



## Submission

Thank you for the opportunity to make a submission to the “Inquiry into the Franchising Code of Conduct”.

This submission is submitted on behalf of Franchise Alliance, a national consultancy business with over 17 years experience in the industry and offices in most states comprising professional consultants with many years experience in all aspects of franchising .

I write this submission based on my personal experiences as a lawyer in New Zealand who acted for franchisors and franchisees, a former international franchisor and now an Australian based franchise consultant.

The greatest tasks facing an enquiry such as this are:

- Separating reality from perception,
- Balancing the interests of two parties at opposite ends of a spectrum, and
- Endeavouring to provide outcomes, in relation to issues which are identified, in a way which is consistent with the realities of business and life in general.

It is always easy for people to criticise and blame others for consequences which have had an adverse effect on their financial and/or emotional wellbeing. These people sometimes become very vocal and can give the perception that an aspect of business or life is in distress when in fact it is only a very small minority who are being affected or it is the actions of an extremely small percentage of the people they are dealing with who are behaving inappropriately or illegally.

Great care has to be taken not to put remedies in place which suite the lowest common denominator but with far reaching and even disastrous consequences for the vast majority of the sector or population.

We already have an industry code covering franchising and whilst change may be appropriate as time and systems evolve, and I comment on this below, great care must be exercised not to implement change in an endeavour to cure the simple fact that life and business is not always fair and some people, no matter what support or provisions are in place, will not be as successful as others through no fault of anyone.

To provide more comprehensive and unique rules and remedies in one sector can lead to other people saying they want similar provisions to cover them. This may or may not be needed but it is for a Federal Government to determine, on an overall basis, whether they wish to change and /or regulate the general business environment rather than it being done piecemeal and hence unfairly.

By and large the Trade Practices Act sets out the Governments requirements for the operation of businesses in Australia and if there are to be other than minor changes, the process for amending statutes needs to be followed so it is applicable to all elements of business transactions not just franchising.

### **Improving the Code.**

- 1) The relationship of franchisor and franchisee has existed in business in one form or another for centuries.

In a modern full business format franchise system, the rights of the franchisor and franchisee are set out in the franchise agreement signed by both parties.

These rights are based on the fact that the franchisor has developed a business concept and associated Intellectual Property which he gives the franchisee the right to use and copy in exchange for a fee.

Naturally the franchisor has to have control over the use of its business systems and Intellectual Property otherwise people could do with it what they liked and denigration of the value of the system and Intellectual Property, the franchisors asset, occurs.

The current code sets out a comprehensive list of requirements which the franchisor must comply with and information it must provide before entering a franchise agreement with a franchisee.

These are aimed at ensuring fairness and good faith on the part of the franchisor towards the franchisee.

The Trade Practices Act itself applies to these transactions so there are the broader concepts of the Act and more specific, to franchising, requirements of the code. The Act provides in section 51AC (3)(k) and (4)(k) that the courts can take in to account the extent to which the parties acted in "good faith" therefore one could ask what is the need to add a specific provision requiring good faith in bargaining other than to make this requirement beyond doubt in business dealings. This however is a matter for the Act and not the code

The question is 'what else can be done'?

The main problem seems to be franchisees getting caught up in the excitement of buying "their own business" and not carrying out appropriate due diligence. To this extent franchising is no different to buying any business and franchising already has more protections and requirements in place via the code than in non franchise business purchases.

You can legislate till the end of time but you will never be able to protect people completely from their own stupidity or enthusiasm. Whilst it is for a Government to "set the acceptable scene" and prohibit dishonesty for business transactions and then to punish the those who break the law it cannot and should not try to dictate the terms contained in contracts or the negotiation process in its entirety.

Having said this I would submit that one change which would address many issues is to make the taking of legal advice compulsory for all prospective franchisees. I pick legal, as any competent lawyer will refer people on to accounting and, if needed, business advice.

You could also make accounting advice compulsory to ensure these people do in fact receive such advice.

If the legal and accounting aspects of a franchise system are investigated by these two professionals all aspects of the system should be independently explained and advice given including taking in to account that advisors knowledge of his client and their skills.

- 2) The question of franchisees rights at the end of a franchise agreement has been raised in recent times. As stated above the franchisor has designed a business system and Intellectual Property associated with it.

He then gives the right to a franchisee to use both to make money for a period of time. The franchisee has to amortise the cost of the system over the years he has it to see if he will make enough profit over and above the cost of the system and outlet set up to justify his efforts. Legal and accounting advice should cover this.

Has the franchisee created any goodwill over his time in the system or is it all about:

- The brand
- The system of business
- The ongoing support, training and strategising of the franchisor
- The group marketing
- The local area marketing devised by the franchisor
- The simple fact of belonging to a franchise
- The benefit of being part of a group and not a sole trader.

I am aware some American states have put in place legislation but can see no justification for it. If we were to change the law in Australia it would have very far reaching consequences for franchising and would likely change the whole design and structure of franchise systems. It would make them more akin to a partnership.

