
# Franchisees Association of Australia Incorporated

(ARBN 119 802 489)

Submission to

# Parliamentary Joint Committee on Corporations and Financial Services

# The Inquiry into the Operation of Franchise Businesses in Australia

10th September 2008

## Executive Summary:

The FAA is 'pro franchising' and supports the 'right to succeed as well as the right to fail' principles. This is a business-driven world and it needs competition within and between business partnerships.

However such competition if often guided under principles of regulation and jurisprudence. These must constantly shift as new industries and new ways of doing business emerge.

There is also jurisprudence affecting employees, contractors & investors.

Franchising is an emerging hybrid of all of these things.

The FAA seeks the adaptation of existing laws and existing principle in the following 7 point plan:

(1) ASIC vetting of Franchise Agreements

- Franchises are investments little different from equities. It's not logical, or fair, that they should be sold without some oversight. There's a big efficiency bonus.
-

(2) A Franchising Ombudsman

- Similar in concept to the format that has worked so well for the banking and communications industries; where small folk have a 'go to' entity which acts a relief valve via its independence and impartiality.

(3) A Franchising Code which includes principles of "Good Faith"

(4) Revision to the "Unconscionable Conduct" provisions of the TPA

(5) An Enforced, as well as enforceable, Franchising Code

- Criminal sanctions for breaches of the Code
- Co-extensive Liabilities (see 6.9)
- Civil Consequences (see 6.3
- Disclosure Documents which work as a Statutory Warranty (11.7 onwards)

(6) Variable (and sensible) terms of contract and tenure

- The term of the franchise must allow an investor sufficient time to recoup entry, and exit, costs and well as make a reasonable return on investment

(7) Use of the Unfair Contracts provisions of the Independent Contractors Act (see 14.1 onwards)

## 1. Introduction

1.1 The Franchising Association of Australia (FAA) is 'pro franchising' and believes franchising is a successful business system with 'win win' outcomes for all participants, especially the Australian Economy, if properly regulated by Government and fairly promoted by Franchisors.

1.2 The reality is that the current regulations promote inefficiency, don't work, or aren't enforced. Franchising remains a 'trap for the unwary'. The ACCC has been often assailed for its lack of effectiveness in franchising oversight.

1.3 There's a wide chasm between what is, and what ought to be, disclosed. Franchisees are often misled by thick disclosure agreements which disclose very little. e.g. "goodwill" is rarely discussed or disclosed. Yet it is vital to the franchisee who assumes, mostly incorrectly, that growth & development of the business will accrue reward and that he/she can sell the business on retirement.

1.4 Nor are "Exit costs" generally discussed or disclosed. Franchisees have 'sunken costs' of their life savings, in addition to borrowed funds. They are repeatedly at the mercy of a franchisor when it comes to negotiating renewal.

1.5 It is a myth that there are low levels of disputation in franchising. The origin of the myth is explained in 13.0 and following. (As is the paradox why the Inquiries of SA and WA were flooded with submissions, and why there are growing numbers of distressed franchisees knocking on the doors of Parliamentarians and Current Affairs programs).

1.6 There are countless stories of economic misery brought about by the current unequal bargaining power involved in franchising. Many remain untold, due to either fear of retribution by franchisors and/or lack of mechanisms to aid franchisees in distress.

1.7 Franchisor behaviour toward franchisees varies from the best examples of acting on 'good faith', to blatant 'unconscionable conduct' in the truest spirit of that term.

1.8 The FAA position is however that the franchising industry should not be susceptible to *death by regulation*. FAA contends that the outcome of this Inquiry should be to introduce a legislative and regulatory regime which is as simplified as possible but effective to redress the worst excesses of franchising and is not so over-regulated as to constrain franchisors and franchisees from having the liberty to make wrong or even bad business decisions in trade and commerce. However, for reasons which are explored in the balance of the submission, the current regulatory regime can, with respect, be improved considerably without overly burdening those franchisors, indeed the majority of franchisors, who are doing the right thing by their franchisees.

## 2. The Nature of the Relationship

2.1 As a matter of law, the relationship between a franchisor and franchisee is an independent contract.

2.2 As a matter of commerce, the relationship between a franchisor and a franchisee is, in the main, a dependent contract. That is, the franchisee is dependent upon the franchisor and the integrity of the franchising system.

2.3 For many franchisees, entry into a franchising arrangement is the largest financial commitment they make in their economic lives. Typically, franchisees are *sold* on a franchising proposition because it is represented that the system is such as to protect and grow capital, afford the opportunity of earning income beyond what one would secure as an employee and, in many but not all systems, that the franchising system, if followed, will substitute for lack of business experience.

2.4 In consequence, the concern of the Inquiry might be, with respect, to ensure that franchisees (in spite of the disclosure obligations under the industry code) are not misled and that there are consequences (beyond those currently available) if franchisees are misled.

2.5 The concern of this Inquiry might also be, again with respect, to ensure easy access to *remedy* for franchisees when the regulatory regime is honoured in its breach, that than in its observance.

2.6 It might be considered trite law that the relationship between a franchisor and a franchisee is a relationship based in *good faith*. Certainly the case law suggests that this is so. *Far Horizons Pty Limited v McDonalds Australia Pty Limited* [2000] VSC 310; *Burger King Corporation v Hungry Jacks* (2001) NSW Court of Appeal; *Gary Rogers Motors (Aust) Pty Limited v Subaru (Aust) Pty Limited & Anor* (1999) ATPR.

2.7 However, there appears to be some resistance, notwithstanding all of the law and jurisprudence around the unconscionable conduct provisions under section 51AC of the *Trade Practices Act*, to provide legislative support for that notion.

2.8 The fact that a franchising relationship, is a relationship of good faith should be, with respect, mandated. After all the mandating of obligations of good faith do no more than underpin the concepts upon which the modern law of contract is based. It certainly underpins the relevant provisions of the *Trade Practices Act*. It simply enjoins each party to the relationship to have proper regard to the interests (including the commercial interests) of the other.

2.9 On the assumption that the Franchising Code of Conduct remains the legislative vehicle perhaps clause 4 – "**Meaning of *Franchise Agreement***" can be amended as follows:

> "*4.* ***Meaning of Franchise Agreement***
>
> *(1)* ***Franchise Agreement*** *is an agreement:*
>
> *(a) that takes the form, in whole or part, of any of the following:*
>
> *(i) a written agreement;*
>
> *(ii) an oral agreement;*

*(iii)* *an implied agreement;*

*(iv)* ***being an agreement in good faith; and …***"

## 3. The Current Approach

3.1 Franchising, currently, takes place in a legal regime which includes:

(a) the common law of contract;

(b) the common law relating to misrepresentation;

(c) the *Trade Practices Act,* 1974 (Cth);

(d) various State *Fair Trading Acts* or their equivalent;

(e) Statutory Rules 1998 No. 162 as amended otherwise known as the *Trade Practices (Industry Codes – Franchising) Regulation* 1998 (**Franchising Code of Conduct**).

