COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Franchising Code of Conduct

FRIDAY, 17 OCTOBER 2008

CANBERRA

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JOINT STATUTORY COMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

Friday, 17 October 2008

Members: Mr Ripoll *(Chair)*, Senator Chapman *(Deputy Chair)*, Senators Boyce, Kirk, Murray and Webber and Ms Grierson, Mr Keenan, Ms Owens and Mr Robert

Members in attendance: Senator Boyce and Ms Grierson, Ms Owens and Mr Ripoll

Terms of reference for the inquiry:

To inquire into and report on:

The operation of the Franchising Code of Conduct, with particular reference to:

1. the nature of the franchising industry, including the rights of both franchisors and franchisees;
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*);
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;
4. the operation of the dispute resolution provisions under Part 4 of the Code; and
5. any other related matters.

WITNESSES

Committee met at 9.01 am

FREEMAN, Ms Julia, Manager, Competition Team, Industry and Small Business Policy Division, Department of Innovation, Industry, Science and Research

GREENWELL, Mr Tony, General Manager, Business Conditions Branch, Industry and Small Business Policy Division, Department of Innovation, Industry, Science and Research

WESTON, Ms Susan, Head, Industry and Small Business Policy Division, Department of Innovation, Industry, Science and Research

CHAIR (Mr Ripoll)—I declare open the third in a series of public hearings by the Joint Committee on Corporations and Financial Services to inform its inquiry into the Franchising Code of Conduct. The committee is to report on the Franchising Code of Conduct and to identify, where justified, improvements to the code. The focus of this inquiry is on addressing broad structural and procedural issues relating to franchising agreements in Australia rather than the details of individual disputes. The committee is investigating deficiencies in the operation of the Franchising Code of Conduct and related legislation and ways in which they might be improved.

I welcome all today, and remind everyone that witnesses giving evidence to the committee are protected by parliamentary privilege. Any act which may disadvantage a witness on account of their evidence is a breach of privilege and may be treated by the parliament as contempt. It is also contempt to give false and misleading evidence to a committee. Witnesses should be aware that if, in the giving of their evidence, they make adverse comment about another individual or organisation, that individual or organisation will be made aware of the comment and given a reasonable opportunity to respond to the committee.

The committee prefers to hear evidence in public but we may agree to take evidence confidentially. The committee may still publish confidential evidence at a later date, but we would consult the witnesses concerned before doing so.

Mr Greenwell—I have an opening statement. We thank the committee for inviting us to present evidence at this inquiry. Under the administrative arrangements order, the franchising code is a mandatory code under the Trade Practices Act and is the responsibility of the Treasury portfolio. However, the Department of Innovation, Industry, Science and Research regularly engages with the franchising sector and provides support and policy advice to the Minister for Small Business, Independent Contractors and the Service Economy on franchising matters, given the sector's small business focus. The department of innovation manages the contract with the franchising code's mediation adviser, which was set up in 1998. The government funded Office of the Mediation Adviser appoints mediators to assist franchisors and franchisees to resolve their disputes through mediation.

Our submission to the committee primarily is around the Office of the Mediation Adviser, which we look after from a departmental perspective in terms of funding, and we have provided some statistics for you. The OMA statistics indicate that around 75 per cent of mediations conducted through it result in binding settlement. The average cost of mediation for each party is approximately $1,500 and the average completion time of mediation after a mediator is

appointed is about five weeks. Last financial year the OMA received around 340 dispute inquiries, and over the same period approximately 100 appointments were scheduled for mediation. This figure indicates that the number of dispute inquiries received and the number of disputes mediated by the OMA are low relative to the estimated 60,000 franchises operating in Australia.

Since 2002 the average number of dispute inquiries received by the OMA has been generally stable at around 360 per year, despite the growth in the franchising sector, which was considerable over the same period. The largest number of dispute inquiries relate to the retail trade industry, including motor vehicle, fuel, and food retailing. The department's submission contains data on the nature and basis of each dispute mediated by the OMA since 2005. This data is indicative only as it was collected prior to the mediation and does not accurately reflect all the issues actually discussed. It should also be noted that there may be one or more bases of each mediated dispute, and therefore that dispute may be included in more than one category.

Parties to a franchise agreement often pursue mediation as a method of preserving a good ongoing working relationship. The OMA's statistics indicate that the most common issue raised in mediation is termination and exit arrangements; that is, where a franchisee or franchisor chooses to end a franchise agreement early, prior to its scheduled end date. The OMA has indicated that while that particular issue may come up the most often in the disputes it mediates, the cases are not always acrimonious. The parties to the mediation may be merely seeking the assistance of the mediator to act as a facilitator in settling exit arrangements. OMA statistics indicate that with the exception of the 2007 calendar year, non-renewal of franchise agreements has not been a major issue needing mediation. That is our statement.

CHAIR—Thank you, Mr Greenwell. In your submission you identify that your statistics and representations focus on identifying any systematic problems faced by the franchising sector. Have you identified through the OMA, besides the one you have already announced, any particular themes in terms of disputes and how those disputes arise? If we talk about terms of termination and exit arrangements, maybe you could give us an example or some examples or some understanding from your experience as to why they arise in the first instance. Why do people need an Office of the Mediation Adviser to deal with an end of term contract? Should that not be more clearly spelled out? Should there be some rules and guidelines that make clear what should happen at that point? What I am asking you is: what are the areas in which those disputes arise?

Mr Greenwell—To my understanding, most of the disputes arise because the firms may have some disagreements on how things should be, or they may not be comfortable in the arrangement. Our understanding, as I mentioned in the opening statement, is that a lot of them are not necessarily acrimonious; they just see the mediator as a good way of coming to an agreed position. Perhaps that may be because one of the parties, probably the franchisee, may not be comfortable. We do not really have full details of those sorts of things because they are all confidential with the Office of the Mediation Adviser.

CHAIR—I am not asking for anything confidential. In fact, I do not want to know anything confidential. What I am asking is for themes and your views.

Mr Greenwell—That is the information we have from the OMA—that that tends to be a theme. They use that as a way of negotiating.

CHAIR—I am sorry, but this is not even coming close. I do not want to seem like I am just pursuing this for my own sake.

Mr Greenwell—No, that is all right.

CHAIR—What I am asking you is: why do you think this ends up being a matter of disputation? Is there some non-clarity about what should take place at the end of a contract that arises and needs mediation? Why is it not clear? Why do people not understand? What needs to happen?

Ms Freeman—There is a range of reasons why things end up in dispute, such as people not having undertaken due diligence. The Office of the Mediation Adviser would be able to give further insight into what are the actual drivers of dispute.

Ms Weston—We do not obviously see these in action, like the ACCC which sees it at the grassroots. We get this and some advice from the OMA about whether there is anything systemic. Certainly he has not pointed out anything systemic over the last little while. We would see more the disputes that would come through ministerial correspondence, for instance, to the Minister for Small Business, Independent Contractors and the Service Economy, so that is where we would hear about some of the issues that might be around.

Ms GRIERSON—Could you give us some statistics on what comes through?

CHAIR—We have got statistics.

Ms GRIERSON—Sorry. On what page?

Ms Weston—Attachment A.

CHAIR—Mr Greenwell, I am just trying to understand. You have made a good submission. I am very happy with what you have there, and you provide some good statistics, but the statistics tell us very little. What they tell us is that the No. 1 issue for disputation is terms of termination and exit arrangements, and then a range of other things, including misrepresentations by franchisors and a range of other things. What the committee is trying to understand is: why does a terms of termination exit arrangement become a point of disputation? Why is that so?

Mr Greenwell—I do not think I can answer that.

CHAIR—Why?

Mr Greenwell—I suppose it is because it is not a major issue that has been brought to our attention in our roles.

CHAIR—It is the No. 1 issue, though.

Mr Greenwell—Yes.

CHAIR—The statistics show it is the No. 1 issue.

Ms Weston—There are not that many though.

CHAIR—All I am trying to understand is how they get there.

Ms Weston—There are not a hell of a lot of them though.

Mr Greenwell—That is my argument, yes.

Ms Weston—Although every one of them, of course, is sensitive to the person who is involved in it. The point of the statistics is that there is an average about 360 inquiries a year and about 100 of them go to mediation.

CHAIR—The statistics themselves always belie the undercurrent, if there are problems.

Ms Weston—Yes.

CHAIR—Just because there is a number to the statistics is not representative of the sector because what you will find is that only a very small percentage of people ever complain about anything.

Ms Weston—Yes.

CHAIR—I just do not want to get that as an excuse—'Oh, look, it's not a problem because it's low'.

Senator BOYCE—I was going to ask you to comment on the fact that we have received over 100 submissions from disgruntled franchisees. Some of them explain issues that obviously have to remain confidential, in terms of how they claim to have been treated.

Mr Greenwell—Yes.

Senator BOYCE—How do you explain the big gap between what appears to be the volume of unrest and concern out there compared to these figures?

Mr Greenwell—I see.

Senator BOYCE—Do you have any suggestions on why that is the case?

Ms Freeman—The OMA is one avenue franchisees and franchisors can use to try to resolve their disputes. They are open to use other mediation services. They are not bound to use the OMA in particular.

Ms Weston—This is where we get to see some of the issues. I am just having a look at some of the ministerial correspondence. People feel, for instance, that there is little legal protection for them at the end. They have said to us that they do not have protection at the termination, for instance.

Senator BOYCE—Protection in what way?

Ms Weston—I am just trying to have a quick glance at these notes.

CHAIR—While you do that, I will just explain the original point of what I am asking. I am just asking for your view as to why you think these disputations arise in the first place. There is no point using, 'Oh, look, it's low', as an excuse to say, 'Oh, we can't tell you.' I am just asking you for your view in terms of the department. Why do you think these disputations arise? Do you have a view at all?

Mr Greenwell—Not really. We have not investigated them to that extent. As you can see from that table, there is a wide variety.

CHAIR—Sure.

Mr Greenwell—The Office of the Mediation Adviser has told us that where there are spikes, most of the time they are inexplicable. When we have looked at those sorts of things, the list of issues that have been raised in mediations, none of them have stood out to us as something that we need to go out and really investigate.

CHAIR—Mr Greenwell, can I suggest, though, that, if that is your response and the department does not really know, there are a whole range of comments in your submissions that I would say are more opinion than fact, because you state, 'Due to low numbers, this and that. Due to this …' There is a whole range of areas there where it actually quotes numbers and says, because of the low rate of complaints, this means there are no systemic problems. You are making a final determination that there are no problems because of these statistics. What I am asking you is: how do the problems arise? How do we know they are not systemic if in the end you are not really sure; they are just numbers?

Ms Weston—The OMA tells us on a regular basis when there are systemic issues. That is the basis on which we rely for that comment.

CHAIR—Yes.

Ms Weston—We have just been through an exercise with the Matthews review where disclosure probably would have to have been the key issue. When you look at all the elements of some of these disputes, it is not having enough information and it is probably the information failure in some of these areas because people may not have had the information, or it could also have been because they may not have done due diligence. There is a mixture there.

We do work closely with the ACCC. It is hard for us in our role because we are not at the coalface like the ACCC or the OMA. Certainly we meet regularly with the ACCC and they tell us the issues that are of concern. What they have put in their submission they have also raised

with us. I guess the point is that we see things coming through ministerial correspondence and we manage the contract. We wanted to tell the committee about the level of disputes. We are not at the coalface with this, but we have investigated.

In the Matthews review, for instance, we undertook significant consultation with the industry, which is reflected in that review. Prior to that, disclosure had been one of the main concerns, which is why the government went down the path of looking at the disclosure provisions. For mine, the history of the issues is largely around disclosure and education. Obviously there can never be too much education. Despite that, some people will still jump into a franchise and go for it without having done due diligence, and sometimes the issues arise because of that.

Ms GRIERSON—Are the minimal conditions in the code sufficient?

Ms Weston—There is always room to make sure that information that is critical, like some of the issues that are raised, is upfront and in lights. There is always value in good education. The ACCC does have good information on its website, but perhaps there are other avenues we can look at to improve that too. The important parts—and I know there are disclosure changes that happened earlier this year—are trying to drive at that education side of things. But also bear in mind it is a relationship between two people. In any business transaction, there is a risk. People need to be cognisant of that.

CHAIR—On the issue of due diligence, we do hear that and there is certainly a call from the sector for more education and more due diligence. To me it appears from the submissions we have received and evidence presented to us that due diligence and the pre-contractual arrangements would not be the problem. There are very few disputes. If you look at your own data, you will find that due diligence almost is not an issue at all and that in fact pre-contractual seems to be quite a good area, and that is it more the end of the contract, rather than before the contract.

You might even say that due diligence is done extensively by everybody else who is already in the franchise. If there are 600 systems out there and you are going to buy in, your due diligence has already been done by 599 others, as well as you doing your own. The point is that where disputations arise, where is the deficiency that has led to this disputation, if there is any? Are there possible deficiencies either in the contractual arrangements, the code or somewhere else, that then leads to a dispute?

Ms Weston—You talk about precontractual, but due diligence could also be finding out what the end conditions are for the contract.

Ms GRIERSON—The exit conditions.

Mr Greenwell—Yes.

Ms Weston—The exit conditions, yes. For instance, if you are caught up in a situation where the franchise is found to be related to the leasing arrangement of where the business is located, then your due diligence is to make sure that you have talked with the owner of the mall or wherever the place is. Due diligence is not necessarily pre-contractual and that sort of thing. I see due diligence as relating to all elements of the franchising contract you enter into.

Ms GRIERSON—One of the dispute areas is the valuation of the business or the equipment in the business. It seems to me that that is something that often a franchisee cannot dispute, if they want to go into that business, so they have to accept the valuation of that business, the valuation of the turnover of that business, and the valuation of the equipment in that business. They also have to accept the maintenance conditions or the obligations of that franchise. It would be very hard to do due diligence to the degree that sometimes would be necessary on those things. How do you get more independent assessments of those things into a negotiation besides what the franchisor thinks it is worth, particularly if the franchisor's bank also is offering the finance to the franchisee, which is often the case?

Ms Weston—With the franchisee's bank?

Ms GRIERSON—When often the same bank is involved.

Ms Weston—Everyone should be getting their own independent legal advice.

Mr Greenwell—That is right.

Ms Weston—Accountants are quite capable of valuing stock and looking at the life of it—its effective life and so on—and do quite often for capital gains tax valuation purposes, for instance. There is a real obligation, and perhaps it should be made clearer, that people should step aside from that relationship. It is very attractive because you might be given a loan against the value of the franchise, which is one of the new developments in the banking sector. For instance, you might not have to take the whole mortgage out against your house. You can borrow against the value of a franchise, which is an interesting development in its own right. But sometimes perhaps it needs to be made clearer that franchisees should step outside that arrangement and seek real professional advice.

