The section has the potential to provide a clear course for redress for franchise disputes and those factors currently obstructing its use should be identified and resolved, even if it requires revisiting the Act.

Alternative Dispute Resolution

7.2.11 The Committee recommends amending the alternative dispute resolution measures available under the Franchising Code of Conduct by:

(c) mandating more effective mediation of disputes;

(d) providing for additional alternative dispute resolution mechanisms allowing the timely and cost effective resolution that would not disadvantage franchisees.

7.2.12 The Committee recommends considering 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 Committee was of the opinion that the current dispute resolution process was not sufficiently comprehensive - in terms of expertise, breadth, flexibility of approach or durability of outcome - and required supplemental measures between the current poles of mediation and litigation. The Committee took the view that the franchise industry would benefit from the creation of a national office of Franchise Ombudsman, or alternatively a separate, national franchising tribunal.

Good Faith & Fair Dealing

7.2.13 The Committee recommends amending the Franchising Code of Conduct by inserting a provision imposing a duty to act in accordance with good faith and fair dealing by each party of the franchise relationship.

7.2.14 The Committee recommends the Franchising Code of Conduct be amended by inserting a provision imposing a duty to conduct renewal negotiations in accordance with good faith and fair dealings by each party.

The Committee received substantial evidence suggesting that the introduction of a statutory duty of good faith would be one way to make explicit the underlying ethical standards expected of the whole industry. The Committee noted that the concept of good faith and fair dealing is not new, and perhaps can be argued to implicitly underpin most business activity, yet the insertion of a legislative provision codifying the presence of such ideals is suggestive of inherent problems, perceived and real, currently afflicting the industry.

Goodwill

7.2.15 The Committee recommends the Franchising Code of Conduct 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.

7.2.16 The Committee recommends 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*.

The Committee recognises that goodwill presents a challenge to the franchise industry because of the unique structure of franchise businesses, the location of brand ownership and the distribution of rights and responsibilities between parties. Yet inherent in recognising that the success of a franchise depends on both parties is the need to recognise and, where necessary, quantify the value of the franchisee efforts over the term of the contract.

While an individual franchise may not succeed without the brand power and resources provided by the overarching system, the efforts of the franchisee operating that outlet at that location need to be acknowledged when the relationship reaches a crucial point such as renewal or expiration.

ACCC Publish Investigation Outcomes

7.2.17 The Committee recommends the ACCC publish outcomes of any investigations in which franchisors are found to be acting unlawfully or persistently in breach of the Franchising Code of Conduct. Such findings should further be kept on a publicly accessible register.

During the course of the inquiry, the Committee was presented with numerous allegations regarding the practice known as 'churning'. The Committee was told that churning involves exposing franchisees to significant market risk and financial strain in order to force that franchisee to exit the system within a short period of time.

Following the departure of one franchisee the franchisor takes steps to replace them with another unsuspecting franchisee willing to buy the franchise, often at an inflated price.

Code Require Disclosure of Leases

7.2.18 The Committee recommends the Franchising Code of Conduct be amended to include a requirement to disclose:

1. a copy of the franchisor's, or associate's head lease over a premises; and
2. any sub-leases over the premises occupied by the franchisee for the purpose of conducting the franchise business.

ACCC increase Education Funding

7.2.19 The Committee recommends 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.

Education was a central element, the Committee was told, to a properly functioning franchise industry. Because many prospective franchisees possessed scant business experience or knowledge, it was crucial for them to be able to gain the ability to assess risk and become aware of their rights and obligations under their franchise contracts.

The Committee recognises that various bodies in the industry provide training, and that independent training organisations also offer services to assist all sectors of the industry. To the extent that any of these services are considered adequate they should be considered by the Commonwealth government as a means through which effective educational material and /or courses could be provided in conjunction with or as an extension of publicly funded initiatives.

ACCC support 51AC actions

7.2.20 The Committee recommends 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.

The ACCC's limited success in contributing to the development of case law in the area of unconscionable conduct was a common criticism to the Committee. A critical aspect of the ACCC's enforcement efforts that attracted comment was its tendency to encourage out of court settlements of disputes. The Committee was of the opinion that the ACCC should invest in bringing, or joining itself to, actions under Section 51AC in an attempt to bring judicial clarification to a section that has the potential to provide wide-ranging and effective relief too many participants in the franchise industry.

ACCC accommodate Alternative Dispute Resolution

7.2.21 The Committee recommends the ACCC's jurisdiction with regard to franchising should be amended 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.

The Committee has suggested establishing a Franchise Ombudsman or a tribunal (or such other body) as an example of the kind of intermediate level authority that could meet the volume of disputes that arise from a large and growing industry.