3.2 There are, in this Inquiry, all manner of other statutes which may require consideration including:

(a) taxation and revenue statutes;

(b) the *Workplace Relations Act* 1996 (Cth);

(c) State based industrial legislation;

(d) *The Independent Contractors Act* 2006 (Cth);

(e) State and Federal Workers Compensation statutes;

(f) any number of Federal and State statutes pertaining to the provision of goods and services which regulate various industries, in which there are franchising arrangements.

3.3 Within the legislative and regulatory regime in State and Commonwealth law, particular focus, in franchising, is directed to aspects of the *Trade Practices Act* and, in particular, those sections of that legislation which pertain to misrepresentation in trade and commerce and section 51AC of the *Trade Practices Act* – unconscionable conduct in business transactions.

3.4 In a number of respects, it is appropriate, at this time, that the Federal Parliament, through this Inquiry, reviews the regulatory regime. This is because in consequence of the, so called, *WorkChoices* reforms to the *Workplace Relations Act* 1996, tested in the High Court of Australia, have determined that the Commonwealth has power to make laws under section 51(xx) of the Australian Constitution (the Corporations Power) and that this mandate further enlivens the legislative power of the Commonwealth in franchising. That is, it would be unusual indeed if there is any franchising arrangement throughout the Commonwealth which does not have as at least one counterparty to the arrangement, a constitutional corporation within the meaning of section 51(xx) of the Commonwealth Constitution.

3.5 Put shortly, the legislative power of the Commonwealth with respect to franchising should no longer be doubted.

3.6 It is in this context that the FAA recognises, including for the purpose of this submission, that the Franchising Code of Conduct has enormously improved the regulatory regime in which franchising operates and the most recent reforms to the Franchising Code of Conduct, in this context, are recognised.

3.7 As will be seen, FAA's contention is that the Franchising Code of Conduct which is expressed to be *mandatory* is in practice often, sadly, honoured in the breach rather than the observance because the Franchising Code of Conduct is *enforceable* as distinct from *enforced*.

**4. Franchising: "A growth path for efficiency and fairness"**

4.1 Franchising in Australia is a $128 billion industry and employs over 500,000 Australians.

4.2 The vast majority of those 500,000 are small business people or their employees. The Franchisees Assoc. of Australia (FAA) is a not-for-profit organisation with all personnel working *pro bono* on behalf of the rights and interests of franchisees.

4.3 The Franchise Council of Australia (FCA) has a number of full-time employees adequately representing the interests of franchisors.

4.4 A large portfolio of the problems within Franchising, stem from unfair and inappropriate franchise agreements signed by trusting, uninformed or unwary investors.

4.5 There is also waste, and inefficiency, built into parts of the current Franchising Cod. E.g., thousands of prospective franchisees are required to employ advisors, who must repeat over and over, the same essential investigations into a franchise system. It is as if every stock market investor had to do his own 'prospectus' because an ASIC body did not exist.

4.6 In reality, only a miniscule % of franchisees receive meaningful legal, accounting or business advice in the spirit required by the Code. If it had not proved totally impracticable for the majority, it has certainly been found woefully ineffective. Those who do attempt it, find their local lawyers and advisors aren't e If it had not proved totally impracticable for the majority, it has certainly been found woefully ineffective. Those who do attempt it, find their local lawyers and advisors aren't experienced in the nuances, omissions, or traps hidden in the complex clauses of many franchise agreements.

4.7 The FAA proposes considerably less regulation in addition to cutting out the above wastefulness/duplication.

4.8 Reduced, better focussed Disclosure Documents will also mean less onerous compliance burdens for franchisors – particularly if it can end the upward spiral in the size of disclosure documents. The FAA has the objective of halving most current disclosure documents. A bonus will be the greater likelihood that they are read and understood.

4.9 Opposition to the FAA's proposals is likely to be "Let's not handicap growth with tighter regulation". It is akin to saying the Wild West will stop growing if you take out the wild part. The contrary actually applies.

## 5. A Franchise Section within ASIC

5.1 Responsible for oversight of the franchising market in the same way it oversees the equity and financial services markets.

5.2 It would require only a few individuals within ASIC to vet the offering of franchise systems in the same way it vets prospectuses to ensure the market is fairly informed & that offerings meet minimum legal standards.

5.3 The FCA in response to the SA and WA Inquiries said such vetting proposals "could be seen as an endorsement". This is palpably nonsense as such accusations are never been made about any stock exchange share prospectus. The disclaimers are well understood.

5.4 In the contrary sense, if the Government via a regulatory body vets equities before they are sold (when most are a small % of any investor portfolio) the onus is much great to provide vetting for investors who will lay out the greater part of their life savings, and their employment, into a franchise.

5.5 Vetting by ASIC would, at a single stroke, cut back on thousands of individual franchisees duplicating each other in consulting lawyers as to whether or not a given franchise system meets the requirements of the Franchising Code, the Trade Practices Act and that market buyers are fairly informed.

5.6 Lawyers for small business people are invariably not experts on franchising issues per se. They would be freed up to attend the other legal needs of their franchising clients.

5.7 Similarly Accountants and Business Advisors have wasteful duplication looking at the same franchise agreements – with few having proper understanding of the traps for the unwary or the seductive practices preying on their clients.

5.8 For *regional* Australians, where franchisees are increasingly being sold, it is obviously more difficult again.

> Example: There is a multi-national franchise, which mainly sells into regional cities, which has a subtle clause in an addendum (i.e. not in the agreement itself) which gives the franchisor the power to increase a turnover fee by as much as he likes, whenever he likes. i.e. a contravention of 6A(a) of the Franchising Code which says a franchisee is entitled to fairly know the costs that will be levied by his franchisor.

5.9 Yet the franchises keep getting sold - and the regional lawyers, accountants and business advisors, mostly inexperienced in franchising, keep missing this 'illegal' clause, as well as others.

5.10 A casual reader of this document would say "But if it's illegal it would surely be ruled as such, at a later date?" Lawyers would probably agree with the casual reader. But they would also point to the cost of obtaining such a ruling. Several hundred thousands of dollars in legal costs, and likely appeals, time and effort a franchisee can't afford away from his business, arguments over the 'sanctity of the contract' signed, etcetera. Prevention is surely better than cure with such clauses.

5.11 Apart from 'merely illegal' clauses there are those that are grossly unfair, or those that are omitted, such as 'goodwill' or 'exit cost' disclosures.