We have a pending court case in Western Australia. If the courts rule that a franchisor cannot refuse to renew then we already have this point covered. If they rule in the franchisors favour then we may need to look further at this question but with different criteria to this enquiry and extensive research and analysis of overseas systems.

The terms of what happens at the end of an agreement should be set out in it and the lawyer and accountant will give advice but I submit there is no reason why a disclosure document could not have this added as an item which has to be specifically set out in it.

- 3) One of the matters often raised by franchisees is the difficulty in enforcing the Act or Code or recovering compensation due to overworked enforcement agencies and/or cost.

Since time immemorial there have been dishonest people in business and there have been issues with justice, punishment and recovery of losses caused by that dishonesty.

The issue of ACCC funding is not something which will happen quickly and it is not just the franchise sector that has issues with this agency being overworked. If we could have an enforcement agency which had all resources necessary to ensure compliance with all the laws under its jurisdiction this would be ideal. I don't know if it is a reality and it would have the flow on effect of more cases for prosecution in our courts which raises more funding issues.

Possibly a dedicated franchise unit with its own resources, as opposed to staff dedicated to franchising, may help as it would not be overwhelmed by general matters but input from the ACCC would be required to answer this.

Franchising does have the compulsory mediation process but this seems to be regarded as not providing sufficient solutions in a timely manner. There are also differences in the legislation governing alternative disputes resolution in a number of the states.

A uniform alternative disputes resolution procedure covering all states and territories could be set out in the code. This could clearly set out time frames, information or documents to be provided, their minimum content and the consequences of parties failing to comply with these.

I would submit that one consequence may be that the defaulting party is obliged to pay all of the costs of the mediation and the reasonable costs of the innocent party.

One has to be very careful not to taint the rationale behind mediation which in part is aimed at each party being able to make statements, concessions etc without prejudice to subsequent action if mediation fails. However a mediator could be empowered to provide a report on the conduct of the mediation and compliance with processes without reference to content or outcomes. This report could cover details of each party's compliance with timeframes, documents and content and possibly even the fact that a party was intransigent in their position without stating what that position was.

This report would be available to be produced in any subsequent litigation at the time of determining costs. So even if a party won they may still not get costs if they have not complied with the mediation process and the intent of mediation where the parties try and resolve their dispute.

Hopefully this would encourage all parties to comply and endeavour to genuinely mediate.

The issue of enforcement of mediated settlements could be provided for by enabling the contractual agreement entered following a mediation and setting out its outcomes as being able to be directly enforced by the same means as

any judgement of a court i.e. give it the status of a judicial decision without the necessity for any appeal rights as it was mutually agreed.

There are many other methods of alternative dispute resolution but they add little to the current structure. The parties are already obliged to try and resolve matters before mediation (although a conciliator might help with this at little cost) and if mediation does not bring resolution the other methods are not likely to help especially if one of the parties is determined that they are right in every respect.

It is a case of very rigorous due diligence before entering a franchise agreement for both the franchisor and franchisee rather than patch up measures afterwards.

- 4) A matter raised by some franchisees is the fact that they are provided with figures at the time of recruitment which are claimed to be the figures being achieved by one or more existing outlets (company owned, franchisees or both).

It becomes apparent after commencing their franchise operation that these figures may not be correct and are significantly over stated. When the franchisee seeks verification documents from the franchisor they are not forthcoming and it becomes impossible, without expensive discovery through litigation, to ascertain if they were reasonable figures to provide or not and hence the franchisee, already in strained financial circumstances cannot afford to go to court so walks away.

This could be overcome by making it mandatory for the franchisor to supply the franchisees accountant with such reasonable information as they require, including access to the base data from which their figures are derived, as is necessary to satisfy the accountant as to the accuracy of the figures provided. It needs to be mandatory upon the franchisor once figures have been provided to prevent franchisors from simply rejecting a potential franchisee if their accountant is asking questions. This makes it clear that the liability rests with the franchisees accounting advisor to verify the figures, subject only to the accuracy of information provided.

The onus of proving the accuracy (or possibly an honest belief in the accuracy, judged objectively) of the information provided to the accountant should rest with the franchisor.

This can easily be policed by the ACCC or determined by an arbitrator or the courts.

This should relieve the franchisor from their potential liability unless they provide false information. This in turn would overcome one of all franchisors greatest dilemmas; what to provide by way of figures for fear of being sued.

- 5) It has also been raised with me that some franchisors are increasing fees and levies at the time of renewal. Whilst this is rare the consequences can be devastating to the franchisee. This however is a matter which should be addressed in the franchise agreement clearly setting out what the powers of

the franchisor upon renewal are and hence would be covered by the compulsory competent legal advice prior to signing the franchise agreement. Possibly this could be made mandatory and included in the disclosure document in the same way as information relating to what will happen at the end of the final renewal of the franchise .

It is perfectly reasonable for a franchisor to require a franchisee to sign their current franchise agreement at the time of renewal but any power to amend fees should be clearly set out in the original agreement and the renewal.

Yours Sincerely

Submitter;  
Geoffrey Edwin Langham