Mr Greenwell—I would agree with that.

Ms GRIERSON—They often use the same bank. I find there is a bit of a conflict of interest in the same bank, but it would not be in your code anywhere and it would not be written down. A caution would be wise.

Ms Freeman—There is a role in the contract between the parties to capture anything beyond the minimum requirements spelled out in the code as well.

Ms GRIERSON—These people are very inexperienced in negotiating.

Mr Greenwell—That is right.

Ms GRIERSON—Or in business realities.

Mr Greenwell—From our perspective, we would still see as a key component that that individual or that person considering taking up the franchise should be making the effort themselves. If there is some concern about the valuation of the assets as you mentioned, they should be seeking advice elsewhere, I would think.

Ms GRIERSON—Is there an adviser within the department that particularly advises on franchise situations?

Mr Greenwell—No.

Ms Weston—Franchise lending, no.

Ms GRIERSON—There is no service available, is there?

Mr Greenwell—No, there is not at all.

Ms Weston—We give policy advice to government. Departments of state do not take that role, but that may be something that someone could consider at some point in time.

Senator BOYCE—Following on from the point you were making about due diligence, if we are ending up with all these disputes around contracts, there is obviously something not going right there. Have you any suggestions how that area would be fixed? Is it just education?

Ms Weston—There are a couple of things.

Mr Greenwell—That is the key thing—that people are fully aware of what they are entering into. They have to know. There has to be information. That is why there has been so much emphasis given to disclosure in all the inquiries and in the structure of the franchising code as it is. There are even various suggestions coming through now through this process of improvements. That is the key thing. I do not know what else you could do than have people better prepared for what they are entering into. Their life savings are going into these businesses.

Ms Weston—You can always do things like simplify language in contracts, put information up front in draft contracts, and make those sort of things more of a requirement. We are seeing that in other areas, too, like in the financial services sector. You cannot give people 90 pages. Four pages would be more appropriate.

Mr Greenwell—Yes.

Senator BOYCE—We have had evidence, or suggestions through evidence, that it would be useful to have publicly available, say on the ACCC website, the standard form of contract for each franchisor and also registrations of agreements. What would your view be on that? The point is that a franchise can look at that to see if what they are being offered is the standard form, or they can look at what a competing franchise might have in their contracts.

Ms Weston—Registration, through whom?

Senator BOYCE—Presumably also on the ACCC website, or something.

Ms Weston—That was considered in the previous Matthews review. The concern with that was that it would appear that the regulator was endorsing the franchise, which is a concern, I guess. But I can see the other side of the point too—that people want to know that that might be a reputable franchise. That aside though, the ACCC website does say which franchisors they

have taken action against and which ones are currently in litigation. That in itself provides information to someone who might be thinking about going into one of those franchises.

Senator BOYCE—Just on your point, Ms Freeman, on the use of outside mediators, do we have any sense of that? Is that a very small proportion compared to the OMA, or might those figures in fact be double? Does anyone know?

Ms Freeman—Generally, we do not monitor. Mediations that go on outside are made, but we understand Mark Brennan in Victoria—

Ms Weston—The Office of the Victorian Small Business Commissioner undertakes some mediations in the franchise sector. We note that the ACCC has suggested looking at that model. That might be something that the government might need to consider.

CHAIR—Ms Weston, just on that particular point, I have a clear understanding now, for the first time, of the mediation process. There is the mediation process undertaken by the Office of the Mediation Adviser with some data. There is mediation that would take place outside, but we do not have any data so we do not know how many, so it is completely open. More than likely, there would be mediation that takes place internally, say, within franchise systems, and possibly—

Mr Greenwell—I am sorry, but the Franchising Code of Conduct requires them to look at that first.

CHAIR—But we have no data on those either.

Mr Greenwell—Yes. That is right.

CHAIR—I am just trying to establish this because a lot of what is purported to be factual in submissions, including yours, is predicated on the fact that, 'Look, this isn't a problem because we've got hard data that says this is really low.'

Senator BOYCE—We have not got it clear.

CHAIR—But I would suggest to you that that is actually not the case. We do not know if there is a systemic problem because we do not know what the data are. If you do not have the data, that is okay. We at least have your submission in terms of some hard data where we do know statistics. For example, the No. 1 problem seems to be terms of termination and exit arrangements, along with other things, such as alleged misrepresentations, franchisees failing to follow the system, franchisors failing to follow the system, inadequate support training, and a whole range of other things.

By what you have presented to me, though, it tends to push into the direction of saying, 'Look, the pre-contractual arrangements don't seem to too much be an issue. People are being educated. They do understand what they are getting into.' But they are finding that the problems are arising post-contractual. It is once they are into the system, then there are disputations. The disputations tend to be closer to the end of contract or when the franchise system is a bit more developed. What I was trying to seek earlier from you was a view, from your experience in the department,

of what might generate those disputes. We know what they are, but what generates them? Where are the failings, the deficiencies or inefficiencies in the current system we have available, which is the code of conduct, that would lead to these disputations?

Mr Greenwell—Our submission draws on the OMA, which are the only statistics that we have, as Sue mentioned earlier. There is also correspondence we get coming through to our minister on real problem areas out there. Those are the things that formed our conclusions in this document.

CHAIR—With the No. 1 problem you have listed, which is exit arrangements, is it the case, for example, that the reason that becomes a point of disputation—and let us not argue that it is low numbers because we have now established this could be exceptionally high numbers in fact—is that it is silent in a contract, there are no terms of exit and therefore it is completely open. People have a dispute and say, 'That's not what I had expected,' or, 'That's not what you had told me,' or 'That's not what I believed.'

Ms Weston—Therein that is a disclosure issue; that is right.

CHAIR—But it is not required to be disclosed under the code, so it is not a disclosure issue. There is no requirement in the code to disclose that information.

Mr Greenwell—Yes, that is true.

Ms Weston—You could say that is education, or alternatively change the standard agreement. But, in any case, that is probably one of the things that you would want to make clearer to people.

CHAIR—But there is not a requirement now, though. This is the point.

Mr Greenwell—That is right.

CHAIR—It is not at all required.

Ms Weston—I have not got with me a copy of the standard contract.

CHAIR—I can assure you it is not required.

Ms Weston—I just did not want to say yes to the question—

CHAIR—That is okay, but I can assure you it is not part of the code and it is not a requirement. I would say that nearly all contracts, unless you have a different view, do not specify what happens at the end. It is completely silent. No-one picks it up in pre-education because it is silent. It is harder to pick up something that is not in front of you rather than something that is in front of you. Maybe you have a view on that.

Mr Greenwell—The only comment I would make is that sort of point has been made elsewhere. The Western Australian franchising review has made some recommendations in relation to provisions that should be put into contracts in that area.

Ms GRIERSON—Excuse my ignorance, but if I wanted to enter into a franchise, would I be able to get a best practice guide from your department, or advisory panels—

Mr Greenwell—The ACCC has a host of products on its website to assist people.

Ms Weston—They have a manual.

Ms GRIERSON—So they have a franchise manual.

Ms Weston—That is right.

Ms GRIERSON—You would refer people to that?

Ms Weston—And we do.

Ms GRIERSON—There would be a link that would be known?

Ms Freeman—Yes.

Mr Greenwell—Yes.

Ms Weston—In the ACCC's website, yes, there is.

Ms GRIERSON—Yes, but I would not be thinking disputes already.

Ms Weston—No, but the ACCC looks after the franchise regulations.

Ms GRIERSON—But I do not think most people, ordinary people, would go to the ACCC website. They would go to an industry or small business website to get information.

Ms Weston—Our website, business.gov.au, does have links to the ACCC website.

Ms GRIERSON—If I want to enter a franchise and search, I would get an easy reference to the ACCC.

Mr Greenwell—We would hope so.

Ms Weston—We are pretty sure that is the case.

Ms GRIERSON—No-one has tried it.

Ms Weston—Yes.

Mr Greenwell—That is right.

Ms Weston—I am pretty sure that is the case. They certainly do reference franchising on the business.gov.au website.

Ms OWENS—In monitoring these statistics, do you do any comparison to the kinds of issues that come up in other business relationships? The reason I ask is that I would naturally expect there would be more disputes at the point when a relationship is breaking down or is being terminated because the stakes are much higher at that point, so I would think that would be normal. How does this compare, for example, to levels of dispute or legal action or whatever?

Mr Greenwell—In the non-franchising area?

Ms OWENS—Yes.

Mr Greenwell—I do not think we get an awful lot coming through to us about contractual disputes between businesses.

Ms OWENS—No, I know. It is just that if you are monitoring statistics, the statistics on their own do not actually mean a great deal unless you compare them.

Ms Weston—It is probably quite hard to compare because you would be looking at small claims courts versus Federal Court and some of those sort of things.

Ms OWENS—I know, and that is exactly why I am asking.

Ms Weston—But I would agree with you. I think that as you go through a contract, it is more likely that it is at the end rather than at the beginning.

Ms OWENS—When money is about to be lost the action will be greater.

Ms Weston—Yes.

Ms OWENS—Regardless of whether it is as a result of regulation or sheer stupidity, the dispute would still be there.

Ms Weston—Generally there is a positive approach to going into business. You see that in the surveys, too. People have quite high expectations.

Ms OWENS—The figures are here, but we do not really have anything to compare them to, yes?

Ms Weston—In terms of having all those various courts, no.

Mr Greenwell—There are ABS statistics on business exits and reasons for them.

Ms OWENS—Is this so?

Ms Weston—Yes, there are. We can provide that information to the committee.

Ms OWENS—That would be very helpful. But we also referred before—

Ms Weston—There may be some other information around the comparison of exits with franchises versus ordinary. That is available, so let me see if I can find that for the committee as well.

Ms OWENS—Thank you. You also mentioned before that you felt that when entering into a franchise, people needed to seek independent legal advice. Is it your perception that a large number of people do not do that but really do just rely on the franchise relationship?

Ms Weston—Legal and accounting advice. I was referring to accounting advice largely about things like appropriate structures and so on. I only have anecdotal evidence of that.

Mr Greenwell—That is what has come through in things like the Matthews review where there have been those sort of consultations and these have been the outcomes—that there has been a bit of an inadequacy in that area—and why there has been such an emphasis on disclosure as well as getting people educated about what they are getting into.

Ms OWENS—If that is the case, there is a need for quite a large education process because you normally would not enter into a contract of that size without independent advice.

Mr Greenwell—That is right.

Ms Weston—Comparing franchising to ordinary contracts, it is treated as a special case. But it is still one person with another person entering into the contract. It is interesting that you differentiate franchising from any contract in that respect.

CHAIR—I think franchising is very different, hence the code of conduct for it and not for an ordinary business. It is a substantially different business arrangement contractually and in terms of its relationship.

Ms OWENS—Even so, it is because of the nature of the relationship that people are entering into it without seeking independent advice. That is a really interesting difference.

Ms Weston—My point is that I would expect anyone who is entering into a contract to make sure they undertook that diligence around that. You are right in terms of franchising being special, but I was making the point that with any contract you would expect that sort of undertaking.

Senator BOYCE—We have evidence from franchisees about the cost of mediation being an issue and a concern for them. You have put it there as an average of $1,500 per party for mediation. I presume that is simply the cost of the mediation and does not include costs of preparing for the mediation?

Ms Weston—Under the mediation arrangement, there is a cap on the cost per hour.

Senator BOYCE—But you would assume probably that a party has spent some considerable time with their paid accountant and their paid lawyer to get ready to go to mediation.

Ms Weston—The $1,500 is—

Senator BOYCE—The $1,500 is just the mediation.

Ms Weston—Yes.

Senator BOYCE—I just wanted to clarify that. The other thing is that I am not aware we have any evidence before about banks now being prepared to offer loans against the value of the franchise itself.

Ms Weston—That is my understanding.

Senator BOYCE—Could you talk a little bit about what you know about that?

Ms Weston—That is my understanding. I would have to clarify where that understanding has come from. My recollection is that it is from a media report that I had read in the past. We could find some more information about that.

Senator BOYCE—That would be good, thank you.

CHAIR—The issue of good faith has been raised by almost every submission. We have certainly heard a lot of evidence about it. Can you give us, in terms of the department, your view with franchising in mind, obviously, about the principles or principle underpinning good faith?

Mr Greenwell—We are not really in a position to comment because we provide policy advice to our minister in that area. All I can say is that we know there have been pros and cons stated clearly for many years on whether there are advantages or not in having a specific definition of good faith because of its reliance on the courts and that sort of thing. Whether it can be explicitly defined is the issue. That is what the government's election commitment is to.

Ms Weston—Could I note too that one of the attachments to the Matthews review report had a few pages of discussion on good faith, which obviously came up in the review, so that will provide some useful information too.

CHAIR—Yes, I have that information, but I was more seeking your view rather than what I have already. I am not seeking a definition.

Mr Greenwell—Yes, that is right.

CHAIR—Let us be clear. I am not trying to lead you down the garden path. I do not want you to define it for me. Just as a principle, what does good faith mean? The Department of Innovation, Industry, Science and Research gives advice on small business. In terms of small business or any business or any relationship, good faith—what is the principle of it? I do not know what it means. Can you tell me what it means, roughly, as a principle, as a guide?

Ms Weston—Lots of people have different views on it.

Mr Greenwell—Yes, that is right.

CHAIR—Is it the opposite to bad faith?

Mr Greenwell—It has been said.

Ms Weston—If you have a look at the submissions relating to the Franchise Policy Council's in 2000, Matthews—

CHAIR—Should people act in good faith?

Ms Weston—You are asking me?

CHAIR—Yes.

Mr Greenwell—Yes.

CHAIR—No-one should act in bad faith. Should people act in good faith?

Mr Greenwell—They should.

CHAIR—It is contained in a lot of acts already. We have it in industrial relations acts, we have it in the Trade Practices Act and it is contained in most of the acts that your department would deal with. There is bargaining in good faith and there is entering into agreements in good faith. Good faith is not a foreign concept. I am not asking you for anything foreign or unusual that is not already written down in law in a whole range of places across Australian law.

Ms Weston—You have to ask yourself about what you are trying to get out of that and whether it is practical. They are some of the issues that have come up in all those reviews since the franchising code has come in. There have been pros and cons of franchising and the practicalities of operating in good faith, whether you put it in or define it or how you define it.