5.12 Compared to the current approach: How easy it would be for an experienced ASIC, or Consumer Affairs Department, to read and detect that a franchise falls short of its obligations! i.e. to comply with the law, or fairly inform.

But because no such vetting currently takes place, thousands of inexperienced investors continue to fall unfair franchises, for which there is often 'no way out', without losing their life savings.

One vetting by ASIC would replace many thousands of vetting sessions by lawyers, accountants and business advisors.

5.13 The FAA implores that ASIC be given this role to achieve this massive gain in efficiencies. This would help reduce the potential conflicts of interest for the ACCC.

5.14 Perhaps the greatest merit of this vetting process is "Prevention is better than cure". Why allow franchisees to go on buying franchises that don't even comply with the law?

**6. An Enforced Franchising Code of Conduct**

6.1 In FAA's submission to the South Australian Parliament in this respect, FAA made the following comment:

> *"Presently the obligations to give proper disclosure to franchisees are sanctioned only at the suit of individual franchisees, and then typically, after substantial losses (to those franchisees) and at great cost. There is currently no Regulator whose role includes imposing sanctions, including criminal sanctions for a breach of statute (as operates in the capital markets) for material non disclosure or indeed other misrepresentation. These sanctions should reach directors, officers or persons relevantly concerned with the management of Franchisor corporations (and businesses) if the Legislature is serious about the enforcement of the disclosure obligations. The disclosure obligations should be continuous, as they are in the capital markets. FAAI reiterates that an enforced disclosure regime, as distinct from a merely enforceable disclosure regime will do much to change the behaviour of recalcitrant franchisor(s) without doing insult to the complying franchisor(s). Much of the angst evidenced by the debate currently around Ketchell's case would be redressed by this approach."*

6.2 It can be seen that the references in the above quotation are directed in particular to the disclosure obligations under the Franchising Code of Conduct but those comments also apply to that part of the Franchising Code of Conduct for example which mandates certain of the contractual content of franchising agreements as are found in parts 3 and 4 of the Franchising Code of Conduct.

6.3 The point is that under current arrangements a recalcitrant franchisor can only be brought to book, so to speak, at the suit of a franchisee with the breach of the Franchising Code of Conduct being the inferior equivalent of a *Statutory Count* that was typical of civil litigation in the past. For example, under the New South Wales *Factories Shops and Industries Act* 1962 it used to be the law that in a civil damages claim (for personal injury for example) that by adding a *Statutory Count* there were adverse civil consequences if that count were made out in the litigation. For example, the breach by an employer of the obligation to securely fence the dangerous parts of a machine if found to be the case would result in the employer (and its insurer) being unable to allege contributory negligence against the injured worker. The short point being that there was a consequence of substance in civil proceedings where a statutory obligation was breached.

6.4 In franchising, such is not the case even when a franchisor is in manifest breach of the Franchising Code of Conduct. We will return to this point.

6.5 An adverse consequence in civil litigation for breach of a statute is a material point but it is a subservient point. That is because the need to resort to contested litigation is a barometer of the failure of the regulatory regime.

6.6 The most profound improvement FAA respectfully submits would be a pared down version of the regulatory regime as operates in the capital markets.

6.7 In the capital markets investors go to those markets knowing that there is a regulatory sanctioned and enforced obligation on persons seeking to raise money in the capital markets to give fulsome disclosure. Indeed, it might be said that the disclosure obligations in the capital markets are overly onerous. We do not contend for overly onerous disclosure obligations in franchising. Indeed, the disclosure obligations under the Franchising Code of Conduct are, in and of themselves, sufficient (subject only to some reservations in that respect referred to at 11.7 and following).

6.8 In the capital markets, investors are not typically mortgaging their homes nor are they typically investing their superannuation savings in a franchised business as is commonly the case in franchising.

6.9 As such, FAA urges the Parliament to pass laws which result in a breach of, particularly the disclosure obligations, under the Code resulting not only in civil consequence of the type referred to at 6.3 above, but also in criminal penalty, that is to say, a penalty in the nature of a fine (or in extreme or recurrent circumstances, imprisonment) for breach of a statutory obligation. To work, that same regulatory regime should create a co-extensive liability so that directors, officers or persons concerned in the management of franchising businesses have a co-extensive liability for breaches of Franchising Code of Conduct by incorporated franchisors.

6.10 A model for co-extensive liability is found in Occupational Health and Safety Statutes. In those statutes (and as FAA submits, in franchising) the legislative intention is manifest. The intention is to change behaviours so that organisations, as a matter of fact, have proper regard to their legal obligations and are at substantial risk, and in the case of individuals with decision making power in such organisations, substantial personal risk in circumstances where there is a serious or recurrent breach.

6.11 Such a regulatory regime should not be the source of complaint from the vast majority of franchisors who do their best to comply with the obligations under the Franchising Code of Conduct. Indeed, such a regulatory regime would impose very little additional burden on the majority of franchisors who strive to comply and do in the main comply with the obligations mandated under the Franchising Code of Conduct.

6.12 There are any number of options, from a menu of options that the Parliament might accept as being an appropriate civil consequence for breach of a statutory obligation. Apart from that which we have exemplified at 6.3 above, those aspects of a franchising agreement in respect of which there is a breach, in effect, of a statutory obligation could be void, or voidable or unenforceable in whole or in part in consequence of the statutory breach. Again, these consequences would serve to moderate behaviours.

**7.** Ketchell's Case

7.1 It is timely that the High Court of Australia has made its decision (unreported 27.8.08) in *Master Education Services Pty Limited v Kietchell* (2008) HCA38 (**Ketchell's case**).

7.2 The case to the High Court was an appeal from the Supreme Court of New South Wales which had held that a material non-compliance with the Franchising Code of Conduct rendered the subject Franchise Agreement unenforceable due to illegality at Common Law. The illegality, so the argument ran, was in consequence of a breach of the statutory obligations contained in Section 51AD of the *Trade Practices Act*, 1974 (Commonwealth) (**TPA**), the duty to comply with the Franchising Code of Conduct.

The decision of the High Court of Australian can be put, and was put by their Honour's succinctly in a number of paragraphs in the judgment. Firstly, from paragraph 18:

> "*In the present case, the prohibition in Section 51AD (a Corporation must not, in trade and commerce, contravene an applicable industry code) is directed to securing compliance by franchisors with the requirements of industry codes, and the consequence of contravention is the grant of remedies provided for in Part VI of the TPA (that is the enforcement and remedies provisions)"*

In other words the High Court held that there was no need to refer directly to the harsh Common Law consequences (unenforceability in consequence of illegality) in circumstances where the TPA itself provided a menu of remedies.

