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Inquiry into Franchising Code of Conduct

Submissions

12 September 2008

1 Introduction

1.1 DLA Phillips Fox welcomes the opportunity to provide submissions to the Parliamentary Joint Committee on Corporations and Financial Services. These submissions reflect the fact that DLA Phillips Fox routinely provides clients with legal advice on the application of and compliance with the Franchising Code of Conduct.

1.2 In presenting our submissions we have:

1.2.1 not responded to all of the terms of reference; and

1.2.2 retained the same numbering as is used in the terms of reference.

2 Submissions

'The Committee is to inquire and report on the operation of the Franchising Code of Conduct, and to identify, where justified, improvements to the Code, with particular reference to...'

1. the nature of the franchising industry, including the rights of both franchisors and franchisees;

2.1 As this has been the subject of significant analysis and submissions previously, and other industry parties will respond, we do not intend making submissions in response to this question.

2. whether an obligation for franchisors , franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code (having regard to its presence as an element in paragraph 51AC(4)(k) of the Trade Practices Act 1974);

2.2 Recently, the Federal Government and State Governments in Western and South Australia, amongst others, investigated whether an obligation for franchisors, franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code. All 3 Commissions of Inquiry recommended explicit incorporation of a good faith obligation, but relevantly the February 2007 Australian Government response to the October 2006 recommendation was that s51AC of the TPA includes *'good faith'* as a factor that can be taken into account when determining unconscionable conduct and declined to import an explicit good faith obligation into the Code.

2.3 Noticeably, all 3 Commissions of Inquiry cited civil law jurisdiction authorities as justification for the recommendation. All 3 Commissions of Inquiry for all practical purposes failed to appreciate that Australian Courts applying common law have inherent jurisdiction to imply a good faith obligation into a commercial agreement.

2.4 All 3 Commissions of Inquiry also failed to adequately appreciate the fact that the franchise regulatory framework in Australia is the most comprehensive franchise regulatory framework in the world, and features:

(a) a comprehensive prior disclosure process as set out in the Code;

(b) a general prohibition on misleading or deceptive conduct contained in ss52 and 51A of the TPA;

(c) a general prohibition on unconscionable conduct; and

(d) a well resourced and effective regulator in the Australian Competition and Consumer Commission (**ACCC**).

2.5 Australian Courts by and large have ruled in favour of an implied good faith obligation. In *Burger King* [2001] NSWCA 187, the New South Wales Court of Appeal (Sheller, Beazley and Stein JJA) noted that there was increasing acceptance that a term of good faith was to be implied as a matter of law which approach was considered to be correct: at [164]. See also *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* [2000] 178 ALR 304 and *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286. In these three cases, the respective franchisees succeeded against the franchisor because the franchisor was held to be pursuing more than the franchisor's legitimate interest, or, putting it another way, the franchisor was acting in a manner that would not be reasonably expected in the context of a franchise relationship.

2.6 In *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310, Byrne J noted that:

> *'There is to be implied in a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose. Such a term is a legal incident of such a contract'.*

2.7 A balancing factor is, where the franchisor can demonstrate that it is seeking to protect a legitimate interest it will not be in breach of the implied obligation of good faith. See *Far Horizons Pty Ltd v McDonald's Australia Ltd.*

2.8 The implied obligation of good faith also does not require a franchisor to act in a contractually altruistic manner or in a manner akin to a fiduciary. Also, a franchisor is not required to subordinate its own immediate or longer term business or other interest to those of a franchisee or its franchisees. Our Courts are aware and approach this issue on the basis that the franchisor's interests arise in the context of an independent, mutual relationship where the franchisee reasonably expects that regard will be made to the franchisee's legitimate interest. It is submitted that our Courts are succeeding in balancing the rights of franchisors and franchisees adequately.