CHAIR—What are the pros and cons? If there are pros and cons, what are they?

Ms Weston—For instance, whether you can properly define something, and whether that will create more confusion and therefore more disputation versus—

CHAIR—Definition has been raised with me. That is fine, and I am happy to discuss it, but if you walk down the street and ask just anybody to define what is acting in good faith, I think you would get a pretty quick and clear answer. People ought to act in good faith. That is why is it is contained, for example, in good faith in bargaining and good faith in a whole range of things, just as a concept. I just do not see it as a foreign concept, that is all. I am a bit puzzled as to why there seems to be this reluctance to even talk about it.

Ms Weston—But if you have a look at some of the litigation there are different outcomes.

Ms GRIERSON—So for some it has become a legal matter.

Mr Greenwell—That is right, and that is what we have seen too.

Ms OWENS—Legal definitions are quite different to assumptions that we all make about what is good faith. Is there confusion, do you think, as it is used now more and more and becomes more defined? Is that part of the problem?

Ms GRIERSON—Or is it what a reasonable person would interpret as good faith?

Ms Weston—It is probably difficult for us to articulate that. We are not lawyers per se, and you are putting us in a position of trying to decide what it is, where it is located, and how it applies. They are all different things. That is probably what you are grappling with.

CHAIR—Can I just say I do not want a legal opinion. That is the last thing I want in this inquiry—lawyers giving us legal opinions—because there is plenty of all of that. What I am asking for and saying is: is there a particular area? Rather than defining it, do not define it. Are there particular areas where good faith arises as an issue in terms of, for example, franchisee disputes/franchisor disputes?

Ms Weston—It depends on what you are saying good faith is. Are you saying it is like this thing—being nice to someone, appearing on time, or things like that?

CHAIR—That is the answer to my question. In a sense what you are saying is that it is good faith how it relates to certain things, acting in good faith.

Ms Weston—If you say it is this—

Mr Greenwell—It depends on the circumstances of the cases that we have seen. As Sue said, we are not lawyers.

CHAIR—No, I do not want legal opinion. It is not going to help.

Ms Weston—What you are saying is as to what it is—

CHAIR—I am not saying it is anything. I am asking you what it is.

Ms Weston—That is what I am saying. I think it is very hard for you to say what it is.

CHAIR—That is right.

Ms OWENS—I think what you are saying is that the definition of good faith is not as simple as it might first appear to be.

CHAIR—Can I ask the question: does it need to be defined? In terms of franchising, does it need to be defined, or not? No? Yes? Maybe?

Ms Weston—That is a decision for government.

Mr Greenwell—That is right.

Ms OWENS—Does it cause confusion?

Mr Greenwell—It is a policy issue that we probably should not be commenting on.

Ms Weston—All I can say is that in the submissions that have come forward since the franchise code has been around, there have been pros and cons for both of them. The decisions of those reviews always have been to go down the side of not defining.

Ms OWENS—I will just ask it again: do you think the lack of clarity causes a problem?

Ms Weston—That is a very hard question—because versus what? Versus defining it, and having some indecision around that?

Mr Greenwell—Yes.

Ms OWENS—I am not asking you to tell me what the answer is here. I am pulling back and asking the question.

Mr Greenwell—You are saying the fact that there is not a definition is a problem. Is that what you are saying?

Ms OWENS—Yes. Does the way it currently operates cause confusion? Does it lead to possible misunderstandings? Without going into what the answer might be, because there might not be one, I am really just asking the question. And it might be the best and worst case.

Ms Weston—You can put that question, but I do not feel in a position to answer that.

Mr Greenwell—That is right.

CHAIR—Thank you very much. I appreciate your time and your submission.

[9.47 am]

DELANEY, Mr Michael, Executive Director, Motor Trades Association of Australia

GARDINI, Mr Robert, Solicitor, Motor Trades Association of Australia

SCANLAN, Ms Sue, Deputy Executive Director, Motor Trades Association of Australia

BOWDEN, Mr Ron, Chief Executive Officer, Service Station Association Ltd

CHAIR—I welcome the Motor Trades Association of Australia and Service Station Association representatives. I quickly remind everybody that witnesses giving evidence to the committee's inquiry into the Franchising Code of Conduct are protected by parliamentary privilege and that any act that may disadvantage a witness on account of their evidence is a breach of privilege and may be treated by the parliament as contempt. It is also contempt to give false or misleading evidence to a committee. I invite you to make opening remarks.

Mr Delaney—I have a few pages, but that may be a bit too long, so I stand ready to stop as soon as you tell me to.

CHAIR—I suggest that rather than reading a long recitation as a presentation, just make some comments in reference to that.

Mr Delaney—We are delighted that the committee has been given this reference and is undertaking this inquiry. I say that because we have been working on franchising issues from at least as long as we have been established—20 years. That is because pretty much everything that happens in the motor trades is done under franchise, such as petrol, cars, batteries and tyres and what have you. It is all largely franchised. Those bits that are not might as well be thought of as franchises because in effect the acquirers of our services, and I am here in effect referring to body repair, are a very small group of insurance companies who require you to do it in their way. Indeed, they are required to authorise you to do that. We have other parts beyond those, such as franchising in motor cycle retailing, industrial machinery, farm machinery, vehicle rental, and it is pretty much everywhere.

One of our major mandates and remits is to try to improve the lot of our franchisee members, and so we put a great deal of effort into that. Perhaps earlier I should have given you some perspective on the size of our trades that are represented by the association. We turn over $160 billion. We have 100,000 retail outlets, 95 per cent of which are five or fewer people. They are pretty much people who have established businesses and earn at roughly average weekly earnings, or AWE. We employ 308,000 people.

We have been involved in every aspect of public policy over franchising from pretty much all of the contemporary times, including all the reviews of the code. I think we could justifiably argue we were responsible for establishment of the original voluntary code; some would claim we were responsible for its demise and translation into a statutory code. We do not mind that being said because we thought it was necessary. We think that matters have greatly improved in

the franchising sector, particularly across my time as the foundation executive director, but that things keep lapsing back into bad and previous practice. We think that there is a lot that needs to be done. We think that the measures in the code in 1998 were significant and welcome improvements, particularly in relation to precontractual disclosure.

As I say, we think there has been behaviour change. However, there is little in the code to mandate standards of behaviour once an agreement is entered into. The previous voluntary code included some clauses dealing with standards of behaviour, but the mandatory does not, and we think that is a very substantial weakness in the current code. It is ultimately that issue that is at the heart of the call by many, including us, for the inclusion of the good faith clause in the code. I listened carefully to the previous exchange about good faith, Mr Chairman.

My colleagues Ron Bowden and Bob Gardini can comment in detail on these issues as well as in answer to any of your questions. We note also that we are increasingly getting problems with tenure. People are entering into franchises on the supposition or promise of tenure sufficient to ground and found borrowings for the cost of the franchise agreement, only to find that, once they are in it, the tenure can be quite wilfully truncated or concluded. We are finding increasingly the use of termination at will and very short, if any, notice—sometimes no more than three months, if that. The future of the whole franchise business model is attended by a very great deal of uncertainty.

I hear some critics say that to do anything about that uncertainty produces uncertainty. We would propose uncertainty is a zero sum game and that what is being talked about is just redistributing it. At the moment there is certainty on one side and complete uncertainty on the other side, which we do not think is terribly fair. However, we are not radicals or fools in the matter of franchising. We figure that the franchisors have to have a disproportionate amount of commercial power; otherwise the whole idea does not work. But it is a matter of how it is used and whether it is fair.

Another problem that is arising increasingly is typically the business model approach. Franchising involves a business territory, and that is particularly true in car retailing, but the franchisors are now wilfully changing the territories. More often than not in many cases they will intrude into the territory of their franchisee and compete directly as a franchisor against the franchisee, which we think is pretty poor form and not good faith. We think that there are not in the agreements measures that would preclude or avoid franchisors engaging in behaviour which produces an atmosphere of fear and intimidation, giving rise to a master-servant type of relationship rather than that of franchisees.

This behaviour has influenced many among our members and affected them. Many would have wanted to be able to come up here before the committee and tell the story of what happened to them. Unfortunately they are all too fearful. The three I had lined up to come along here today withdrew at the last minute on the grounds that it would not do their circumstances any good whatsoever. I did warn them all about parliamentary privilege and intimidation of a witness and the like, and it still was not sufficient, I have to say, Mr Chairman—which, in my long experience in dealing with the parliament, is the first time I have come across that being so extensive.

We think that there should be a good faith requirement included. We note that in 1998 the code initially was expressed as having a goal of addressing the power imbalance between franchisors and franchisees and raising the standards of conduct in the franchising sector without endangering the vitality and growth of franchising. We think that subsequent amendments might have had that in mind, but we do not know that they have ever actually got there. In coming towards the end of what I wish to say, I next note that Competitive Foods, as both the franchisor and franchisee, in its submission to you proposes a good faith clause. We are very heartened by that and certainly support what is there said, as indeed it is in our submission.

We think that there need to be stronger and more transparent dispute resolution provisions, further disclosure requirements for franchisors, provisions to provide for mandated minimum tenure, provisions to deal with terminations at will without due cause, provisions to deal with unilateral variation of franchise agreements, and amendment of the code to remove any exemption from it for agreements which comprise less than 20 per cent of a franchisee's total business turnover. We think there is a case for further strengthening the code so that the balance in the relationship is more equitably shared in order to create an environment which is mutually beneficial for both parties. I hope that was not too long.

CHAIR—That was perfect, Mr Delaney. Thank you very much, and thank you for your substantial and thorough submission. I take you directly to 4.1 in your submission, which deals with the interaction between the code and part IVA. There are a number of issues there, but I want to specifically raise with you the inclusion of the concept of good faith into the code in an explicit manner, rather than it being applied through the Trade Practices Act. Could I have your comment on that? Then we will discuss the difficulty about this issue of defining what good faith is.

Mr Delaney—I am the author of the submission but for all practical purposes the bush lawyer behind it, so can you ask Bob, who has advised me on this, unless you want to continue—

CHAIR—No, Mr Delaney. I am happy to hear from both or either of you.

Mr Delaney—And he will not do it in a lawyerly way.

Mr Gardini—No, and you can stop me if I do.

CHAIR—Thank you.

Mr Gardini—Having a good faith provision in the code really puts into the code, if you like, a standard of conduct. At the moment the code really focuses more on disclosure, and indeed has had some quiet success in cleaning up and enhancing the reputation, standing and growth of the industry since 1998. But the basic weakness is that the code really does not have standards of conduct. The standard of good faith is implied as a term into franchise agreements anyway by the courts. The difficulty is that you can actually write it out in a franchise agreement by having clauses which exclude it. You can do that just contractually. So the MTAA sees great benefit in having, within the code itself, a standard of conduct.

Chairman, you asked the simple question earlier: what does good faith mean? It is not really a great mystery. It just means acting honestly and taking into account the interests of the other

party. That is what the courts have said it means. If you want to have difficulties about certain concepts, such as unconscionability, that was an argument that was run 10 years ago, before the act was amended, by certain parties who said that, 'We don't understand what is meant by unconscionability.' The courts previously, for many decades, had made sense of unconscionability. The courts can make sense of unconscionability. The difficulty with unconscionability is that it is just too high a test.

In a definitional sense, good faith simply means acting honestly and taking into account the interests of another party. It is implied at common law. It can be excluded though, and having regard to how agreements are negotiated, often in a one-sided manner, there is often an inability of franchisees to prevent a franchisor from excluding that implied term of good faith. If the parliament were to make regulations under the act to amend the franchising code to include a provision of good faith, that would substantially enhance standards of behaviour during the course of a franchise agreement.

It is all very well understanding the business proposition when you come into a business. However, the contracts of franchising are described as incomplete contracts in that they turn on the operation of those terms in the agreement during the course of that agreement. That is the uncertainty; that is the opportunity for exploitative behaviour. In the MTAA's view, good faith is the mechanism to address that potential exploitation and indeed the exploitation that Mr Delaney has referred to.

CHAIR—Mr Delaney or Mr Gardini, can you explain to the committee what might be a problem that would arise in terms of retrospectivity if a very base inclusion of good faith was included in the code—a very minimalist approach to including 'the parties will act in good faith towards each other'. What would be the retrospective issues that might arise?

Mr Delaney—In all the conventional ways, we would never, I suppose, be supporters of anything retrospective. We are happy to live with prospectivity from a declared and announced date. We would rather think that if that is the course you recommended, and the parliament were to take, that would have very serious moral and educative benefits for any agreements on foot. We would think that is useful. I have a spreadsheet of all of the motor vehicle dealer agreements in the market, which I have not passed over to you. If I were to do that, I would need to do it in confidence. I mention it because what is happening as the years go by is that the term—

Senator BOYCE—What is it? What will it tell us, or what would it tell us?

Mr Delaney—It would tell you the agreements between every motor vehicle supplier the term as in tenure, the extension, the ability to vary the PMA, the first right of refusal, the right of termination at will, the right to repurchase stock and parts on termination, and the exercise of rights, performance of obligations and the like, breaking it down.

CHAIR—Mr Delaney, I am sorry, I appreciate that, but just to follow on with that thought though, I am not suggesting anything retrospective. I am asking the question just because I want to understand how it might apply. If there were to be a good faith provision in the code, would that have a retrospective impact in terms of existing contracts?

Mr Delaney—No.

CHAIR—I did not think so.

Mr Delaney—The reason for mentioning that thing was that the terms of tenure are getting shorter and shorter, so it would not be very long at all until a new round of negotiation, done under the code, with a good faith provision in it came to apply.

Mr Gardini—If you said that it was a simple description of good faith, the impact on existing agreements would be to say that the courts already imply a term of good faith into those agreements. So it would be just providing statutory backing to the implied term that already exists.

CHAIR—Sure.

Mr Gardini—However, it might apply to some agreements where that implied term had been excluded from the agreement.

Senator BOYCE—You mentioned the negating of good faith and fair dealing from contracts. I was going to ask you to talk a bit more on that anyway. How do you do that?

CHAIR—Are there contracts that explicitly say that they exclude good faith? Does that exist in your industry?

Mr Gardini—I do not think that I am aware of any particular agreements that explicitly exclude it, but there are some provisions of agreements. For example, if you have a clause that states, 'This agreement reflects all the terms and conditions between the parties,' and if then a franchisee attempts to argue that there is an implied term of good faith, it is possible to argue that that implied term has been excluded.

Senator BOYCE—Has that happened?

Mr Gardini—Yes. In the MTAA's submission, there is a reference to a case. One of the arguments in that case was that the franchisor took that very point—that the implied term was excluded.