7.3 At paragraph 38 of the judgment their Honours' wrote, as to the remedies:

> "*The Act, (TPA) provides a more flexible approach. It allows a Court to prevent entry into a Franchise Agreement, to vary the terms of the Agreement entered into in breach of the Code, or to terminate such an agreement or provide compensation for loss and damage, if it is shown to have been caused by the contravention…"*

7.4 Their Honours continued at paragraph 39:

> "*One of the purposes of the Code is the protection of the position of the Franchisee…it would be an unusual result if, (in circumstances where the Franchise Agreement was rendered unenforceable) that a franchisee's bargain was struck down in every case regardless of the position in which it placed the franchisee. It is not to be assumed in every case that a franchisee wishes to be relieved of the bargain. To render void every Franchise Agreement entered into where a franchisor had not complied with the Code would be to give the franchisor, the wrong-doer, an opportunity to avoid its obligations and at the same time place the franchisee in breach of obligations (the franchisee may owe) to third parties"*.

7.5 With that, the Court concluded (also at paragraph 39 of the judgment):

> "*A preferable result, and one for which the (TPA) provides, is to permit a franchisee to seek such relief as is appropriate to the circumstances of the case"*.

In this respect, their Honours were referring principally to Section 87(2) of the TPA which provides a menu of remedies including declaratory relief, orders varying the contract, orders permitting the avoidance (in whole or in part) of the contract, orders providing for the return of property and ultimately orders providing for damages (money compensation).

7.6 It is now apparent that on the issue raised in Ketchell's case, at least, the High Court has had a final word.

7.7 The conclusion of the High Court can perhaps be put colloquially:

> *Even though the TPA mandates that a Corporation will not to, in trade and commerce, contravene the Franchising Code of Conduct such a breach at worst either has no necessary consequence and at best provides a gateway to further litigation under other provisions of the TPA.*

'Other provisions' include the remedies under Section 87 mentioned at 6.5 above and possibly remedies under Section 51AC (unconscionable conduct in business transactions).

7.8 The rhetorical question is, is this where the Law should be?

7.9 In this respect we refer to our comments at paragraph 6.3 and following which can be redacted to the following propositions:-

(a) a breach of a statutory obligation ought to have consequences;

(b) those consequences can be:

(i) criminal;

(ii) civil;

(iii) both criminal and civil.

**8. A Franchising Ombudsman.**

8.1 There needs to be a "go to" entity for franchising which can:

(a) Be independent and impartial in the tradition of how the role works in the Banking, Communications and other sectors

(b) Dispense educational material

(c) Advise franchisees, or franchisors, as to their options

(d) Readily recognise and distinguish between different elements of complaint/query

(e) Record/tabulate those elements

(f) Monitor the Franchising Industry and report to Parliament annually on performance and possible amendments to the Code.

8.2 Would be required to keep a 'Register of complaints' which he would make available to prospective franchisees investigating a given industry or franchise system

The criteria for allowing any complaint on to the Register would ensure that it is not frivolous or vexatious.

8.3 Currently the Franchising Code of Conduct has a similar sentiment/objective by requiring a Franchisor to disclose any legal proceedings under way. There are frequently many

franchisees in distress with complaints against a franchisor, but they cannot afford court proceedings – thus the intent of the Code, that such disputes should be known by prospective franchisees, is totally circumvented.

8.4 To achieve the intent of the original Code there needs to be less stringency and more openness. Good franchisors would recognise that legitimate complaints are best handled in a fair mannered way.

8.5 As an offsetting cost saving, it might be possible to remove the Office of the Mediation Advisor which was, after all, created in concert with the original Code. However, if it has developed a role outside franchising that should be considered on its merits.

8.6 Mediation has an extremely low level of success in franchising because (a) the disputes tend to be "in principle" rather than over 'one off' transactions. The Franchisor is particularly intransigent because of the implications for his entire system, and (b) There is no compulsion on the franchisor to attend.

8.7 The FAA is aware that an alternative has been promoted of using Small Business Offices in each State, modeled on the Victorian operation. This would be a backward step in the same manner as the Office of the Mediation Advisor. i.e. Nothing can be done about "in principle" intransigence by the franchisor. The idea has merit for other small businesses, but not franchising.

8.8 Such State-based Offices would also be fragmented in their awareness of franchising law and practice.

8.9 There would also be duplication and probably inconsistent ourcomes. What happens if a given chain of franchisees around the country all have the same problem with a unilateral change in the franchise agreement by a recalcitrant franchisor, as often happens?

8.10 Of real consideration is the very small operation and extremely long hours worked by many franchisees. There is simply not the energy or time to meet, discuss and try to reach agreements on complex issues such as jointly raising funding to seek legal advice. Operating Franchisee Councils are a rarity. The characteristic is truly that of small independents up against a big system.

8.11 To quote from a book review on 'The Ombudsman in New Zealand': "The office is marked by independence and impartiality, openness and accessibility, simplicity of procedure and minimal structure, reliance on moral authority and working towards conciliation and resolution rather than coercion"

8.12 Further, the Ombudsman is "expected to tell the weak and the helpless that their complaints have no foundation when this is so and to tell those that consider themselves wronged that they have received due process". It is not a one-way street for franchisees.

8.13 The FAA implores the Government to take the bold step of appointing a Franchising Ombudsman. The alternatives are actually likely to be more costly if the Federal Government has to contribute to many State Offices. They will certainly be less effective.

8.14 *How can Australia have a $128 billion dollar industry, and 500,000 investor/employees, and not have **any** form of **independent** measurement, insight, or advice?*

**9. Funds to establish a legal framework for the industry via test cases under the Franchising Code of Conduct as it is incorporated into the Trade Practices Act.**

9.1 This was promised with the original setting up of the Code, but never delivered.

9.2 The ACCC supposedly has the current role of oversight of the industry but has not had the ability, or the resources, to run any test cases to conclusion to allow legal precedents.

9.3 The current modus operandi of 'talking/persuading/cajoling is better than litigation' is a misplaced sentiment and an excuse for a stymied industry. It helps only the few individuals who can attract the ear and the resources of the ACCC. In the meantime hundreds, if not thousands, have few or no legal precedents on which they can proceed.

9.4 Examples of first and third line forcing, cry out for test cases.

9.5 This has meant a virtual impossibility for any aggrieved franchisee to take a franchisor to Court. ("Protected by law" is a hollow phrase if the law is made more difficult inaccessible through lack of precedents or legal clarifications. Many lawyers advise franchise clients not to go to Court simply because of this uncertainty of the law).

**10. A review and strengthening of the "Unconscionable Conduct" provisions of the Trade Practices Act**

10.1 There have been repeated calls for this, including by the ACCC. It's time it was done.

10.2 Most of the industry is aware of the Berbatis case where the ACCC took up the cause for what they believed to be unconscionable conduct. They lost the case on the basis of what most thought was an incredibly harsh interpretation of the law.