2.9 Given the nature of franchise agreements, franchisors normally retain a contractual discretion, but given the interpretation adopted by our Courts, a franchisor cannot exercise that discretion in a way likely to cause the franchisee's rights to become *'nugatory, worthless or is seriously undermined'*. As a result of this, the exercise of a contractual discretion is made capriciously, or for some extraneous purpose if there is no rational basis for the exercising of the right or no explanation for the exercise of the right that is in accordance with the parties' reasonable expectations. See *Far Horizons Pty Ltd v McDonald's Australia Ltd* [120].

2.10 In support, when arguing a breach of the implied good faith obligation, a franchisee can also rely on verbal or written representations made by the franchisor prior to entering into and during the term of the franchise agreement. Clause 16 of the Code removed any doubt by rendering a general release or waiver of any verbal or written representation made by the franchisor illegal.

2.11 Further, our Courts have also ruled that a typical *'entire agreement'* clause in a franchise agreement does not exclude the implied good faith obligation. See *Far Horizons Pty Ltd v McDonald's Australia Ltd* [123]. In *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* [2003] 128 FCR1, Finn J stated that he found *'arresting the suggestion that an entire agreement clause is of itself sufficient to constitute an "express exclusion" of an implied duty of good faith and dealing where that implication would otherwise be made by law'* [922].

2.12 The prohibitions on unconscionable conduct contained in the TPA and State Fair Trading Legislation operate effectively in the context of the franchise relationship and adequately enhance and support the implied good faith obligation accepted by our Courts. Section 51AC(3) and (4) providing a non-exhaustive list of factors that can be taken into account to determine unconscionable conduct, include consideration of *'good faith'* as one of many factors to be taken into account in determining unconscionable conduct.

2.13 For example, in *ACCC v Simply No-Knead (Franchising) Pty Ltd* [2000] 178 ALR allegations against the franchisor included, amongst other things, a refusal by the franchisor to discuss matters in dispute with the franchisee despite requests from the franchisee to do so, the exclusion of the franchisee from advertising literature of the franchise, competing with the franchisee, and the deletion of telephone numbers of the franchisee's business from directory information. Sundberg J described this conduct (at page 320) as disclosing *'an overwhelming case of unreasonable, unfair, bullying and thuggish behaviour in relation to the franchisee which amounted to unconscionable conduct'*. In reaching this conclusion, His Honour noted that in his view, the expression *'unconscionable'* in s51AC was not limited to cases of unconscionability as defined by the unwritten law or equity. The principal pointer to an enlarged notion of unconscionability in s51AC lie in the factors to which a Court might have regard and the fact that these factors are not exhaustive.

2.14 It is suggested that the current state of our common and statutory law provide adequate protection and any attempt to introduce an explicit good faith obligation into the Code may not only be unnecessary but an unfortunate legislative indication that *'good faith'* has a different meaning as currently understood, applied and continually further developed by our Courts.

3. interaction between the Code and Part IVA and Part V Division 1 of the Trade Practices Act 1974, particularly with regard to the obligations in section 51AC of the Act;

2.15 Part IVA of the TPA deals with unconscionable conduct and Part IVB deals with industry codes.

2.16 It is submitted that these Parts of the TPA are complimentary and in combination provides powerful protection to franchisees.

2.17 Part IVA of the TPA amongst others provides that:

> *'A corporation must not, in trade or commerce, in connection with:*
>
> *(a) the supply or possible supply of goods or services to a person ...*
>
> *(b) engage in conduct that is, in all the circumstances unconscionable.'*

2.18 In determining whether a franchisor has engaged in unconscionable conduct, it is necessary to have regard, amongst others to the following:

(a) whether the franchisee was in a weak bargaining position;

(b) whether the franchisee was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interest of the franchisor;

(c) whether the franchisor used any unfair tactics against the franchisee;

(d) whether the franchisor's conduct towards the franchisee was consistent with the franchisor's conduct in similar transactions between the franchisor and other franchisees;

(e) whether the franchisor has complied with the requirements of an applicable industry code, namely the Franchising Code of Conduct.