Senator BOYCE—That was in a contract that someone freely entered into?

Mr Gardini—Yes. But obviously you get to the end of the contract and the various miscellaneous provisions, one of which says that you read it on its face. It just says in a general sense, 'This agreement reflects all the terms and conditions applying to the commercial arrangements between the parties and no other shall apply.' So you can have some—

CHAIR—Can you legally write into a contract the removal of good faith, even though it is in the Trade Practices Act? It is a core principle in basically all—

Mr Gardini—Chairman, it is just one element there. Although it is written into the Trade Practices Act, it is one element of a number in 51AC, so there is no statutory prohibition against doing so. So the parties have freedom of contract.

CHAIR—And we are clearly both talking about the same thing when we refer to good faith? We are not talking about fairness, either.

Mr Gardini—No.

CHAIR—Because they are different concepts.

Mr Gardini—We could have taken your absolutely pure concept of acting in good faith—quite so.

CHAIR—In terms of your industry experience, and there is a fair bit of industry experience here, if good faith in its most minimal form were contained in the code, would that result in franchisors or those who are giving the contract no longer being willing to invest or give a franchise at all? Would they say, 'No, look, that is too high a mark; we no longer want to play in this area'?

Mr Delaney—I think that utterly unlikely. I mean, the whole essence of franchising is the avoidance of spending the franchisor's capital and having responsibility for employees and the rest of it. It is a very successful model. It works, depending on the history. It might have been invented by Henry Ford; we are not sure. No, I think that is completely unlikely. The franchisors, and most franchisees I am happy to say, are treated pretty well and the returns are very good on account of the system.

I just think that my comments about the redistribution of uncertainty are relevant in what most franchisors want to do. I make a distinction here: there are excellent international franchisors who are brilliantly successful, and there are lots of franchisors who are not of that character. The ones that are brilliantly successful are allied pretty much always to fairness, equity and a good working balance. It is not of they whom we speak. However, there are others who spend their whole time, whatever the health and success of the system, wanting to strip out any area of uncertainty that they can find in the system and remit it across to the franchisee. Indeed, when it comes to economic or financial circumstances, they seek to do the same. One of the things that has happened as our economy has become more competitive is that our franchisors have moved to cap our returns and to move costs across to us. It is part of—

CHAIR—Is that concept an issue of good faith or an issue of fairness?

Mr Delaney—I think it is an issue of good faith.

CHAIR—In the terms of the original bargain.

Mr Delaney—Yes, exactly.

CHAIR—In terms of what the relationship is.

Mr Delaney—Exactly, just as the prime market area is an issue of good faith. The case on the North Shore in Sydney of the $14 million new dealership and service operation, and the taking away of the contract or the franchise agreement 16 months later, is one of the ones where the person was not game to come here. It happens. It happens so frequently to us.

Mr Gardini—In terms of your question, at least one motor vehicle distributor recently has agreed to insert a good faith provision because they have no fear of the consequences of it. That reflects—

Senator BOYCE—Can you tell us who that is?

Mr Gardini—I am restricted by confidentiality as a lawyer. They have a leading market share in the industry. They have very strong relationships with their dealer network. They work cooperatively. They are a bit of an exception, but we do not wish to overstate the situation in the industry. You take different companies with different cultural approaches. The submission focuses on the exploitative conduct of a significant number of them and often the relationships. There are notable exceptions where they say, 'Look, we think we can actually enhance our market share by having agreements which are fairer and which have a mutuality about them so that everyone employs more people, everyone gets on, and is very successful in everything they do.' They have nothing to fear and interestingly enough other aspects of their agreements reflect better practice.

CHAIR—Maybe just to finish on good faith, my next question on the issue of good faith was: Is good faith written into any specific contracts within your industry? How common is that? We have already received evidence from others that they include it in their contracts. They take a standard level above what is already required in the code.

Mr Delaney—Very rare in ours. That is the only example we can give you across all of our trades, and we have 60-odd trades that we compare.

CHAIR—Can I just go on to the no-right of renewal and the issue of renewal? There are perhaps just two things: one is industry practice, and what might be a best practice model.

Mr Delaney—The issue here is that, as the years have gone by and as described in some our case studies, the expectation on tenure and term have sort of altered. Things have become more rigid or more specific or explicit, and the right of renewal is one of them. Again we take that as the franchisor wanting to remove any element of any character of uncertainty. The problem that we have is that, for a modern car dealership, you are talking in terms of tens of millions of dollars.

Senator BOYCE—For what?

Mr Delaney—For the dealership to build stock.

Senator BOYCE—Is that the licence fee?

Mr Delaney—No. For the car dealerships there is usually not a fee for the franchise. There is instead a capital requirement to build the whole facility and to stock it. It is just extremely difficult if there is no right of renewal. We just think that is commercially very harsh.

CHAIR—Typically, how long are contracts?

Mr Delaney—Probably the longest is about five years, but it is a nominal five years because the right of termination at will is there and often without notice.

CHAIR—Often we hear that people need to go in with eyes wide open, with due diligence, and educate themselves. Obviously we are talking about sophisticated, educated people making multimillion-dollar investments. Why do they sign?

Mr Delaney—We have asked ourselves the question for all the years we have been working for them. The answer seems to be they are optimists; they think the best is going to happen to them, never the worst; they do go and get advice; that is pointed out to them, but they still take the oral presentation or representations made to them as being indicative of what is to happen in the future; and those oral representations are really very compelling. You might say that they are greedy; that they think they can get returns by taking this measure of risk incommensurate with what they could otherwise get; they believe in themselves; they are small business people; they have faith.

CHAIR—Would you say that there is a high degree of expectation that what is sold to them is an ongoing relationship?

Mr Delaney—Absolutely.

CHAIR—Not something that will end in six months.

Mr Delaney—Absolutely.

Mr Gardini—It is indeed. And, as Mr Delaney said, it is industry practice that although the agreements were of relatively short duration, they will be renewed. Industry practice over 20, 30 or 40 years has been that. You have entered into an agreement that is renewed throughout those 20, 30 or 40 years at three or five year intervals, whatever the interval is. What has happened in the last couple of years is that the agreements, when they come up for renewal, are being changed to fixed term agreements. Essentially that is saying that, despite the industry practice that has continued, these agreements now will be for a fixed period. The best agreements you now get in the motor vehicle dealer agreements is a five-year term with a right, in meeting certain criteria and performance, of having a further five-year term, usually though on the condition that it will be a different agreement.

When you make the original investment, that is really when you have the ability to do the due diligence and make a free choice. Once you have invested capital into that business over 20 or 30 years, the agreements get changed, but your ability to negotiate the change, either on an individual basis or through the dealer counsel's negotiating with the distributors, is just a total power imbalance. It is not freedom of contract. It does not reflect contractual negotiations that exist more generally in commerce because of the relationship that exists. It is a very different situation.

Mr Delaney—Ron might want to offer you something briefly on the petrol side of it.

CHAIR—Yes.

Mr Bowden—The petrol side for many, many years was governed, I suppose, by two acts, the franchise act and the sites act, when the industry was dominated by the oil companies.

CHAIR—Not the Oilcode as well?

Mr Bowden—The Oilcode is a fairly recent thing that has replaced those acts. Unfortunately, the code covers only a very small area of the oil company or the master-servant relationship in the oil industry. There are quite a few agreements in the marketplace now that are not covered by the code. In fact, they are not covered by anything other than just contract law.

Senator BOYCE—Why is that?

Mr Bowden—Because the Oilcode allows that to happen.

Senator BOYCE—They are just straight commercial contracts?

Mr Bowden—That is right.

Senator BOYCE—Is that what you are saying?

Mr Bowden—Yes. I have one in front of me here. Because it does not require a capital injection up front by the franchisee of $20,000—it is less than $20,000, in fact it was zero—the code does not apply.

CHAIR—Does that mean it is a franchise then?

Mr Bowden—Legally, I do not know whether it is a franchise or not. It may just be a commercial agreement.

Senator BOYCE—Are you suggesting it may have been deliberately designed to avoid being caught by franchise law?

Mr Delaney—Yes.

Mr Bowden—That is what we believe.

Senator BOYCE—Thank you.

Mr Bowden—For example, this particular agreement gives the franchisor the right to terminate with 48 hours notice.

Senator BOYCE—But they are not called a franchisor.

Mr Bowden—They are not called a franchise. It is called a commission agency agreement. The biggest problem with the 48-hours notice of termination is that it means that the commission agent has no rights. If the franchisor or the company does not follow any of the obligations that

this contract spells out and the commission agent objects, all they have to do is wave clause 23 and say, 'Forty-eight hours notice,' and they just buckle.

Ms OWENS—This relates to what you said in your submission—that the definition of franchise agreement might not be wide enough.

Mr Bowden—That is right.

Ms OWENS—How would you like to see it changed?

Mr Bowden—We would like to see it cover master-servant relationships where the master controls the site, the brand, and the conduct of the business, and the servant agrees to that, and in terms of agreeing to that, has expectations of profitability. Those sorts of relationships where the financial might between the two parties is so different, they are things that really should be covered by a franchise agreement because then you bring in those concepts of fairness and you bring in those concepts of good faith. That gives the franchisee some level of confidence that, by entering into a relationship that is a very inequitable relationship, they will have some form of protection.

CHAIR—Does the trade practice code of conduct apply to your sector now?

Mr Delaney—No.

Mr Bowden—It does not.

Mr Delaney—What has happened there is right from the outset petroleum was left out because there was the franchise and sites act. That was repealed on the promise of an oil code that would do all of these things, including what the franchising code does, except it does not. We pointed this out to the parliament and all the parties at the time. Petroleum now just sits out there, all on its own, not covered by either its own statutes, as was the case, or the franchising code. There is a review of the Oilcode underway by government presently. We have written to the minister and proposed that that review should be deferred or adjourned until your report comes down because you might have a view about whether the sector should be covered, as it once was.

CHAIR—Can I now ask you specifically about stronger and more transparent dispute resolution provisions. What is currently wrong? If it is the case that your industry and your sector do not have the code applied to them, that is the problem in the first place. You will not have a dispute resolution mechanism as it applies to other franchisees, even if that one needs improvement. Is that a sufficient answer?

Mr Bowden—Yes, it is. The dispute resolution procedures in the Oilcode are not as beneficial to my members as is the current franchise code.

CHAIR—But in the motor trades area the franchise code does apply.

Mr Delaney—Oh, yes—pretty much everywhere else beyond petrol.

CHAIR—In that case, what needs to be improved in terms of dispute resolution?

Mr Delaney—We think there is a lot of confusion between settlements and satisfaction. A lot of people go into mediation. You will see all those wonderful numbers from the relevant department, you will see all the statistics, and here it is baldly asserted that they have been settled. Well, they have not been settled. All that has happened is that they have been concluded, but not necessarily to anyone's particular satisfaction, and the reason is that nothing requires or obliges either side, to be fair in this comment, to agree to or do anything. We find that for the major part nothing comes out of it. In the case of some of the engagements over these things, the other side will just go into them for the sake of form, completely stonewall, the thing runs out of time, the mediator is not allowed to report to anyone what the behaviour was, and nothing can be relied upon in any proceedings thereafter.

The one on the North Shore of Sydney, which we are not allowed to talk about, ended up being millions and millions and millions. In the end, the dealer got some satisfaction by finding that, in an error, the supplier—the franchisor—had made the jurisdiction Victoria, which provided under its fair trading arrangements opportunities for him to pursue redress there, notwithstanding it was a New South Wales matter, and he succeeded. He got what was a fair sum in all the circumstances, but that is just absolutely rare. That one would have just gone into the mediation process and it would have been recorded as a settlement. The settlement number does not tell you what we think is really happening.

Mr Bowden—One of the issues that we have is that there is a dispute resolution procedure and there are processes. Proponents of that would say, 'But you have a high history or a high record of dispute resolution,' whereas all that just tells you is whether they were concluded or not. It does not say whether they were resolved satisfactorily.

CHAIR—Sure.

Mr Bowden—In the cases where we have represented members, the resolution was less than half of what was a fair claim, but that is not reflected in the reports.

Senator BOYCE—But that stands right outside franchise mediation at present.

Mr Bowden—Yes.

Senator BOYCE—I just want to follow up on something we talked about with the department, which was they do not really know from the figures they provided to us from the OMA what level of disputes that reflects. Could you talk about your knowledge of the use of alternative mediation?

Mr Delaney—In a sort of micro or global way across all our trades, over all the years, from the voluntary code right through to the mandatory or statutory code, there has been great unhappiness and very little satisfaction. We do not believe that beyond the behaviour change about which I have spoken anyone would have come out of it with satisfaction, or what might be called good faith. We are not informed of every one of them but we pretty much know all of them in very poor terms. I mention quickly that we are a federation, so the motor trades organisations or automobile chambers of commerce in each jurisdiction are members of ours and

we work closely with them. Our people would come mostly to us or to our member bodies for the mediation process and we would track through to establish the point to which it had got.

Senator BOYCE—Would you go to the OMA and would the OMA be used in the main or not?

Mr Delaney—The OMA would be used but we would not go with them—they would make their own way. The attitude is really pretty jaundiced; it does not get you anywhere. If anything, people end up being unhappier. They invest in something like the code, its mediation process and its existence under the Trade Practices Act in the belief that it is for real and that it will do something. I have only to remind all of you of your adjournment and other speeches in parliament on all the cases, of which there are many.

I write to every member and senator who raises these cases to inform them just how many terribly unhappy people are in the community, what it has cost them and what they have lost. At the risk of getting into anecdote, and I cannot name the franchisor, no more than one kilometre from here is a shopping centre that again has an empty shop that keeps being turned into a franchise cake shop. To my knowledge, in the time that the shopping centre has been open, which is about five years, seven people have gone through it. They all paid the money up front, they have all walked out and they have done the lot.

Mr Gardini—Senator, in response to your question about mediation, over the 10 years that I have mediated motor vehicle disputes, a number of major matters have had mediations perhaps more than once. Often the case has had mediation at the beginning, sometimes before the litigation starts, and perhaps during litigation. At no time in those 10 years have I ever experienced a settlement from mediation in a motor vehicle matter.

Senator BOYCE—Never?

Mr Gardini—Never. Basically it has been a case of, 'We do not believe there is any basis for you to take legal proceedings in court,' or 'You will succeed,' or 'Even if you do succeed there are jurisdictional reasons why the court will dismiss that matter.' Ultimately, in my 10-year experience I have never experienced a case of settlement. I practice in this area and each year I have five significant major motor vehicle disputes that either do not get to court or, if they do get to court, both alternatives involve mediation to try to resolve the matter. You end up being confronted by the other side which says, 'You have no remedy, so why do we need to offer you anything?'