10.3 Clearly the law needs better clarity and guidance than the guidelines now given under Section 51AC of the Trade Practices Act.

10.4 Here's an example of what the FAA believes is unconscionable conduct in the franchising sector:

> A franchisee, leading negotiations on behalf of all licensees in the group, had his cash flow cut-off by the franchisor. (In some franchise systems, the franchisor collects the payments from national clients via a central billing service and distributes the payments back to individual franchisees who supplied the service).
>
> The cut off of the cash flow would, within days, mean a default with the franchisee's banking covenants. He wrote and protested the action.
>
> The franchisor wrote back and said it was "a mistake' and that it shouldn't have happened. Nevertheless, this was in conjunction with other 'mistakes' and harassment to force the franchisee to sign an unfair new agreement. This put enormous emotional, as well as financial, strain on the franchisee and his wife. They 'caved in' to the franchisor's demands.
>
> Subsequently another Licensee was appointed as Chairman of the negotiating group. The technique of cutting of cash flow was employed a 2nd time, again along with other harassment.
>
> By now, others in the system knew not to follow suit, or they might suffer the same fate. (The unfair action only needs to be done once or twice for the fear to be ingrained).

The dispute was taken to two Mediations where correspondence would show the Franchisor would not accept the Legal, Accounting and Business Advice obtained by the Licensees – that the conditions of the franchise were unfair and unjust, and in contravention of the Franchising Code.

This advice took many tens of thousand of dollars to obtain.

This was surely a 'watershed' - a case of franchisees doing exactly the right thing as intended by the Franchising Code.

A large legal firm, a large accountancy, specializing in franchising, and one of the country's most experienced franchise advisors – were engaged. Each gave independently written opinions for the franchisees to pass on to the franchisor- that the renewal contract was illegal, unfair and shouldn't be signed. Only to be ignored by a multi-national - "basically in defiance of Australian laws" as the Business Advisor put it.

The franchisees, unfortunately, had 'sunken' costs and without any 'run out' period would suffer instant bankruptcy, so they all had to sign the unfair agreements under duress.

*Was all of this action, and the imposing of an unfair agreement, "unconscionable conduct"?*

The lawyers thought so, but they also said that an "unconscionable conduct' would be incredibly difficult and ground-breaking law to try and tackle. Unless you have a million or more dollars, and could give up 'years of your lives', the advice was "don't do it'. After all, the Franchisor was a multi-national, multi-billion dollar corporation who would fight through many appeals.

A "paper trail" of contemporary correspondence exists for the above.

The FAA believes that if this particular franchisee group could go through all of this process, basically well-organised, basically well-financed & professionally advised – but still lose so comprehensively – what hope is there for other franchisees?

The current 51AC has characteristics which are listed as (a) through (k) to help identify contributing elements to unconscionable conduct, but the courts seem to take the view of guidance from the phrase "in all the circumstances" as meaning all elements, not just some, or the majority, must be present.

10.5 Clearly there is a gross failure of the intent of 'unconscionable conduct' under current Trade Practice Laws. The FAA requests that Section 51AC should be redrafted and then re-tested by the ACCC so that a fairer balance is obtained.

## 11. What should be disclosed?

11.1 FAA respectfully submits that there is not much that is wrong with the content of the Franchising Code of Conduct with respect to disclosure. Annexure 1 to the Code in its 23 provisions provides a prospective franchisee or a renewing franchisee with a substantial amount of necessary and desirable information, subject of course to the franchisor complying.

11.2 In considering disclosure obligations, the Inquiry is respectfully enjoined to focus on the commerce as much as on the legal issues.

11.3 The commerce can be expressed simply: a franchise agreement which facilitates entry into a franchised business does so to the following intent:

11.4 that the franchisee will become a member of a broader organisation which will, over time, provide the franchisee with the opportunity to obtain a return on capital investment; and

11.5 in the meanwhile the franchisee could expect to earn good income in the franchise business; and

11.6 in most cases the franchisee can realise its capital investment by selling the business into the market overt as an ongoing concern.

11.7 FAA's direct experience is that the current disclosure regime is not efficacious with respect to a fulsome disclosure of these commercial fundamentals. That is not to say that the current disclosure regime is not concerned with these issues however the disclosure regime could in this respect, as well as with respect to the current disclosure obligations become a document in the nature of a warranty by the franchisor given to the franchisee being a warranty which is of course necessarily qualified.

11.8 The nature of the warranty by dint of disclosure is that the disclosure is accurate and can, in all respects, be relied upon. The nature of the qualification is that the warranty does not extend to a guarantee that the franchisee will be successful in the operation of the franchised business.

11.9 FAA, if invited in the course of the Inquiry, would be happy to work on a model disclosure document.

11.10 Perhaps we can best illustrate the points we are attempting, here, to make by example.

11.11 With a focus on the commerce, the franchisor might be obliged to disclose (being a disclosure in the nature of a qualified warranty as referred to above) exemplified as follows:

> *"Capital investment:*
>
> *(a) In order to become a franchisee in our system you will need to either accept the new territory offered in the appendix, or negotiate with the current franchisee to acquire that business as a going concern. As your franchisor we cannot exercise any control over our franchisee, from whom you seek to acquire the business as to the appropriate price. You should take your own advice to be factored in to the capital costs of entering the franchise arrangement referred to more particularly below. Where you are financing your acquisition of this franchise, you should additionally factor in the cost of finance including interest costs and the period of the borrowing about which you should also take specific legal, financial or accounting advice.*
>
> *(b) The fees payable to us entering the business are:*
>
> *(i) training fee $ ;*
>
> *(ii) franchising fee $ ;*

*(iii) security bond $ ';*

*etc.*

*(c) Of the fees mentioned above only [**identify fee**] is refundable and in the following circumstances [**disclose circumstances**].*

*You can expect to get a return on capital, assuming you operate your franchise successfully as follows:*

*(a) By building and operating a successful franchising outlet;*

*(b) By having the opportunity to sell your business as an ongoing concern in the knowledge that we will provide you with security of tenure and offer approved incoming franchisees a term sufficient for them to realise a return on their capital investment. Currently that term is [ ] years.*

*(c) In order to assist you in maintaining the value of your capital investment, we:*

*(i) will afford you an exclusive prime marketing area being [**describe area**];*

*(ii) a term of not less than [ ] years;*

*(iii) will not operate a 'company' or competitive store within your prime marketing area;*

*(iv) will operate the franchising system such that if you perform to benchmark standards (see below) you can expect to generate earnings before interest, taxation and amortisation (EBITA) of [ ] percent of your revenue including after deduction of franchising fees, royalties and your contribution to the marketing fund;*

*(v) will not unreasonably refuse to approve an income franchisee, acquiring your franchised business from you:*

*(d) To enable you to achieve benchmark performance, we operate our franchising system in a manner more particularly referred to at [**describe section of the disclosure document pertaining to revenue generation and costs**] [**and so on**]."*

11.12 In maintaining the focus on commerce and having disclosure in the nature of qualified warranties, the disclosure document ought to obligate the franchisor to disclose how the system operates commercially with respect to revenue and profit generation. In that respect, the disclosure regime would refer to aspects of business planning, including branding and marketing, the cost of marketing (to the system generally and to the individual franchisee). The disclosure regime would also obligate the franchisor to describe in considerable detail how it operates on the, so called, *supply side*. For example, constraints around sourcing goods or services, the costs or costs benefits under the particular franchise system. The system of rebates to or from suppliers of goods or services. The identification of the beneficiaries and the extent of the benefit in relation to any rebate or other regime. Credit arrangements, accounting standards and material of that kind should also be the subject of fulsome disclosure.