(f) whether the franchisor was willing to negotiate the terms and conditions of the franchise with the franchisee;

(g) the extent to which the franchisor and the franchisee acted in good faith.

2.19 This list is not exhaustive and as mentioned by Sundberg J in *ACCC v Simply No-Knead (Franchising) Pty Ltd*, the expression *'unconscionable'* in s51AC was not limited to cases of unconscionability as defined by the unwritten law or equity. The principal pointer to an enlarged notion of unconscionability in s51AC lie in the factors to which the Court might have regard and the fact that these factors are not exhaustive.

2.20 In another case, *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2003] ATPR (Digest) 46-229 the Judge concluded that the franchisor had acted capriciously and unreasonably in the circumstances as there was not a sufficient basis to terminate the contract.

2.21 These cases suggest that there is a strong argument that a franchisor has engaged in unconscionable conduct where the franchisor interferes, uses unfair tactics, do not act in good faith and the like which may all result in the franchisor having acted unconscionably.

2.22 Part IVB provides in s51AD that:

'a corporation must not, in trade or commerce, contravene an applicable industry code'.

2.23 Section 51ACA(1) defines an *'applicable industry code'* to mean prescribed provisions of any mandatory industry code relating to the industry.

2.24 A *'mandatory industry code'* is defined to mean an industry code that is declared by regulations under s51AE to be mandatory. The Franchising Code of Conduct has been declared to be mandatory. It came into effect on 1 July 1998 and applies to franchise agreements entered into after 1 October 1998.

2.25 The mandatory industry code puts the Code squarely within the ambit and reach of both Parts IVA and IVB of the TPA.

2.26 The fact that the Code is a mandatory industry code, also puts franchising within the ambit and reach of Part V of the TPA.

2.27 In particular, although fundamentally concerned with preventing anti-competitive conduct and providing appropriate safeguards for consumers, ss52 and 53 are also relevant to franchising.

2.28 Section 52 relates to misleading and deceptive conduct and its broad scope deals with issues relating to franchisor conduct during the formation of an agreement and during the term of the franchise agreement. Section 52 can be applied to prohibit franchisors from making misleading statements with regard to, amongst other things, projected turnover or profitability. This view is supported by the provisions of clause 20 of the Code.

2.29 Failure to observe the standard of conduct required by s52 has consequences under Part VI of the TPA (Enforcement and Remedies). These include remedies available at common law and other compensatory remedies under s87, which apply when loss or damage is likely to be suffered by a franchisee.

2.30 Section 53 is also relevant as it prohibits false or misleading representations made in relation to the supply of goods and services. For example, it prohibits a franchisor from making a false or misleading representation to its franchisees in relation to the price of goods or services and their origin.

2.31 It is accordingly submitted that the provisions of the TPA and the interrelation between the relevant Parts of the TPA as they apply to franchising are robust and broad enough in scope and application to provide adequate protection to franchisees.

Conclusion

2.32 There appears to be no justification to explicitly import a good faith obligation into the Code as the common law as applied by our Courts already implies and gives meaning to a good faith obligation in franchise agreements.

2.33 The different Parts of the TPA compliment each other, apply to franchising and offer an adequate and robust mechanism for the ACCC to use and provide adequate protection to franchisees. The TPA also compliments the implied obligation of good faith and in fact make it obligatory to consider when considering unconscionable conduct.

2.34 The franchising sector in Australia is currently highly regulated and has one of the most robust and comprehensive regulatory regimes in the world.

2.35 There appears to be no reasonable basis to treat franchising and franchise agreements different to other forms of commercial agreements, which are not subjected to such rigorous regulation.

2.36 Any proposed changes to the TPA and/or the Code should be approached with great caution. Over regulation may detract from franchising as a functional method of doing business which may adversely affect its attractiveness. Currently, the franchising sector makes a substantial contribution to GDP and creates a substantial number of employment opportunities.

2.37 It is well documented that the State of Iowa suffered under the consequences of over regulation to the extent where the franchising sector shrunk substantially and franchisors deliberately avoid franchising into Iowa, resulting in lost contribution to GDP and job creation.