Senator BOYCE—And it keeps going on and on?

Mr Gardini—Yes.

Mr Delaney—Senator, the code provides for a process but it does not provide for an outcome or a settlement.

Senator BOYCE—There is no penalty.

Mr Delaney—If you add some good faith to it, it just does not do what everyone claims.

Senator BOYCE—Following up on that, we have had evidence to the effect that the average cost of mediation is $1,500 for each party. Would what would be your view on that?

Mr Gardini—That would be reflective of an average figure across the franchising sector. If I am representing a party in the motor vehicle industry I provide to the other side the names of three mediators, two of whom would be former judges of various courts—the Supreme Court or the Federal Court—to try to maximise the opportunities for settlement. The cost of those mediators each day is outside the OMA regime. In that case the cost each day can be between $6,000 and $10,000 for the mediator. Earlier I heard questions being asked of the department about preparation. Often the lead-up work requires the mediator to go and speak to both parties separately before the day of mediation.

If you are really going to try to achieve an outcome you need to take these preliminary steps because the amount of money at stake in these disputes is considerable. You then need to take into account the preparation time of getting financial and legal advice because you may need accounting advice as to the valuation of the business. You certainly need legal advice to prepare for it. In this industry, as opposed to the rest of the franchising sector, the cost of mediation is extremely significant.

CHAIR—And all that was predicated on the basis and principle of acting in good faith in the mediation process?

Mr Gardini—Yes. Despite very skilled mediators who, as I said, often are former judges of the Supreme Court or the Federal Court, when you talk to the parties essentially you are left with the proposition, 'There are no legal remedies, so why do we need to offer you anything? We will offer you only one thing today. On the date of the termination of this agreement we will talk to you about what cars are returned, what parts are returned and the terms of that settlement.' Does it go to the point of achieving some level of satisfaction in an outcome? The answer is clearly no.

Ms GRIERSON—I congratulate you on your submission and thank you for all the recommendations that you have made. They are great. I am sure that the member for Hasluck thinks it is a good submission and I note that you agree with her comments. But it is the termination at will that interests me. It is obvious that both the franchisor and franchisee can bear the loss due to termination at will without due cause.

The situation that interests me is this: a new franchise is set up, the business grows well, there is a defined location for that business and then two new franchises are set up in that same location. Often these are not located in shopping centres, et cetera; you often find them located in the financial service areas. A franchisee builds up a huge turnover and business and a franchisor then decides that the area can maintain two or three franchises but, of course, that person's turnover reduces. What would be a way forward that would be fair to everyone?

Mr Delaney—One thing we do not want is for things to get locked up in time because markets change. We are alive to the fact that if one franchise brand suddenly takes off like that and a single franchisee cannot meet the market in that way, the franchisor should be able to adjust the territories to respond to and meet the market. At that point we think that is where good faith, consultation and negotiations with franchisees come into play.

Ms GRIERSON—If you do not bankrupt the first franchisee.

Mr Delaney—Exactly. On the motor vehicle side of it, that used to happen over the years but it does not happen any longer. We are saying that that is an area of good faith. We think it is possible, economically and financially, to come to a new structure that does not disadvantage anyone in any particular way and that reflects the best interests of both sides. It is just that that is not the mindset or the mode at the moment, and that is what really causes these problems. I do not want to rely too much on the car dealing side, but I will just give you a 'for instance'. We have one of the most open, contested motor vehicle markets in the world and about 64 different makes come into this market.

Over time, the quality and price of the products change. Different franchises become more valuable, less valuable, or what have you. Most of the motor vehicle dealers will own their real estate, their property, and all the rest of it. I will answer in part the chairman's earlier question, 'Why do they keep doing it?' I say that they are optimists, but they keep doing it because the brand of the day, the brand du jour, which at present is Volkswagen and Mazda, have come from nowhere over the past four or five years. The dealer will sign on at the point in the cycle where that franchisor has been very generous in making a terrific offer and suddenly, through the success of the franchisees and the franchisors, it will take off that way and they will then start to go in the other direction in the cycle and try to claw back.

Coming back to your point, in circumstances where, say, one make of car, for example, Mazda, is probably the best selling car if you leave out commercials, you do not have enough franchisees to meet the market. That is when we think the agreement should provide for revision of private market areas but on a no detriment basis. We do not think that is very hard to work out.

Ms GRIERSON—Do you think that the flexibility is there?

Mr Delaney—No, not at the moment. We know of franchisors, in particular in food, that operate in that way and who do not get complaints. Often they will split the territory and offer the second one to the same person, but within another corporate structure. We think that is desirable. Some multifaceted franchisees—and I do not want to name any of them either negatively or positively—who are very good at it will go into new classes of offering. They will do it by franchise and offer it to a franchisee in another style of things.

One of the beauties of franchising is that it should be very flexible. That is part of its success. As I said, we do not want to lock up anything in time. We think it is a bit odd if you get someone to build a $15 million state-of-the-art outlet and three months later you tell them that you are terminating their franchise and that the franchisor will take over the territory. That is cruel.

Ms GRIERSON—What is your position on automatic renewal of a franchise?

Mr Delaney—We think that, subject to the initial offering, if there is not something to the contrary for good reasons—

Ms GRIERSON—So you anticipate that it should renew if everything is going fine?

Mr Delaney—Exactly.

Ms Scanlan—If you do not reach agreement you maintain your targets in all circumstances.

CHAIR—Do you have a preference for a good cause termination?

Mr Delaney—We think so.

Ms GRIERSON—To cover the people who have done exceedingly well, so that they anticipate that they will let go?

Mr Delaney—We think so. There is another aspect to franchising that we ought to mention quickly. When times get tough, like at present, the franchisor will load you up involuntarily with stock to move the capital cost of the holding from it to you. If you are a car dealer you suddenly go from—

Ms GRIERSON—Are you predicting that that is what will happen?

Mr Delaney—It will. It is already happening.

Ms GRIERSON—It is already happening.

Mr Delaney—You suddenly go from 30 days to 90 days with car stock and the hire costs are astonishing. That happens right across the system. The other thing they do in those circumstances is to come around and say, 'Under the operations manual or the operations policy we are varying the targets.' They double your target at a time when their sales are going down. If you have not met that target they come around at the end of the agreement and they say, 'Sorry, you did not meet your target.' The targets are arbitrarily picked out of the air and usually, in their untowardness, are reflective of the state of the economy.

Ms GRIERSON—Do you think that in this climate you will be busy advocating for people?

Mr Delaney—Yes.

Ms GRIERSON—Is there something that governments should do in the meantime to ensure that financial losses are not exacerbated, or that the shift of those financial losses are not onerous. Is it too hard?

Mr Delaney—No is the answer. We are not fans of red tape or greater regulation. We confined our recommendations here to what we think is commercially sensible. The world has changed, it will never be the same again, and the impacts are starting to come through. Just on car dealing, there is the availability of what is called floor plan financing—that is to say, we do not own the stock; it is all financed. It is becoming extremely difficult to obtain and extraordinarily expensive if you can get it. There will be impacts for trades but then everyone will be impacted. I do not know whether there is much that governments can do.

Ms GRIERSON—Thank you for your honesty.

Mr Gardini—Under present circumstances there are turnovers that might be referred to the ACCC relating to stock issues. However, I do not think it would be unconscionable conduct under section 51AC. The only aspect is to rely on the implied term of good faith, but at the moment there is not such a provision in the code.

Ms GRIERSON—Expressly.

Mr Gardini—Nothing is expressed in the act. I think taking it up with the ACCC will not bear any fruit. That is no fault of theirs; it is just because of the regulatory arrangements that are in place. The only basis would be to argue that at common law. Nothing is written into the agreements and there is no basis in the code. You may succeed but you may be risking tens of thousands of dollars.

Senator BOYCE—How do you fix that? Best practice guidelines or something like that? You would never get it in a contract.

Mr Gardini—We had a provision of good faith, and Competitive Foods was one of the elements. In its proposal to the committee it grasped the concept of acting honestly and having regard to the interests of the other party. The former voluntary code had some business standards, which were lost in the mandatory code. One of them said, 'You have regard to the risk of each of the parties in the establishment and conduct of the franchise business.' If you say, 'The risk in now forcing stock onto dealers is not a legitimate business consideration having regard to the marketplace' you then have a basis on good faith with certain elements as a guide for the courts to say, 'You are now exposed to some excessive risk and it is not protecting your legitimate commercial interests.'

Ms GRIERSON—There could be extreme circumstances in the next period. Should franchisors be open to renegotiating obligations?

Mr Gardini—For one distributor I am in the midst of—

Ms GRIERSON—How do you encourage that?

Mr Gardini—Invariably the motor vehicle distributors provide an opportunity for dealer councils to negotiate over two or three months to two years. I have been involved in such negotiations. But to try to get change on the issue of the PMAs, for example, I drafted a clause that allowed for the recognition that markets change and you are in competition with other franchises. If you want to be the best let us have some clauses about the PMAs and that make provision for a change in circumstances. That would give a right of first refusal to the adjoining PMA that had the biggest market share. However, in the most recent negotiations last week in Melbourne for a whole day those sorts of provisions were totally rebuffed. They said, 'That is too prescriptive.' But another franchise system has adopted that regime.

Ms OWENS—Listening to you and to the other presenters over the past few days it seems as though there is a great parallel with unfair dismissal law.

Mr Delaney—There is and we are astonished by it. At one point franchising is terrific because we know that it takes away uncertainty for the franchisees, particularly for the successful ones.

At the other point where it is not as is described by the Franchise Council and others, an avoidance of the employment relationship creeps into it. In effect, they want both capital and the avoidance of hiring you. They want you to do these things and to carry risks and, in many respects, it is open to abuse, bad treatment and bad behaviour of a sort that in any employment relationship would not be contemplated or tolerated. But it happens. There are people who behave criminally in everything. I am not suggesting that they are not talking of anything of that sort; it is just that it is a way of avoiding statutory burdens and the cost of capital that is employed by a lot of people, but for poor reasons.

Ms OWENS—I want also to talk a bit about risk because it seems to me that in the rolled gold sorts of franchise models there is quite a clear business model on the part of the franchisee that is profitable. The risks taken by the franchisor and by the franchisee are quite specific. In the case of issues like inventory—in a business like motor vehicles, that is one of the big strategic elements of the business model—it almost seems to fall outside the franchise model in that you enter into a relationship with one business model and suddenly that model is changed through the change of the territory or the nature of the risk.

Mr Delaney—That is correct. On the car dealing side the operations manual and the policy manual can be changed at will by the franchisor with the effect that it changes the franchise agreement and the contract. They get up to it all the time. You are absolutely right. When the franchising code started as a mandated code, in all the negotiations leading up to it Minister Reith was told by the car manufacturers and suppliers that they were not franchisors. They went to every extent to avoid getting caught up.

In the end Mr Reith simply wrote in that car dealing was franchised and, of course, it is. What has happened in the time since the passage of the mandated code? It moves away from franchising to a great extent, in that the distribution of risk and return has been greatly altered. But it is still not a master-servant relationship; it is still not a co-investment relationship; and it is still not an employment relationship. If it is none of those things what is it? It is still a franchise agreement. If you look at food, which I have used as a comparator, you see that the franchisor has to protect the integrity of his name, the materials used, cleanliness and the health of the premises, and occupational health and safety aspects. He takes that risk away from the franchisee and, in return, gets quite a good return for himself.

The franchisee is protected from a lot of those things and, therefore, presumably has to get a lesser return on capital. By contract, in the case of car dealing, if all the risk in our other trades is being redistributed back to the franchisee but the costs of being the franchisee do not go down—indeed, they go up—that is where it starts to be really bad. That is what has happened in the past decade.

Ms OWENS—You said earlier that it was a highly contested market. Just to confirm my belief, it is protected parallel importing, is it not, so the franchisor has a protected market?

Mr Delaney—In all of ours intellectual property precludes parallel importation, absolutely, yes.

Ms OWENS—By the way, there is no judgement in that question. It is interesting that the franchisor has a protected market.

Mr Delaney—Yes.

CHAIR—Given the time, I want to wrap up quickly. I have two quick questions for you. You mentioned further disclosure. Are you referring specifically to anything in particular? You mentioned eight points in your submission, for example, provisions for parties to act in good faith, stronger and more transparent dispute, and further disclosure requirements for franchisors.

Ms Scanlan—It is an ongoing disclosure list.

Mr Gardini—I think that is the point.

Ms Scanlan—One of those issues was a disclosure of previous disputes that occurred.

CHAIR—That is now in place with the changes introduced in March this year.

Ms Scanlan—That is, franchisees that have left the system?

CHAIR—Yes.

Ms Scanlan—No, we are talking about harm.

CHAIR—Actual disputes.

Ms Scanlan—Actual disputes, on the basis that that might act as an incentive for people to resolve disputes.

CHAIR—Right. That would be the detail of the disputes, or just that a dispute took place?

Ms Scanlan—No, I do not think you could do that. I think you could say, 'We have had X number of disputes about this clause in the agreement,' or something like that, without naming the parties concerned.

CHAIR—Is it your view that all contracts meet the code?

Mr Delaney—No.

CHAIR—It is not a trick question; it is just a straight question.

Mr Bowden—No. When it is in doubt they say, 'No, there is no remedy.'

CHAIR—You do not believe that they meet the code, perhaps even in its application?

Mr Delaney—No. I cannot work out why the ACCC does not spend a bit of time to have a look.

Senator BOYCE—What volume are you talking about? Are you saying that there are a few—10 per cent or 20 per cent?

Ms Scanlan—In our view most agreements would be relatively consistent with the code, but there will be some where they are drafted perhaps not to comply with the full definitions of a franchise agreement.

CHAIR—But no-one would know because there is no registration, filing or any other mechanism available.

Ms Scanlan—I think that is one of the reasons why for some years we have asked for a register of disclosure statements and an ongoing audit process for disclosure statements.

Ms GRIERSON—Do you think they would be more relevant, or would that be happening more with the very large franchisors, the smaller ones, or both? If it reveals a pattern of behaviour who is doing it most?

Ms Scanlan—I think the areas where we have struggled a little have been perhaps in some of our smaller sectors, not in some of our bigger sectors. Perhaps we have had more experience with some of the bigger franchise agreements.