11.13 To the extent that disclosure exposes material that is commercial in confidence, the current law provides an adequate protection to a franchisor in these respects and it would be reasonable that a franchisee enters into a confidentiality arrangement possibly with provisioning for forfeiture of a security bond or the like in the event that confidence was breached.

11.14 The overarching point remains: the disclosure obligations ought to extend not only to the legal infrastructure but also to the most important matters of commerce. The current disclosure regime is after all an attempt by various Parliaments to mandate a *basis of contract* regime which binds franchisors. In other words, franchisees are encouraged to enter a franchise system on the basis of representations and consequently misrepresentation of material facts ought to result in consequences which are adverse to the representor. Whilst it is said that the current legal regime covers off on this point, it does so in a most unsatisfactory way. That is, franchisees are forced to litigate and in so doing, they bear the onus of proof in establishing material misrepresentation and, indeed from time, in franchising, injurious falsehood.

11.15 A more particular disclosure regime would not shift the legal onus. The franchisee in contested litigation would still have the legal onus to prove its case. A more particular disclosure regime would however shift the evidentiary onus because the disclosure documents (modified as envisaged) would be simply tendered in the proceedings and would constitute discrete evidence of the basis of contract and the basis of disclosure. Further, the disclosure regime would operate as a warranty from the franchisor qualified only in the manner described above.

11.16 To the extent that this aspect of FAA's submission is met with the admonition: *"This is far too onerous … this is death by regulation … "* FAA submits that the representations as to the commercial aspects of a franchise system are made in the context of commercial negotiations between franchisors and putative franchisees in any event. All that is asked is that those representations (which are supposed as a matter of law to be other than *false and misleading*) should be reduced to writing under a regime that is concerned to ensure they are true and correct. As such (apart from the paperwork which might be involved) the obligation is not objectionable.

**12. The drawing up of "Fair Franchising Standards"**

12.1 Much is said about how Franchising is a "relationship", almost like marriage where a complete prescription just isn't possible. Nevertheless, it would be beneficial to consider some "Improved Education" as an appendix to the Code itself in the form of the most common and more contentious sub-activities in franchising. To this end, the FAA is compiling a draft set of "Fair Franchising Standards" Just a few examples of the areas covered:

12.2 **Advertising and Marketing funds.** (How they operate, how the money is spent, audit procedures, use of trust funds etc).)

12.3 **Pricing controls.** (Sometimes a price ceiling is unfairly placed on franchisee pricing by the franchisor. There is a conflict of interest between the franchisor, who wants to see volume, with the franchisee who might not be able to cope with low margins needed to get that volume).

12.4 **Third Line Forcing.** (Anecdotal accounts are that this is very common in franchising but, as with unconscionable conduct, it is near impossible to take action under the TPA. The FAA has had examples of Franchisees talking to the ACCC who agree the practice is going on, but it's not a priority for them. The ACCC clearly does have resources issues, but it would still help if there was either (a) A Test Case or two - or (b) Guidelines that

would alert the franchisee about good and bad practice toward him when he is forced to buy from certain suppliers.

12.5 **Non Compete terms.** (More accurately described as "Restraint of Trade" clauses masquerading as "Non Compete" clauses). A litmus test is at the end of almost any Franchise agreement. Most are incredibly harsh on the departing, or cast out, franchisee, even if he/she was in the industry *prior* to taking up the franchise. Fair standards/guidelines need to be established.

12.6 The inclusion of a set of fair franchising standards would serve the purpose of exposing potential franchisees to principles, potential problems and knowledge that they would not otherwise have access to, prior to starting in franchising. Going into a franchise partnership, the franchisor knows about the above concepts, why shouldn't the franchisee?

**13. The Myth of low levels of disputes in Australia**

13.1 A survey of Franchisors by Griffiths University in 2006, sponsored by the FCA, found that "Some 35% of franchisors reported that they have been in a substantial dispute with a franchisee over the previous 12 month period (that is, a dispute referred to an external advisor for action)". This is not the statistic quoted by franchisor representatives to the ACCC, politicians or the media.

13.2 The survey didn't include disputes which were not a "referral to an external advisor". The FAA believes this 2nd category of disputes would be far the majority. For reasons of lack of resources, or implied intimidation, many Franchisees don't, or can't, take them further.

13.3 Only franchisors were surveyed. There was no input from franchisees. Yet this survey is the one most used to assure Parliament of a low rate of disputes in franchising.

13.4 Had a survey been done of franchisees, rather than franchisors, the conclusion may well have been reversed regarding whether the problems of franchising were isolated, or systemic.

13.5 The Inquiry will also hear that in the dispute resolution processes which operate under the industry code, that well over 90% of cases are successfully resolved. That proposition should be tested.

13.6 The truth is that many franchisees settle, but only in despair, having no alternative, especially given the imbalance in bargaining power.

13.7 A mechanism of Commercial Arbitration would be far more likely to be fairer than the current regulatory reliance on Mediations.

13.8 The FAA requests that the Government commission a survey of franchisees in lieu of accepting those opinions exclusively drawn from franchisors. It is palpable that the level of disputation being promoted is erroneous.

**14. Unfair Contracts**

14.1 In certain States of the Commonwealth, for example New South Wales, franchising agreements were susceptible to the reach of unfair contracts jurisprudence under Part 9 of Chapter 2 of the *Industrial Relations Act* 1996 (NSW).

14.2 Notwithstanding that the unfair contracts jurisprudence fell into disfavour and indeed was in large measure, if not completely, ousted by the *WorkChoices* amendments to the *Workplace Relations Act* 1996 (Cth) a good deal of what was in Part 9 of Chapter 2 to the New South Wales Act found its way into the *Independent Contractors Act* 2006 (Cth) (**ICA**).

14.3 The Federal Magistrates Court of Australia, and the Federal Court of Australia have been granted jurisdiction under the ICA.