4. the operation of the dispute resolution provisions under Part 4 of the Code; and

2.38 We have a number of members of our firm who are accredited mediators and who on the Office of the Mediation Adviser's (**OMA**) panel of mediators for franchising disputes. Those partners regularly act as mediators in franchising disputes.

2.39 As a general comment and in the most part, the Dispute Resolution procedures are appropriate and work well. Statistics indicate it is successful in resolving disputes without the need for the parties to resort to litigation.

2.40 However, one of the key difficulties that we have as both experienced mediators and solicitors acting for franchisors is compelling the parties (if acting as mediator) or the other party (if acting for one of the parties) to participate in the mediation in a prompt manner once the mediator has been appointed by the OMA. In our experience, it is relatively easy for both franchisors and franchisees (through their solicitors or otherwise) to attempt to prolong the time before the mediation can be held. The effect of such conduct includes:

2.40.1 The franchisor and franchisee continuing to operate their businesses together in a strained manner while a dispute 'hangs over their heads'.

2.40.2 General discontent amongst some franchisees of the particular system if the disputing franchisee is inclined to discuss the dispute with other franchisees;

2.40.3 Giving the franchising industry a poor reputation for failing to resolve disputes quickly;

2.40.4 Giving the Code a reputation for being ineffective in resolving disputes quickly;

2.40.5 To potentially escalate the number of franchisee complaints made to the ACCC;

2.40.6 Cause the mediator unrecoverable expense in an attempting to co-ordinate the convening of the mediation.

2.41 We submit that there should be some mechanism to compel the parties to:

2.41.1 Attend the mediation; and

2.41.2 Attend the mediation without unreasonable delay.

2.42 This compulsion could come in the form of some costs ramifications or monetary penalty for the offending party and/or legal ramifications if the mediation is not held within a certain period, say 2 months from the date of appointment of the mediator by the OMA.

2.43 In our submission, a maximum period of 2 months is a reasonable time within which to expect the parties to be available to mediate the dispute.

2.44 The monetary penalty could be a requirement for the offending party to pay the whole cost of the mediation rather than just their share of the mediation.

2.45 Legal ramifications could flow from a determination by the mediator that the offending party has acted in bad faith or in an unconscionable manner for the purposes of s.51AC of the TPA. An effect of such a determination could include an investigation by the ACCC and the seeking of penalties under the TPA by the ACCC, and the seeking of damages by the innocent party.

5. any other related matters.

Goodwill

2.46 Whilst not specifically addressed in the Committee's terms of reference, the Commissions of Inquiry directly or indirectly recommended a good faith obligation to apply at the end of the franchise term and payment of a *'goodwill'* component to the franchisee. It is assumed that the Committee may consider this proposition under *'other related matters'*.

2.47 Presumably, justification for a goodwill payment at the end of the term to the franchisee is based on the franchisee having enlarged the franchisor's goodwill or more precisely the value of the franchisor's intellectual property. Little if any justification has been advanced for this proposition. See for example the April 2008 report to the Western Australian Minister for Small Business, in particular Chapter 5.

2.48 Justifications cited are based on legislative intervention in civil law jurisdictions and draw on an analogy between franchising on the one hand and agency and distribution arrangements on the other hand.

2.49 It is suggested that the analogy is not well based and, in fact, ignores the requirements of clause 4 of the Code. Before an arrangement can be considered a franchise, it must satisfy the definition in clause 4.

2.50 Critically, the one requirement of clause 4 generally absent in agency or distribution arrangements is a *'grant of a right to carry on the business of offering, supplying or distributing goods and services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor'*.

2.51 Our Federal Court has on 2 occasions in *Capital Networks Pty Ltd v AU Domain Administration Ltd* [2004] FCA 808 and *ACCC v Kyloe Pty Ltd* [2007] FCA 1522 relied on the absence of this requirement to distinguish distribution and agency arrangements from a franchise.