Mr Gardini—It is a bit patchy. Since the code came in a clear trend has been emerging to insert provisions that legally work against the code. In negotiations I take the view that the code should be interpreted broadly. Let us say that certain clauses are in breach of the code. The distributor says, 'It is not really a waiver to provide release from suing us; it is just an acknowledgement that certain things are this way.' In a number of areas within the code attempts have been made to work around the technical legal provisions in the code. In other words, if the code does not achieve the desired outcomes it has defeated the purpose.

CHAIR—Thank you very much. We appreciate your time and your submission.

Proceedings suspended from 10.48 am to 11.02 am

MALONEY, Mr Philip, General Counsel, McDonald's Australia Ltd

MULLEN, Ms Kristene, Vice-President, and Director, Corporate Communications, McDonald's Australia Ltd

CHAIR—Welcome. Would you like to make a brief opening statement?

Mr Maloney—By way of an opening statement, I will give committee members an understanding of what McDonald's is and does, even though some people already may have an idea from travelling around the countryside. Currently in Australia 760 restaurants are operating. We have been in business in Australia since 1971, and obviously we are the subsidiary of an American parent. To that end, currently we have 280 licensees operating approximately 75 per cent of the 760 restaurants. The average turnover of each of the restaurants in the system in Australia at the moment is $3.5 million. We employ something in the order of 72,000 people.

From a supply chain perspective, we are the third largest acquirer of produce after the supermarket chains. We acquire approximately $800 million in produce each year. Let me give you an understanding of the McDonald's model because one of the points to make throughout the course of the today's submission is that there are franchises and there are franchises. There are many different types of franchises, but the model that McDonald's employs is a twofold model. We licence the business system itself to our franchisees and we lease the property to our licensees. Basically, that is the fundamental underpinning of the McDonald's system and it has been since the 1960s from the United States.

As a consequence, the company in Australia and through our parent is responsible for the capital investment of making and building the restaurants and providing ongoing support through the life of the franchise. The franchise term, or the licence term, as we describe it, is a 20-year term. Throughout that time we provide financial support, marketing support, employment support, occupational health and safety support, legal support, real estate support, communications support, supply chain support, operation support, and any other support that is asked for by the licensees.

I will give you some understanding of the process we go through in the selection of licensees. If someone were to come in today with a superannuation payout and wanted to open a restaurant on Monday, we would not let them. They would have to undergo a long process of selection and training to ensure that they want to become a licensee, so it is not a question of us taking the money today and pushing them out tomorrow. The registered applicant process normally would take something in the vicinity of eight months, with no guarantee that the person will be offered a franchise at the end of that time, but in most circumstances that follows. As a consequence, once a person has been through a fairly robust training process, even if they have come from a totally different walk of life from the restaurant business, they have a full and complete understanding of exactly what it takes to be in the McDonald's restaurant business.

CHAIR—Thank you, Mr Maloney. There is no doubt that the McDonald's system puts a lot of effort into pre-education and it sets a very high bar for people that it allows in. I appreciate your comments, your information and your submission. I draw you directly to some key issues

that might be of help to us. You made a number of comments in your submission, in particular, that the provision of inaccurate information provided in a disclosure document would be a breach of the code or of the Trade Practices Act; that strong sanctions apply in the event of a breach; and that the ACCC is a vigilant and effective regulator.

Mr Maloney—Yes.

CHAIR—My question is in two parts. How does that apply to the McDonald's system and then more broadly across the franchising sector? I am assuming that McDonald's complies with all its requirements and therefore it really would not be an issue.

Mr Maloney—No.

CHAIR—The only way that you can determine a breach in the broader sector is for someone to investigate it and, further, for someone to take it to court to determine whether it is a breach?

Mr Maloney—Correct. From our perspective, we take a robust approach to exactly what we put in our disclosure document. I do not want to sound too flippant about this, but I was hoping to bring one of ours today and the excess baggage requirements prevented me from taking it on the plane. Given the recent changes, our disclosure documentation represents a small telephone book, if you understand what that means. Certainly from our perspective we have not any issues with the amount of information we have disclosed, notwithstanding the fact that a large amount is disclosed to potential franchisees.

In respect to the amount of disclosure that is given to other participants in the franchise industry, I cannot comment with any degree of certainty on whether what is being provided to other participants within the sector is accurate or inaccurate. From our perspective, the only thing we can do is ensure that, as long as there is an obligation on us, we provide the required information.

CHAIR—Sure. In your view, that information relates specifically to McDonald's system; it is not necessarily reflective of the industry?

Mr Maloney—No.

CHAIR—You also state in your submission that parties should be free to negotiate commercial terms in their business relationships, full stop.

Mr Maloney—Yes.

CHAIR—I assume that that relates to all laws, regulations, principles and other matters.

Mr Maloney—Of course.

CHAIR—You state that it would be totally inappropriate and may distort existing commercial arrangements if you were to provide franchisees with specific rights of renewal?

Mr Maloney—Yes.

CHAIR—Could you explain that a little more and indicate how that relates to good cause non-renewal?

Mr Maloney—Yes, sure. I am happy to do so. Let us take it from the beginning of the relationship to the end of the relationship. If there is a specific right of renewal, a positive renewal, or a presumption in favour of somebody to renew an agreement at the end of its term—and in our case, for example, we have a 20-year term—the issue for us is that, part and parcel of our being able to deliver a business system model by which we provide our restaurants around the country, the standards we ask for and expect of our franchisees need to be upheld.

CHAIR—You do not specifically expect after 20 years—even though that seems to me to be a longish period for an agreement—that just because it is over that is the end of the relationship and everyone walks away. There is no specific reason why you would not renew someone for a further 20 years, given that the relationship is fine.

Mr Maloney—Subject to their not meeting criteria.

CHAIR—Sure, absolutely. That was not a trick question.

Mr Maloney—That is understood. The issue and the correlation to that to me is that, in instituting some form of compulsory right of renewal in favour of a franchisee, if that is what it is, we run a risk that their capacity to maintain the required standard may be diminished somewhat because they feel that they already have another term in the bag, so to speak.

CHAIR—But, clearly from your perspective, you are saying that nothing specifically prohibits you or there is no particular reason—other than, say, a dispute or a good cause—from renewing the contract for another 20 years after the contract has ended?

Mr Maloney—I think it is fair to say that in any board review we undertake with licensees, which takes place in about year 17, we would be going there with an open mind to look at re-entering another relationship with them.

CHAIR—Sure. Given that you do that at the 17-year mark, why do you leave three years open?

Mr Maloney—In case there are some issues that we need to resolve.

CHAIR—So that would give you some options, but it would also give your franchisees the option to divest themselves of the business?

Mr Maloney—Absolutely.

CHAIR—To move on or sell to someone else?

Mr Maloney—Yes.

CHAIR—And to realise their capital and, dare I say it, their goodwill, and whatever else they have built up in the business.

Mr Maloney—Maybe not the word 'goodwill' but yes.

CHAIR—Whatever they have built up relating to the value of the business. Everything has a value if they put it on the market.

Mr Maloney—Of the business that they have, yes.

CHAIR—Whether you call it goodwill or something else, the value that they have built up, which may be more and different from when they initially invested?

Mr Maloney—That is correct.

CHAIR—In paragraph 5 of your submission, you refer to specific rights of renewal, which we have covered, or other statutory entitlements at the end of a franchising agreement. Does the McDonald's system have specific statutory rights at the end of an agreement?

Mr Maloney—Only in the operation of the code as it currently works at the moment. There is nothing else that we consider at this stage.

CHAIR—In other words, no-one has any rights at the end, apart from what is contained in the contract?

Mr Maloney—That is right.

CHAIR—It is just whatever is there at the end. Potentially, it is a drop dead clause?

Mr Maloney—Potentially, yes.

CHAIR—Is it the experience of the McDonald's system that, if that is to be the case, you would negotiate an exit strategy, or do you include some sort of exit strategy for people in their contracts so that they are fully aware, because it is written in, that at the end of the term, these are the things that might happen, and these are your options?

Mr Maloney—Currently we do not do that, no.

CHAIR—Is it your experience that anybody in the sector does it?

Mr Maloney—I am not aware of that.

Ms OWENS—Can I ask that in another way?

CHAIR—Sure.

Ms OWENS—You seem to have a process that starts at year 17, which will either lead to the continuation of the contract or the termination of the contract?

Mr Maloney—Correct.

Ms OWENS—Can you talk us through that? If you discovered in year 17—obviously you would have known before that—that things were not going right, what is the termination process, or the review process, or the second-chance process, or whatever you want to call it, that you go through before you decide to terminate?

Mr Maloney—In my experience, I have not come across anyone being terminated. I think we had better put that on the table to start with.

Ms OWENS—Yes.

Mr Maloney—The issue that licensees have in relation to the way in which the review works is that there is a potential for them to be advised that there will be no rewrite, but they have an opportunity to cure. We give them an understanding of what requirements they have not met. If it is what I would describe as being key, critical, operational and/or financial requirements, that is where that would come into play. In the second instance, we might also grant them a rewrite at that stage. They know that they will get a rewrite, but there are conditions on that rewrite, and there are some things that they may have to do—again probably more of a minor nature at that stage—that they need to rectify to make sure that complies.

CHAIR—Can I explore that point further? It is quite interesting. You have in place long or substantial 20-year agreements. You do not renegotiate until the seventeenth year, which again is a substantial period.

Mr Maloney—Correct.

CHAIR—You are very confident in your system that the people you have chosen are of excellent standard. Given that you have not had cause to terminate anyone at that point, you have a very good system. What distinguishes the McDonald's system, or your approach and how you deal in the relationship, that makes it so good? What is your approach? What is your philosophy as to how this works?

Mr Maloney—It is the fact that some people say we are a food business and some people say we are a property business. In some respects we are a people business. It is the people relationships that we develop in the business over time that are really the key. We have licensees who are interested and who are engaged in the main in wanting to run McDonald's restaurants and to be successful as much as the company wants them to be successful. We have no interest in investing capital in building the restaurants in the first place if we do not have a licensee that will be successful. That is not to say that some people are not as successful as others. Some people have different perceptions of their own abilities as opposed to others. But from our perspective, that is where it comes from.

Ms OWENS—It seems as though there is also a substantial front load in the cost of recruiting a new one?

Mr Maloney—Yes.

Ms OWENS—And not only the process of interviews and testing beforehand. Is there a substantial front load when the new franchisee moves in?

Mr Maloney—In terms of what we charge the licensee?

Ms OWENS—No, in terms of the cost to McDonald's.

Mr Maloney—The cost is not insubstantial. But again, the issue is that it is part the process we go through in selecting those people before they get to go through what we call the recent applicant process for the eight months. That is part and parcel of understanding that the person has the capacity to be a long-term licensee with the company.

Ms OWENS—If, during that 20 years, there is a perceived need to adjust the business model, as you have recently with your coffee and all the rest of it—

Mr Maloney—Among other things, yes.

Ms OWENS—Or if there were a sudden potential downturn in the economy or whatever, is there a negotiation process in that at all? How does that happen?

Mr Maloney—It would be fair to say that there is a negotiation process. Again, it is a question of looking at what is mutually beneficial for our licensees. It is not a question of going back to the licence agreement, for example, and finding a clause that states, 'This can be done and that cannot be done'; it is a question of saying, 'Okay, we think there's an opportunity here. We think this is the scope of the opportunity. We think we can do this within this amount of time. This is what it will cost,' and we consult.

CHAIR—Would you say that in all your dealings the principle with which you approach all this is one of acting in good faith, without leading you too much where I am going?

Mr Maloney—We were in a court case a long time ago that talked about good faith. In any negotiation, I would have thought that that should be the underpinning requirement.

CHAIR—Do you include good faith in your contracts?

Mr Maloney—We do not, no.

CHAIR—Are you aware that other systems do?

Mr Maloney—I am hearing that that is what happens, yes.

CHAIR—Would you have any objection to including good faith—just, 'The parties will act in good faith towards each other' in your own contracts?

Mr Maloney—If it is the way that Mr Justice Byrne spelled it out in the Far Horizons case to which we were a party, I do not think I would have a problem. It is a question of whether it is more than that. That is the issue.

Senator BOYCE—Do you have an internal dispute resolution process?

Mr Maloney—Not a formal dispute resolution process. It is really the responsibility of each regional manager to deal with internal disputes with a licensee as they come up. That can be escalated to the chief executive, if that is what is required.

Senator BOYCE—How many franchises, roughly, would a regional manager manage?

Mr Maloney—It depends on the region, but in New South Wales, for example, there are a couple of hundred.

Senator BOYCE—Regional managers?

Ms Mullen—Licensees.

Mr Maloney—No, we have three regional managers for the country to manage the 280 franchises.

Senator BOYCE—Do you have any internal way of benchmarking your performance in relation to internal disputes? I am trying to get a sense of how you handle those and what you do?

Mr Maloney—Disputes arise at different levels about different things.

Senator BOYCE—Absolutely.

Mr Maloney—The issue for us is working out exactly what is major and what is minor. For us the proof of the pudding is that our process works. We might have been to the OMA once since the code was put into place. Referring to benchmarks, or if you want to talk about a score card, no, we do not keep a score card.

Senator BOYCE—Presumably it would be useful for you to know whether there were trends in disputes, if you are having similar disputes in four different regions across Australia.

Mr Maloney—Sure. Absolutely, yes. But the point is—

Senator BOYCE—How do you collect that sort of information?

Mr Maloney—The point is that I am not sure we have ever really seen what you would describe as an endemic dispute anywhere. Normally they are one-offs and normally they relate to finance. Normally they are issues on which we will then go and assist the licensee.

Senator BOYCE—Sorry, finance in what sense?

Mr Maloney—If a licensee needs to organise more finance with his bank, we will go and have a discussion with the bank about that, if that is the case. Those are the sorts of things.

Senator BOYCE—That probably raises another question in an area of which I was not aware until this morning—the idea that banks are lending to franchisees against the value of the business as opposed to against the value of something like their home.

Mr Maloney—Yes.

Senator BOYCE—Does that occur with your franchisees?

Mr Maloney—Yes.

Senator BOYCE—Do you have any sense of whether it applies to half of them, a small number, or a large number?

Mr Maloney—Are you talking about lending money against the business itself?

Senator BOYCE—Against the business itself.

Mr Maloney—A fair proportion would have that funding in place, yes.

Senator BOYCE—What do you think are the critical components for that to happen?

Mr Maloney—In terms of what?

Senator BOYCE—Probably what I am asking you to tell me is whether it is the long terms of your contracts, et cetera, that enable banks to feel comfortable with doing that?

Mr Maloney—Definitely.

Senator BOYCE—Is there anything else?