14.4 The ICA is designed to regulate arrangements between so called, independent contractors, by reference to commercial law as distinct from by reference to industrial law more attuned to the relationship of employers and employees.

14.5 The objects of ICA are expressed to be:

> *"(a) To protect the freedom of independent contractors to enter into services contracts; and*
>
> *(b) To recognise independent contracting as a legitimate form of work arrangement that is primarily commercial; and*
>
> *(c) To prevent interference with the terms of genuine independent contracting arrangements … "*.

14.6 There are a number of threshold conditions before one can get to, so to speak, the unfair contracts jurisdiction under ICA.

14.7 The first of the threshold questions relates to "services contracts". The language which distinguishes between independent contract and contract of employment as it has developed in the law is not helpful. An independent contract is described as a *"contract for services"* (**services contract**). An employment contract (master/servant relationship) is described as a *"contract of service"*. Under ICA a *"services contract"* is defined as follows:

> *"A **Services Contract** is a contract for services:*
>
> *(a) to which an independent contractor is a party; and*
>
> *(b) that relates to the performance of work by the independent contractor; and*
>
> *(c) that has the requisite constitutional connection specified in subsection (2).*

14.8 The requisite constitutional connection is at least that one party to the arrangement has to be a constitutional corporation within the meaning of section 51(xx) of the Commonwealth Constitution. In franchising, as already noted, typically if not universally, at least one party to a franchising arrangement will be a constitutional corporation susceptible therefore to the reach of the legislative powers of the Commonwealth. A question has arisen in the cases (although as presently advised FAA believes that the point has not been judicially determined) as to whether or not a franchising arrangement constitutes a "services contract" within the meaning of the ICA. We can dispose of the point shortly. The contention against franchising arrangements being susceptible to the reach of the ICA is based upon the proposition that a services contract, as defined, does not on its proper interpretation, encompass franchising arrangements which in all other respects

might be thought of as independent contracts. This is because, so the argument runs, that a franchisee, although a counterparty is not performing work for the benefit of the franchisor but is rather performing work for the benefit of third party consumers in a franchise system. In other words, a franchising contract (and arrangement) is not by dint of definitional questions a *contract for services* and therefore a *services contract* within the meaning of ICA.

14.9 The Inquiry is respectfully invited by FAA to amend the ICA to put the issue beyond doubt. There is no reason, in principle, why franchisees should not have access to the Federal Magistrates Court of Australia and to the Federal Court of Australia to take advantage of the unfair contracts jurisdiction and the jurisprudence yet to be developed under ICA.

14.10 FAA apprehends that the worse excesses of the unfair contracts jurisprudence as it operated in New South Wales (real or imagined) pertain not to the question of *unfairness* as such, but rather to the issue of *remedy*. That is, the remedies achieved went beyond the gravitas of the unfairness to be addressed. Whether that be right, or wrong, is not a matter for present debate. It is sufficient to recognise that the Federal Parliament in ICA has modified the Court's jurisdiction so far as it pertains to remedy. Part 3 of ICA contains section 16 which, relevantly, contains the following:

> *"16 Orders that the Court may make*
>
> *(1) If the Court records an opinion under section 15 in relation to a services contract, the Court may make one or more of the following orders in relation to the opinion;*
>
> *(a) an order setting aside the whole or part of the contract;*
>
> *(b) an order varying the contract."*

14.11 Importantly, subsection (2) of section 16 qualifies the Court's remedial power. It is in the following terms:

> *"16(2) Any order may only be made for the purpose of placing the parties to the services contract as nearly as practicable on such a footing that the ground on which the opinion is based no longer applies."*

In other words, the remedy must address the contract only to the extent that it is unfair and not to any further extent. With respect, this is an important restriction to the unfettered remedial powers available, for example, to the Industrial Relations Commission in Court Session (now the Industrial Relations Court) of New South Wales.

14.12 There is provision too for the Court to make interim orders to preserve the position of a party to a services contract. This is found in subsection 16(3). Importantly, that jurisdiction could be used for the Court to make injunctive or 'cease and desist' orders pending disposal of contested litigation. In franchising this can be a most important remedy indeed designed, as it is, to maintain the status quo or to prevent continuation of conduct which may be causing serious commercial damage.

14.13 In this context it is instructive to note the powers given to the Court. They are found at section 15 of ICA and are relevantly in the following terms:

> *"15 Powers of Court*

*(1) In reviewing a services contract … the Court may have regard to:*

*(a) the relative strengths of the bargaining position of the parties to the contract and, if applicable, any persons acting on behalf of the parties; and*

*(b) whether any undue influence or pressure was exerted on, or unfair tactics were used against, a party to the contract; and*

*(c) whether the contract provides total remuneration that is, or is likely to be, less than that of an employee performing similar work; and*

*(d) any other matter that the Court thinks relevant … "*

FAA asks, respectfully but rhetorically: What is wrong with that in the context of franchising?

14.14 Accordingly, the Inquiry is, as indicated, invited to recommend to Parliament that a law be passed opening up, or rendering unambiguous, the unfair contracts jurisdiction under ICA to franchising. In this context it should be recalled that the object of these reforms is to change behaviours. As such, the ICA might be further amended to create a co-extensive exposure to directors of franchisor corporations who engage in behaviours that fall foul of the unfair contracts provisions of the ICA. Any such legislative amendments should be appropriately qualified so as to maintain the integrity of the protection of the limited liability of corporations other than for behaviours which result in such corporations showing a contumely disregard for proper and lawful conduct in trade and commerce.

## 15. Unilateral Variations

15.1 The existing Franchising Code of Conduct in Para 6A(a) says that the Disclosure Document has the purpose "to give information to help the franchisee to make a reasonably informed decision about the franchise". There can be no better example of systemic problems in franchising if (a) No entity vets the franchise being offered to the investment market as reasonably complying with this condition or (b) There exist Service or Operational Manuals which have the effect of materially altering the costs of compliance to the advantage of the franchisor but the disadvantage of the franchisee. (This should be read in conjunction with our views in section 1).

15.2 For example, a fee which is 'subject to change, without qualification, at the franchisor's discretion', is in an Addendum to the Agreement - without the 'discretion' being mentioned in the disclosure document. (Despite repeated pleas by the franchisees up for renewal, plus the written advice of the professional advisors, the Franchisor refused any qualification. e.g. a link to inflation)

15.3 These issues take on most of their significance because they are progressively introduced as part of unjustifiably frequent renewal requirements. Such changes/updates to the agreement have the potential to enrich the franchisor at the expense of existing franchisees at a time when franchisees are powerless to resist because of their sunken investments.