2.52 The absence of this element in an agency or distribution arrangement is not conducive to any attempt to justify a goodwill payment to a franchisee at the end of the term based on agency and distribution practices in civil law jurisdictions.

2.53 By way of example, it is significant to note that Article 7:422 of the Dutch Civil Code which deals with goodwill compensation to which an agent is entitled in the event of termination of the agency agreement does not extend to franchising. In fact, goodwill compensation payable to a franchisee at the end of the term is nowhere applied in any EU country. The reason for this is clear. An agent or distributor does not have the benefit of offering, supplying or distributing goods or service **using a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor.**

2.54 Whilst it cannot be denied that the franchisee needs to apply a certain level of business acumen and skill, it does not have an obligation similar to an agent or distributor to develop the market using its own initiative, systems or marketing plan. Accordingly, it is difficult to appreciate on what basis, if any, a franchisee has contributed to or added to the franchisor's customer base using its own systems, marketing plan and the like, and thus goodwill. Clearly, this would be the only basis on which a franchisee may arguably be entitled to some goodwill compensation because for the balance, the franchisee relies upon and uses the franchisor's intellectual property. By operating a franchise under an agreement, using the franchisor's intellectual property cannot entitle a franchisee to a proprietary interest in franchisor intellectual property convertible to a dollar value.

2.55 The concept of a franchisee, or for that matter, an agent, distributor and the like having any residual goodwill claim on termination of the agreement is foreign to Australian Law and in fact foreign to the common law jurisdictions.

2.56 To provide for some form of goodwill compensation at the end of the term will in addition invite disputes and increase franchising cost which may adversely affect the viability of franchising as a feasible business model/method of doing business.

Clause 4 - Meaning of *franchise agreement* - 'system or marketing plan'

2.57 Clause 4(1)(b) sets out the second element of a franchise agreement. It states:

> A franchise agreement is an agreement:
>
> ...
>
> (b) in which a person (***the franchisor***) grants to another person (***the franchisee***) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor; and

2.58 The element is too broad in that the element is satisfied where a franchisor merely 'suggests' a marketing plan or system, but does not enforce it. Arguably, this deters suppliers from providing advice and assistance to distributors which may be of considerable benefit to those distributors for fear that the arrangement will fall within the definition of 'franchise agreement'. Further, the word 'suggests' potentially only creates interpretation difficulties and adds little to the element. See for example the cases cited in paragraph 2.51.

Clause 4 - Meaning of *franchise agreement* - 'wholesale price'

2.59 Clause 4(1)(d)(v) refers to 'wholesale price'. 'Wholesale price' is not defined in the Code. DLA Phillips Fox submits that it would be useful if a definition of 'wholesale price' is included in the Code to provide clarity as to what types of payments will or will not satisfy clause 4(1)(d).

2.60 Having regard to the purpose of the Code, it is clear from the 2001 amendments (which inserted 'usual' before 'wholesale price' in clause 4 (d)(v)) that the wholesale price is the usual price of goods and not an 'artificially set price'.[1] The effect of the amendments was that would-be franchisors that charged an inflated amount on the sale of goods, profiting off an increased margin on the goods or services, were unable to avoid the application of the Code. However beyond that clarification is it unclear what is meant by wholesale price. For example what is the wholesale price where the supplier does not have a retail channel and therefore there is no retail price.

2.61 If the purpose of the section is to ensure that a supplier does not make a margin or profit on any supply so that the arrangement is more than a supply or distribution one, it should also contemplate the following situations:

2.61.1 Where supplier is merely on-supplying goods or services supplied to it from a third party without any additional fee or margin;

2.61.2 Where supplier covers its own cost for the provision of services (for example training services);

2.61.3 Where the distributor pays an advertising levy and all the moneys paid are used to promote and advertise the brand with none being retained by the supplier.