Mr Maloney—No, it is really the strength of the system. That is probably the one thing more than anything else that gives banks the confidence, given our track record and given the financial performance of the system over the past 30 years in Australia.

Senator BOYCE—There is just one other area. You distinguish two types of franchise.

Mr Maloney—Yes.

Senator BOYCE—You talk about product distribution franchises and you suggest that car dealerships, for instance, are one of those.

Mr Maloney—Yes.

Senator BOYCE—You say that these franchisees simply sell the franchisors' products.

Mr Maloney—Yes.

Senator BOYCE—This morning we heard evidence to the effect that a car dealer spent $14 million to develop the facilities simply to sell the product.

Mr Maloney—That is right.

Senator BOYCE—To me that seems like something that is a lot more than simply selling the product.

Mr Maloney—From a definitional perspective, and having heard the submission, I am not too sure exactly what is involved in the car dealerships. But at the end of the day, it is still a product distribution franchise. There is an investment—I did not mention the investment involved—but, clearly, Coca-Cola bottlers, for example, in each of the countries around the world do not just sell the product. There is an investment involved for them to be able to sell the product. Coca-Cola Amatil, for example, is a good case in point.

Senator BOYCE—I am trying to understand what the difference is between someone who sells a car, and you can pick any brand, and someone who sells a McDonald's hamburger.

Mr Maloney—If you were to do our training for eight months, you would understand exactly what we do—

Senator BOYCE—I promise not to.

Mr Maloney—That is right, Senator, but the point is that you would walk away with the business in a box. It is not a question of just signing up, and three months' worth of cars arriving on your doorstep. The whole cradle to grave of running the business is something that we teach franchisees. So it is not a question of having—

Senator BOYCE—So it is a more sophisticated system. Is that what you are seeing as the distinguishing point?

Mr Maloney—Absolutely. That is what a business format franchise is all about.

CHAIR—Would you say that you are top of the tree in terms of your system? I am seeking an opinion. But are you pretty much the best out there in terms of—

Mr Maloney—I would like to think so.

CHAIR—That is fine. That in itself is reflected through the length of your contracts, the fact that you do not terminate, you work with your franchisees and, in principle, everyone acts in good faith and so forth. Given that, do you meet everything in the code now?

Mr Maloney—Yes.

CHAIR—You do. Would you say you set a high bar and a high standard?

Mr Maloney—We hope we do. We can only be judged by others, not necessarily by ours. For example, again, I do not want to sound flippant, but we are relatively high profile and, as a consequence, it is in our interests to be the best we can be.

CHAIR—I would like to explore the statutory entitlements a little bit further. It probably does not relate as much to your system because it has not been a issue. But you obviously have some strategy statutory rights in terms of the end. Hypothetically, if there were to be a termination at 20 years and everyone walks away, what are your rights?

Mr Maloney—In essence, the essential right is that we take back what we have given in full.

CHAIR—What have you given—hypothetically, because it has not happened to you? I am talking about the sector.

Mr Maloney—First of all, it would be the restaurant, because we have leased that to the licensee. That is probably the most important part to take back. And then all the intellectual property that goes with running it.

CHAIR—Branding and that sort of thing?

Mr Maloney—Absolutely. If there was stock on hand or some equipment that had been purchased by the licensee, we would pay them for that.

CHAIR—Would you negotiate? If you decided not to continue at the end of that 20 years, would you sit down and negotiate and say, 'We are not going to renew you at the end of 20 years. We will negotiate that through.'

Mr Maloney—That would be the preferable course of action.

CHAIR—You also mention that there is no demonstrable need for further disclosure of the respective rights of the parties in terms of renewal or extension of a franchise agreement. Everything we have heard is that contracts are silent on this. Whatever length it is, it is simply a matter of, 'Here is the term', and then it expires. It is completely silent.

Mr Maloney—That is right.

CHAIR—So no-one really knows what happens at the end. Maybe it is nudge nudge, wink wink, or 'You'll be right mate.' But it is not written down. How does anyone actually know what is going to happen?

Mr Maloney—I think, again, it is an education process for licensees through the life of their franchise.

CHAIR—It is more built upon an expectation.

Mr Maloney—That is right.

CHAIR—Your system would be that as long as there is no good cause not to renew you would anyway, because you continue the relationship. It is just a matter of whether it is 10 years, 15 years, 20 years or 25 years. It is a continuation of the system.

Mr Maloney—We are not in the business of trying to churn.

CHAIR—You would not be with 20-year agreements.

Mr Maloney—No. The issue for us is that it is there.

CHAIR—Certainly there is no demonstrable need in your system, but it is an issue in the wider sector. There would not be a need for some further disclosure to deal with in this problem.

Mr Maloney—Again, I think the term of our licences gives people that level of comfort over a period of time.

CHAIR—So it is more specific. I understand what you are saying, but it is more specifically related to your system.

Mr Maloney—Yes.

CHAIR—That is fine. I have no argument with that.

Ms OWENS—I refer back to the definition of a franchise. I think that is really interesting. I have often wondered whether some things that are called franchises actually are.

Mr Maloney—It is like my view of the franchising industry.

Ms OWENS—It is actually a business plan and you fit into the business model. Would you like to see it defined? Is there a point to defining it more narrowly?

Mr Maloney—For our purposes we define it internally anyway. People understand what our system is and certainly it is as set out in our licence agreements. Again, from what I am hearing in terms of submissions and the submissions that I have read, there may be some need to work out exactly what sectors are good at franchising and what sectors are not.

Ms OWENS—They are actually licence agreements.

Mr Maloney—Yes, to work out exactly what we need to be doing. If it helps to regulate or to ameliorate the pain that some people suffer as a consequence, I do not see a problem with that.

Ms OWENS—In terms of the law, assume for a minute, as I do, that if people are acting in good faith, doing the right thing and doing what they do well, they really should not be bumping against the law, because law should be here and McDonald's is probably there. Are there bits of the law now that you actually bump against and think, 'That affects the way we do things in a way that is unnecessary'?

Mr Maloney—There is nothing that gives me friction bumping against the law. In terms of the field that I manage within McDonald's in Australia, it is very definitely a question of the fact that you are not going straight to the mattresses every time you think you have a problem. It is a question of working within the framework you have.

CHAIR—In section eight of your submission you say it would be totally inappropriate to require parties to a franchise agreement to negotiate in good faith. You have already said that everyone should act in good faith. But you are talking about negotiating, which is distinctly different from acting. You have written that in. How do you define that for me so that I can make some distinction between what I see as negotiating something in good faith or perhaps acting in good faith?

Mr Maloney—I suppose the issue is that to me it was more a question of the duplication of the phrase. We have good faith with all these different layers within the regulation that works at the moment. The underpinning for me is that everyone needs to act in good faith. The point is that if there is some obligation in the code that says you need to negotiate in good faith—

CHAIR—It is more about the negotiation. Maybe this comes down to how we each define it.

Mr Maloney—Yes.

CHAIR—To act in good faith also means to negotiate in good faith. But it does not mean that you have to negotiate fairly. Perhaps fairness is a different concept in terms of when you say, 'Look, we do not want to be restricted in our ability to get something which is advantageous to us.' That does not mean you are acting in bad faith; it just means you are a good negotiator.

Mr Maloney—True.

CHAIR—Is that more related to the concept that you have proposed here?

Mr Maloney—To be blunt, I think the other part a franchise agreement is that it is not a balanced document at times, because of the nature of the fact that there needs to be a franchisor who is managing and growing the system and a franchisee who is able to take advantage of the system. So the point is that in some situations you may want to have the provision to be able to say, 'Okay, we are making a change in what the system is and you need to do this now because the decision is in everyone's interests.'

CHAIR—But that in itself is not a case of acting in bad faith. A decision based on trying to do the right thing by the system does not mean you are trying to do the wrong thing by the franchisees.

Mr Maloney—No.

CHAIR—I would not expect that that was the case.

Mr Maloney—No.

CHAIR—I am trying to understand your sentence there about specifically saying 'negotiate' and what you understand you are saying.

Mr Maloney—My comments about good faith underpin a broader definition of good faith, not the minimalist definition, if we want to call it that, or the simple definition.

CHAIR—The Trade Practices Act contains reference to good faith. It is certainly implied, but it is not in the code. If we to insert the exact same intent implied in the Trade Practices Act into the code, how would that materially change anything that currently goes on, for example, in the McDonald's system?

Mr Maloney—I do not think it would change anything if it was in its simple form.

CHAIR—In its simplest form and exactly what is in the act—implied versus the explicit?

Mr Maloney—Yes. Because, again, we have had experience in dealing with this in a case more than 10 or 11 years ago, before the code was in place.

CHAIR—In fact we have heard from witnesses that some—I will not name them—include it in their contracts. So they already set the high standard anyway. For them it was just not an issue; they actually wanted the parties to act in good faith.

Mr Maloney—Sure. You may find some people who put it in the document and then just totally ignore it.

CHAIR—That is always possible. This is more about trying to make it as difficult as possible for those who would want to deliberately do that rather than those who are already doing the right thing. There are plenty of examples of those. In that same section 8 you also talked about there already being a substantial amount of protections for franchisees entering into franchise agreements.

Mr Maloney—Yes.

CHAIR—Can you explain that a bit more in terms of what that protection is in practical terms?

Mr Maloney—I think the way the code of conduct works at the moment, franchisees, if they feel they are not being dealt with in an efficient fashion, can put disputes into mediation, can go and see the Australian Competition and Consumer Commission and the ACCC can come and knock on our door and we can have a discussion. That is pretty much that if you put it in simple terms. To be frank, it has happened on a couple of occasions that our licensees have had an issue and we have needed to resolve it—and we have been able to resolve it. From my perspective, and the underpinning of the code itself when it was put in place and mandated, it was to protect franchisees. That is still its role today.

CHAIR—For that protection to take place, it takes a number of forms, that is, there needs to be something to be protected and it has to have a mechanism of protection.

Mr Maloney—Yes.

CHAIR—Therefore, if it is not in the code, those who would abuse the system—and this is only about those who would abuse the system—will use that and do whatever they like. That is why the code is there in the first place and it is mandatory. The previous voluntary system just did not work. That is why the code is there.

Mr Maloney—Is that a voluntary question?

CHAIR—I am just trying to establish the standard.

Mr Maloney—I think we are very aware of the balance of the relationship and the way in which things work.

CHAIR—Section 9 of your submission relates to the precedence of application of unconscionable conduct provisions in the franchise context. I am interested in what you mean in terms of the franchise context. That may be different from other forms of understanding of unconscionable.

Mr Maloney—No, just in relation to the fact that there were cases relating to franchising issues and unconscionable conduct was part and parcel of the grounds for the cases and so on.

Ms OWENS—Clearly we have had a lot of submissions about the fact that franchisees can have their situation terminated on very short notice and clearly there is a lot of pressure coming from various sectors to change that. As you said, McDonald's has quite a lengthy and fair termination process in place, yet you still have that capacity to terminate at will. Can you explain why you might want that?

Mr Maloney—We might want it if things get to such a point with a franchisee that we need to take action to preserve our reputation in the marketplace and the standing of the way in which the business operates. That is probably the primary reason I would see us taking as immediate action as we can under the code as it currently exists. In general terms, we find that the business suffers when a licensee potentially becomes somewhat absent from their business. It is a challenge for us to get them back and involved in their business again to get things up and running. Again, it is not something we have needed to utilise. Having said that, we have had to in New Zealand in recent times. We had a licensee who was in a lot of trouble on both a financial and physical level and we needed to take those steps to relieve him of the obligation that was just overpowering him. That is what it boiled down to in that situation.

Senator BOYCE—I have a couple of questions about who owns the properties that your franchisees work out of. What is the model you use?

Mr Maloney—We will either buy the real estate freehold—

Senator BOYCE—So McDonald's, the franchisor, owns the property, or—

Mr Maloney—Or we will be the head lessor on the lease if it was a shopping centre, for example.

CHAIR—That is specific to your system?

Mr Maloney—Correct. In fact, Ray Kroc, who founded the licensing of McDonald's, worked out that by franchising alone he was not making any money. The McDonald's brothers came up with a system of taking all his money. It was only when he had a smart finance guy who said they needed another stream of income that the real estate model became part of the McDonald's model.

Senator BOYCE—We have had evidence that obviously points out that you change the power balance even further when the franchisor controls the lease or the property. How do you deal with that?

Mr Maloney—What do you mean by 'change the power balance'?

Senator BOYCE—We have had evidence pointing out that the franchisor is in a far more powerful position in negotiations than the franchisee, full stop, but particularly so when the franchisor is also the lessor to the franchisee.

Mr Maloney—I think it is fair to say that we take on obligations and pass them through by way of sublease when we lease the premises. Again, that is usually when we are going to licence that particular premises or franchise it. It is something we would discuss with the licensee. The issue is that from both our mutual perspectives it is a balanced outcome for the parties. It is certainly not something we use as a lever, if you will, in negotiations, if that is the point you are trying to make.

Senator BOYCE—That is what has been suggested has been done by others. I am not making suggestions about McDonald's.

Mr Maloney—I think I am safe to say that we have not done that.

Senator BOYCE—Is it the same company that owns the properties and the system?

Mr Maloney—Yes.

CHAIR—I refer to section 13 of your submission, where you say it is inappropriate to somehow 'enshrine' good practice and that that is not the role of legislation. I would like your view on that. That happens already. Good faith is not only enshrined in legislation, but it is also contained in dozens of acts, which make specific reference to it. It may be in different circumstances such as bargaining in good faith, mediating in good faith and so on. If it is good enough to be in all of those areas, including good enough to be in the Trade Practices Act, which gives power to the code, why is it not good enough to be in the code itself?

Mr Maloney—I think the point I am making there in respect of good practice is a little bit different from good faith. Codifying behaviours was more the point I was making there. If a franchisor does not behave and the role of government is then somehow to provide the system, dare I say it, stating what the franchisor needs to apply in his dealings with the franchisee, that is where we have the mismatch in that situation.

CHAIR—The term or concept of 'good practice' or codifying behaviour is what the code is all about. It is actually about codifying behaviour and saying that the parties will act in a particular manner, they will behave in this manner.

Mr Maloney—I would agree that there is good practice in the code. I think the issue then is how far you take that.

CHAIR—I appreciate that.

Ms OWENS—For franchisors, termination is the last resort when all else has failed.

Mr Maloney—Absolutely.

Ms OWENS—Assuming the franchisee is doing the right thing and the franchisor is doing the wrong thing, given that the franchisor can terminate at will, what is the last resort remedy for the franchisee, or what should it be?