## 16. Term and Tenure

16.1 The most systemic abuse of franchising 'per se', is the tendency of franchisors to specify a term for the agreement which in all probability does not allow a potential franchisee to recover his entry costs, his capital investment and his exist costs at the end of the term. Invariably franchisees rely on the fact that renewal will be available and that their investment will not be at risk. Thus the franchisees become trapped, with little to no bargaining power, at the end of term.

16.2 Implicitly the promise of renewal is often made along the lines "We have a 95% renewal rate and there's no reason why we wouldn't renew a successful franchisee" fails to disclose that large numbers of franchisees only sign renewals under duress, because their alternative is bankruptcy - because of sunk costs and long-term leases of premises and equipment.

16.3 In one example virtually an entire chain of 25 franchisees fought their multi-national franchisor over clauses in their offers of renewal. Their Business and Legal advisors told them many clauses did not even comply with the Franchising Code, including 6A(a). Only 2 franchisees were financially independent enough to exit the franchise. The others, being vulnerable, were subject to a mix of intimidation, refusal to mediate and withholding of funds and bookings before succumbing under duress to renewals on terms dictated by the franchisor. Over $200,000 was expended in legal advice and multiple approaches were made to the ACCC over the initial years of dispute.

16.4 The legal advice was that it was too uncertain (e.g. 51AC on unconscionable conduct) for the many franchisees to collectively afford, and stay together, for what would be litigation over many years.

16.5 The ACCC advice was that they could not see any illegal behaviour per se on the part of the multi-national franchisor. This was despite direct requests to the ACCC by politicians and bodies such as the Motor Trades Association. (Correspondence available on request). The ACCC did not see its role as reading & vetting the legality of franchise agreements – only as to whether or not illegal behaviour was taking place and that it was worth their resources.

16.6 The supreme irony is that this long-running dispute never qualified as an issue that had to be disclosed by the multi-national to prospective new franchisees under 4.1 of the Code. There never were any actual "proceedings" by a public agency, criminal or civil proceedings.

16.7 Under this new franchisees were signed up regularly in blissful ignorance. Despite many of these new franchisees seeking business, accounting and legal advice, their advisors did not detect this or other clever "non disclosure" techniques.

16.8 The FAA contends that there be a new standard in the Franchising Code of Conduct such that the Franchisor shall not fail or refuse to renew a franchise agreement. In this we mirror much of the submission by the owners of KFC Rockingham and their suggestion of a Clause 23B.

(a) However, the FAA sees a wider context than proposed for their Clause 23C and the suggestion of "Notice of Intention" (on renewal) being given 'Not later than 90 days before the expiry of the franchise agreement'. Truck rental franchises, for example require vehicle leases of up to 8 years. As most Agreements have a 'non compete' clause on the termination of the franchise, for whatever reason, the franchisee is unable to use a vehicle to which he is otherwise bound to, by expensive lease, the early exit of which might be financially ruinous.

Here highlight the necessity to addend the regulatory regime to ensure that the term and tenure is secure so as to afford the realisation of return on capital.]

**17. Exiting a Franchise**

17.1 The FAA submits that a Disclosure Document includes advice that Exit Costs (on the assumption of non-renewal) must be considered by the Accountant and/or Business Advisor of the franchisee and listed with a diligence to match that of start-up costs.

**17.2** That "Non compete" clauses (often better described as "Restraints of trade"), not apply when the early termination of the franchise is non-voluntary or when the term of the franchise expires with the effluxion of time.

**18. Further Views and Considerations:**

18.1 The cure for most of the known ills in franchising lie in 'matching/mirroring' investment and labour practices in proportion to the hybrid of those two markets we call franchising.

18.2 Nothing requested in this submission is new to either the financial or labour markets, including the need for criminal sanctions.

18.3 Deterrence has been totally absent in previous regulation of the franchising market with the result that disputes (and variations of economic serfdom) are potentially systemic, if they are not already so. Every system needs its checks and balances, as well as protection of the vulnerable.

18.4 Lack of access for franchisees to fair and reasonable dispute resolution has been a hallmark of franchising history in Australia.

18.5 Commercial arbitration would be far more successful, as would access to Magistrate Courts.

18.6 Claims that the level of disputation is low and inconsequential are, at best, based on ignorance. The rising level of complaints reaching the Current Affairs programs is more testament that something wrong, as is the ACCC's tendency to find smoke, but not fire.

18.7 The FAA submits that the ACCC's role would be better serviced in tandem with ASIC vetting franchises before they are sold, and that choice of access to an Ombudsman, Arbitration and the lower Courts should be facilitated.

18.8 For some franchisors to claim, in response to the SA and WA Inquiries, that secret commissions taken by franchisors from 3rd parties as result of franchisee endeavours, should remain confidential – condemns their claim of legitimacy to speak on behalf of the franchising industry as a whole.

18.9 How can a $128 billion industry employing nearly 500,000 Australians **not** have prudent oversight and checks and balances in sync with the other markets out of which franchising has grown.

18.10 The reforms mentioned above will make this vital and successful sector of the industry more efficient, with dramatically lower levels of dispute.

18.11 Disclosure costs will be dramatically less (and the FAA is pledged to work in this direction) if the regulatory regime takes on a form akin to other market practices with the simple override that the parties in franchising must act "in good faith" to one another.

18.12 The claim, by some franchisors, that the investment documents they offer franchisees should be free of prior vetting - is akin to the fox wanting to design the hen house.

18.13 Assisting "Small Business" has long been an enigma for successive Australian Governments. The FAA trusts that the above proposals will make a long hoped for break through. Franchising is only one part of Small Business, but the fastest growing, and a harbinger of things to come.

18.14 "Small Business" has long been seen as the engine room of the Australian economy, but nobody until now has seriously examined what lubricants and safety equipment are needed to keep it functioning for the health of the Australian Economy.

18.15 Franchising is one sub-section of "Small Business", but it can have some levers with which to measure it, understand it, guide it, assist it.

18.16 The current assumption is that franchising is a 'business-to-business structure". It isn't. It's far more akin to the "sale of investments".

18.17 It is also far more a 'master/servant relationship'. There is enormous dependence by the franchisee that the franchisor will act "in good faith".

18.18 The majority of franchisees are *not* experienced business people. Most invest *all* of their life savings and their *entire* employment career into their franchises.

**Summary:**

The Franchise sector is a dynamic part of the Australian economy that employs over 500,000 Australians, but it has significant and growing problems.

The great majority of the 500,000 are micro or small business franchisees or their dependent employees.

Many Franchisees feel that they have no voice in government and that the governments of the day tend to be overly influenced by the voice of the Franchisors.

**On behalf of the approximate 99% of the 500,000 people in the Franchising Industry, who are mostly at the wrong end of current franchising laws, the FAA makes this passionate plea for reform in accordance with the above principles.**

**The Hon. David P Beddall**
**Chairman**