Clause 6B(2) - Requirement to give disclosure document

2.62 Clause 6B(1) provides as follows:

(1) A franchisor must give a current disclosure document to:

(a) a prospective franchisee; or

(b)a franchisee proposing to:

(i) renew a franchise agreement; or

(ii) extend the scope or term of a franchise agreement.

2.63 'Scope' is not defined in the Code. DLA Phillips Fox submits that 'scope' requires a definition as:

2.63.1 'Scope' is an ambiguous term (compared, for example, to 'term of a franchise agreement'); and

[1] Explanatory Memorandum.

2.63.2 Without such a definition it is not clear what type of changes and to what extent a change would trigger the requirement to provide a disclosure document by a franchisor.

Clause 6B(2) - Requirement to give disclosure document

2.64 As a result of the amendments to clause 5(3)(a) of the Code, foreign franchisors and master franchisors with more than one Australian franchisee are now subject to the application of the Code. While DLA Phillips Fox welcomes these amendments, it submits that the disclosure obligations of foreign and master franchisors under clause 6B requires further clarification.

2.65 Clause 6B(2) states:

> *(2) If a subfranchisor proposes to grant a subfranchise to a prospective subfranchisee:*
>
> *(a) the franchisor and subfranchisor must:*
>
> *(i) give separate disclosure documents, in relation to the master franchise and the subfranchise respectively, to the prospective subfranchisee; or*
>
> *(ii) give to the prospective subfranchisee a joint disclosure document that addresses the respective obligations of the franchisor and the subfranchisor; and*
>
> *(b) the subfranchisor must comply with the requirements imposed on a franchisor by this Part.*

2.66 In DLA Phillips Fox's view, it is unclear whether 'separate disclosure documents, in relation to the master franchise and subfranchise respectively' means that:

2.66.1 the franchisor and the subfranchisor must each prepare disclosure documents about their own businesses (i.e. the master franchise and the subfranchise); or

2.66.2 the franchisor and the subfranchisor prepare disclosure documents about the franchise system as a whole.

2.67 If the correct interpretation is contained in paragraph 2.66.1, DLA Phillips Fox submits that this should be changed for the following reasons:

2.67.1 Such a disclosure document would inevitably contain sensitive information regarding the commercial deal struck between the franchisor and the subfranchisor. It would be unusual in any analogous business context for such information to be disclosed.

2.67.2 The purpose of the disclosure document is to assist a prospective franchisee to make an informed decision about entering into a franchise agreement. It is not clear what benefit the prospective subfranchisee obtains by being provided with complete details of the relationship between the franchisor and the subfranchisor. There is a reasonable basis to submit that it would be beneficial for there to be a more focused

disclosure of information regarding the relationship between the franchisor and the subfranchisor in so far as it impacts the prospective subfranchisee (for example the information regarding associates, pending litigation, business experience etc of the franchisor would be relevant but not the commercial terms between the parties).

2.68 Further, it is unclear whether the joint disclosure document under section 6B(2)(a)(ii) would contain exactly the same information as the separate disclosure documents required under section 6B(2)(a)(i). There are differences of legal opinion about the interpretation of these provisions.

2.69 Opinions include that a joint disclosure document would expose the franchisor to claims that it endorsed the contents provided by the subfranchisor. The position should be clarified.

2.70 Finally, the purpose of clause 6B(2)(b) is not clear. If it is that if the franchisor does not comply with its obligations under clause 6B(2)(a)(ii), but the subfranchisor must, this would not be reasonable. On that interpretation, if the franchisor failed to prepare a disclosure document for the prospective franchisee, the subfranchisor would be liable for that failure. This does not seem reasonable given that the subfranchisor has no control over the actions of the franchisor.

Clause 10 - Franchisor obligations

2.71 The amended clause 10(c) provides that the Franchisor must give the prospective franchisee, 'a copy of the Franchise Agreement in the form in which it is to be executed'.

2.72 This requires that no amendments can be made to the franchise agreement or to the details in the schedules, no matter how minor (for example the address of the franchisee may have to be corrected), without triggering a requirement that the disclosure document be reissued. The consequences of this requirement can lead to unnecessary delay, duplication, and cost.

2.73 This issue could be overcome with the addition of 'substantially' before 'in the form'.

Clause 16 - Prohibition on release from liability

2.74 As a result of the amendments to clause 16 of the Code, franchise agreements must not require a franchisee to sign a waiver of any verbal or written representation made by the franchisor. The amendment should not apply retrospectively to agreements entered into or after 1 October 1998. We submit that the amendment apply for agreements entered into or after 1 March 2008.

Annexure 1 - Item 1.1(d) - cooling off period and franchisor's expenses

2.75 Annexure 1 item 1.1(d) of the Code requires the first page of the disclosure document to state, *inter alia*:

'If you decide to terminate the agreement during the cooling off period, the franchisor must, within 14 days, return all payments (whether of money or of other valuable consideration) made by you to the franchisor under the agreement. However, the franchisor may deduct from this amount the franchisor's reasonable expenses, if the expenses or their method of calculation have been set out in the agreement'.

2.76 The issue is that if a disclosure document with this statement has been provided to a prospective franchisee, and a payment has been made but a franchise agreement has not yet been signed, there is no binding agreement and the franchisor's reasonable expenses or their method of calculation are not readily apparent to a prospective franchisee.

2.77 We submit that this issue could be rectified by the inclusion of an amount in dollars of the reasonable expenses, or the method of calculation of the reasonable expenses, in this item 1.1(d) of the Disclosure Document.

Annexure 1 - Item 11 - Sites or territories

2.78 The amendments to Annexure 1 item 11 of the Code now require that the details of the territory or site to be franchised (as set out in item 11.2) be provided:

2.78.1 in a separate document; and

2.78.2 with the disclosure document.

2.79 With the introduction of Annexure 1 item 11.3, it is now unclear whether:

2.79.1 the *entire* history of previous franchisees needs to be provided; or

2.79.2 merely the details and circumstances of the franchisee *immediately prior* to the establishment of the new franchise.

2.80 The item should be interpreted as set out in paragraph 2.79.2 as the words in Annexure 1 item 11.2, such as 'a franchise business' (singular) and 'previous franchisee', seem to suggest that franchisors need only provide information in item 11.2 to franchisees in regards to the previous franchisee *immediately prior* to the new franchisee.

2.81 In DLA Phillips Fox's experience, in well established franchise businesses or with businesses where there is a high turnover of franchisees, a territory or site may have a long history of franchise owners. In these cases, preparing a lengthy site history is unduly onerous on franchisors.

Annexure 1 - Item 20.2 - financial details

2.82 It appeared to us from reviewing submissions made to the Matthews Committee in 2007 that in relation to Annexure 1 Item 20.2, there was overwhelming support to allow a franchisor company which is part of a group of companies to prepare

and make available group financial statements, or to prepare and make available financial statements for the franchisor company only. Despite this, Item 20.2 as amended on 1 March 2008 now requires a franchisor company being part of a group of companies to do both which achieves little but to increase compliance costs.

2.83 In our submission, the word 'and' at the end of Item 20.2(a) should be substituted with 'or', 'if: (c)' should be deleted so that 20.2(c) forms part of 20.2(b) and 20.2(d) should be simply form part of the end of Item 20.2. Therefore, Item 20.2 should read as follows:

> *'Financial reports for each of the last 2 completed financial years in accordance with sections 295 to 297 of the Corporations Act 2001, or the foreign equivalent for a foreign franchisor, prepared by:*
>
> *(a) the franchisor; or*
>
> *(b) any consolidated entity to which the franchisor belongs if the franchisor is part of a consolidated entity that is required to provide audited financial reports under the Corporations Act 2001;*
>
> *if a franchisee requests the reports.'*

2.84 The proposed amendments will bring about the desired effect/choice and reduce compliance costs without adversely affecting the quality or sufficiency of disclosure.

Dated 12 September 2008

DLA Phillips Fox

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DLA Phillips Fox

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