Mr Maloney—In dealing with the company?

Ms OWENS—Under the law, your final protection for your brand and your other franchisees is that you can terminate if you need to.

Mr Maloney—Again, I would probably characterise it as being the fact that one of the things I think franchisors tend to forget from time to time is that licence agreements place obligations on franchisors as well as franchisees; they are not a one-sided discussion. The issue then is that at the first port of call there are clearly obligations under the franchise agreements that franchisees can look to see whether they are being adhered to by the company. Secondly, if there is anything else that is happening that is in breach of the statutes, such as the Trade Practices Act—and unconscionable conduct certainly comes to mind—that is another opportunity for a franchisee in that situation to basically have a discussion with the regulator to bring us to account, if that is what is required.

Ms OWENS—You think the current law is sufficient then as a final remedy?

Mr Maloney—Yes.

CHAIR—I thank you both very much.

Ms Mullen—Thank you.

[11.49 am]

DE LEEUW, Ms Deanne, Private capacity

CHAIR—Welcome, Ms de Leeuw. I remind you that you are protected under parliamentary privilege. I also remind you of your obligations in relation to the making of false or misleading comments.

Ms de Leeuw—Thank you for the opportunity to address you today. I do not have any legal qualifications; rather, I am here today to highlight some of the failings of the current franchising regulations by using examples of my experiences as a former franchisee of Bakers Delight. The complete story of my experience with Bakers Delight cannot be discussed in full in the timeframe allowed. However, I would like to focus on what I think is important to the current franchising discussion.

With that in mind, I will give you a brief outline of my background and I would then like to focus the discussion on four key areas. They are good faith, goodwill, the difficulties I encountered as a franchisee in dispute with my franchisor, and how I believe that we can help to fix the current regulatory system so that others do not have to go through what I went through.

My background is military. On completion of my HSC I joined the Royal Australian Navy by general entry in 1989. For the next seven years I served on different bases throughout Australia. In 1997 I accepted a commission as an officer in the Navy and went to the Australian Defence Force Academy here in Canberra where, over the next three years, I completed a double degree majoring in information systems and history. I then served for a further two years, including sea service on board HMAS *Sydney*. It was in the Navy that I met my husband Mark, who is still a serving member. Mark is a helicopter warfare instructor on the Seahawk helicopter. He is currently the flight commander on board HMAS *Parramatta*, serving a six-month deployment in the Gulf. In 2001 I started to look for opportunities outside the Navy.

I wanted to go into my own business and build a strong future for my family. As I had no business experience I looked at franchising as a way to pay for a proven system and someone else's expertise. A general point I make here is that I, like most prospective franchisees, looked at franchising in general. It has been said that prospective franchisees identify themselves as looking to buy a franchise believing in the promise of franchising, which has been so successfully promoted by franchisors and their lobby groups. That was certainly the case with me. It is the franchising sales pitch to which I responded—statements like 'Be in business for yourself, not by yourself' and 'We have a proven system. Follow it and you will be successful,' and 'No experience required. We will teach you everything you need to know to be successful.'

It is the franchising concept and its promise to which we are attracted and not necessarily any particular brand. This type of pitch is usually directed at people like me who have no previous experience in business and who do not know the risks that exist in any business, regardless of whether it is a franchise or an independent. I looked at franchising as an investment opportunity where I could be my own boss and pay for the support that I needed to build a successful business. I was prepared to invest my money, my time, and my best efforts to do that. In that I

am no different from the thousands of others who buy franchises. I believed I was buying an investment that I could build into a future capital asset, but instead I found that I was just buying a job.

Mark and I looked at a number of systems before deciding on Bakers Delight. A big factor in our decision was their promised training and support, but all their promises turned out to be false. I was a franchisee of Bakers Delight between December 2001 and February 2005. Our first Bakers Delight franchise was in Vincentia on the New South Wales south coast. In August 2003 we purchased the Kiama and Shellharbour franchises. We settled on the Shellharbour franchise in January 2004. By the end of February 2005 all three of our franchise agreements had been terminated. My husband and I were the guarantors. Our trading and capital losses as a result of franchising with this company exceeded $2.5 million and are climbing due to the accruing interest on outstanding debt. We are paying bakery debt every week and we will continue to do so well into the future.

Our personal financial losses are around $1 million. It is not possible to put a price on the toll that that has had on our health and on our relationships. My husband and I lost our home. Being evicted from your home is something that no-one should have to go through. We had four other properties—three investment units and a home that belonged to my husband's grandmother. We also lost those. I have lived with the threat of bankruptcy for the past three and a half years. Our credit rating has been destroyed. All our money goes on bakery debt. It is very hard to start again when you are in that position. I want to talk to you about how the current gaps in the franchising code and the Trade Practices Act have allowed this to happen to us.

I want to help you understand the problems that we as franchisees faced when our franchise relationships were abused by our franchisor. I want my experiences to be used to develop a solution that will result in franchisees having access to real protections, and I want to prevent what Bakers Delight did to us from happening to other people. My experiences with Bakers Delight also include fraudulent accounting, misrepresentation and poor training. Some parts of our experiences with Bakers Delight will be referred to the Federal Police in coming weeks. Whilst answering your questions on good faith and goodwill I will use examples of the bullying, harassment, threats and intimidation to which I was subjected. I will talk about fabricated breach notices, termination of franchise agreements, ignoring the code, and refusing mediation.

I will talk about the failings of the mediation process and my experiences with it. I will talk about how Bakers Delight manipulated their sale process and I will talk about the theft of property, breaches of confidentiality and deals done with the bank. I experienced all these things as a franchisee of Bakers Delight. Bakers Delight acted unconscionably towards my husband, me and my businesses. They used threats and intimidation tactics to create emotional and financial distress. They misrepresented the level of training and support I would receive as a franchisee as well as ignoring the code and their own responsibilities within their franchise agreement. Their behaviour was calculated and designed to result in their own monetary gain. Opportunistic franchise relationships are not accidental; they are calculated and they are systemic.

On a personal note, our future appears to lie in the courtroom where Bakers Delight and Deacons law firm are using the court system to try to deny us justice. It is to be a war of attrition as Deacons have told our lawyers that they will appeal any technical point they can—and they

are. They are determined to grind us down until we run out of money or the fight to go on. We have been in litigation against Bakers Delight since November 2005, and we will continue. The personal cost is enormous and the financial cost is staggering—over $250,000 in legal bills and rising. We are no closer to getting our case heard than when we started three years ago. This is what I hope can be rectified through this committee. Franchising is rife with personal vindictiveness.

Unfortunately, I went through much that I did not have to, suffering financial, emotional and personal abuse under the current system. There was nothing I could do to prevent it. I believe that I was well suited to be a franchisee as I am hard-working, positive and I believe in following systems. I was prepared to invest in the franchisor's proven system and I worked hard to get results and to build a future for my family. I am no different from the majority of other people who buy into a franchise. Bakers Delight told my husband and I that they had done this to us because they did not like us. I will answer questions and give my examples through questioning.

CHAIR—Thank you, Ms de Leeuw. You raised four specific areas—good faith, goodwill, disputation and possible recommendation for changes to the regulations. I would like to deal with each of those and add a number of other matters that you have raised. I will start with the expectations, what was sold to you, what was marketed to you and why you specifically chose the Bakers Delight system. Was it in writing or was it oral? How was it communicated to you what the experience would be, and what were your expectations based on that?

Ms de Leeuw—Our expectations came from a few personal meetings that we had with Bakers Delight in their Sydney office, a lot of written sales paraphernalia that we received, and glossy brochures. As Bakers Delight is a large system we could see that there were a lot of other franchises in Australia. At the time we believed that the system must work because of the numbers on the ground, the sites in Australia. There were just under 500 sites when we looked at going in. Support was an important factor for me—because my husband, being in the Navy, is away a lot—along with the training and the Bakers Delight pitch that you do not need any experience to be a Bakers Delight franchisee; they teach you everything. It was competency based.

I was made to sign off on my training agreement under risk of not being able to open my store, losing my deposit and my store going to someone else because we did not get through my training agreement—which meant, of course, that I did not receive all my training.

CHAIR—Did you sign that document even though you had not completed it?

Ms de Leeuw—Yes, I did.

CHAIR—Let us try to put this into context. Obviously you have a lot of information, you made a substantial submission, and we have limited time. Let us try to put some of these issues into a workable context. From everything that was given to you—orally, in meetings, in writing, and through glossy brochures or whatever other method—what were your expectations as to what the relationship would be and the sort of business you would be operating and growing compared to what your experience was? Put that into context.

Ms de Leeuw—Bakers Delight promote themselves as being a family, 'We work together, we are a partnership and we will give you support. We want you to be successful. We are building our brand. We have big plans and we want you to be a part of it. Buy a franchise with us and you will be successful.' The actual experience was far from the promise. As I said, we were franchisees for just over three years and all three of our franchise agreements were terminated at the same time.

Ms OWENS—What was the timeframe between you buying the first franchise and the second and third franchises?

Ms de Leeuw—The first one was in December 2001 and the second and third were a package deal in August 2003, so 18 months. We settled on the third one six months after.

Ms OWENS—When you went into the second and third franchises were things still okay?

Ms de Leeuw—Yes.

Ms OWENS—At what point did they go bad, and what was the indicator that things were not right?

Ms de Leeuw—When we took over the Kiama store, the second store, I uncovered a non-payment of wages issue by the previous franchisee. I really pushed Bakers Delight to assist in rectifying that because obviously it was a brand issue. It was also in the area and it needed to be sorted out. At the time I was told by my business consultant that it was not in my best interests to follow the line because it was a national issue of non-payment of wages in Bakers Delight, which has come out in different states over the years. I was also questioning the reconciliations of the set-up of the Vincentia store because I believe that they owed us money and they were refusing to reconcile it.

They sent me four different reconciliations over that time and all four reconciliations stated that I owed them money, but they refused to provide us with invoices or proof so that we could sit down and say, 'Okay, fair enough; we owe you money,' or 'You owe us money.' They would just deny and delay. I believe that pushing those two issues was the turning point in our relationship. I refer to the representations that were made to us in regard to the Shellharbour store. It was an unprofitable store and we knew that when we went into it. We went in with our eyes open and we knew what the turnover was. They made representations regarding advertising, support and promotion, and the usual statement that the previous franchisee was a bad operator.

CHAIR—Did they do that in writing, or just orally?

Ms de Leeuw—Orally. I had some marketing plans. We sat down and said, 'We can do this and we can do that', but the main thing that came through was that the previous franchisee was a poor operator and he was never in his store. We were told, 'Once you get in there you will be able to turn it around immediately.' Since looking into this whole issue with Bakers Delight, we found those things are said about everyone that they terminate or try to push out of the system.

Ms OWENS—Why did you not finish the training agreement in the first instance?

Ms de Leeuw—Basically, I ran out of time. I was doing my franchise training in neighbouring downtown Nowra. The franchisee of that store, the cousin of the franchisor, is a man called Ross Wellington. I did my training in that man's store and paid over $10,000 for it. When we were approved to open our franchise in Vincentia, Ross Wellington decided that he wanted the site for himself. A few weeks before I was due to open he cancelled my training, so I thought that I would not finish my training and he would be able to walk in and pick up the site.

After I purchased the Kiama and Shellharbour franchises Ross Wellington set out to intimidate, harass and threaten my staff and me. Obviously he was related to the franchisor and he was also a friend of the previous owner of the Kiama store who had to pay back his staff. As I have said, this man stalked and harassed and physically threatened my staff and me. He verbally abused my staff and he made derogatory and vindictive comments about me to other franchisees in our area. He followed me in his van, he verbally abused my wholesale customers, and in November 2004 he rang up my bakery and told one of my apprentices to pass the message on that he would break my legs if he saw me in town.

After I received that type of physical intimidation I went to Bakers Delight to get their assistance. I am assuming that, because he was related to the franchisor, they refused to help me. After this final personal threat we went to the police station and took out an apprehended violence order against this man. Two weeks later I received breach notices on all three stores with seven days to rectify. It is those breach notices that saw the termination of our stores.

CHAIR—Were the directives and the relationship with Bakers Delight's headquarters, or was it more a localised local manager problem? Could you describe that?

Ms de Leeuw—Bakers Delight has a head office in Sydney. Victoria is obviously where their main office is located, but they have offices in Sydney, Queensland, South Australia and Western Australia. A lot of my problems stemmed from the Sydney office because that is the company with whom I had direct contact. When we were breached in June 2004 we requested a meeting with Roger Gillespie, the franchisor, to discuss the issues and it was refused, even though it is part of their franchise agreement that they will meet with us.

CHAIR—Were you seeking or did you seek mediation?

Ms de Leeuw—No. At that time we just sought a meeting to discuss what was going on. We thought, 'Maybe we can just talk about it, be reasonable and sort through the issues.' But we were refused.

Ms OWENS—When the breach notices were handed to you with seven days to rectify you said in your submission that at that point Bakers Delight withdrew all contact and support?

Ms de Leeuw—Yes.

Ms OWENS—You were issued with breach notices, you had seven days within which to rectify, and you had no support from your franchisor?

Ms de Leeuw—The withdrawal of support happened when we were breached the first time in June 2004. They told me that there would be no more support and there would be no contact until I had either rectified the breaches or I was terminated.

CHAIR—Can you explain the breaches? Were they financial breaches?

Ms de Leeuw—They were financial breaches. The first round of breaches we received was fabricated: based on a non-payment of royalty. It was based around a repayment plan that we had in place with Bakers Delight. We had not missed the payment but they used that to breach us.

Ms OWENS—Was that circumstance cleared up on the first breach?

Ms de Leeuw—Yes, we paid the breaches. As part of those breaches we had to pay money that we did not believe we owed them, and about which we were in dispute. We had to pay the money to avoid being terminated and losing our substantial investment.

Ms OWENS—Up until that point was it just you and Bakers Delight, or did you have lawyers, accountants, or any of your own support?

Ms de Leeuw—When we were breached we went and sought legal advice. Once we had rectified the breaches I believed that our relationship should continue as normal because we had rectified the breaches. We wanted to move on. The main issue—what put us into the financial position we were in and resulted in the final breaches—was that the Shellharbour store was failing and we could not get out of it. We requested to sell it or eventually even to close it, but they would not let us out of the agreement. Rather, they just sat back and basically watched us fall over.

We had to pay the bills that were coming in for the Shellharbour store with the takings from the other two stores. Effectively, the Shellharbour store dragged down the other two. We believe that, if they had acted in good faith, we could have rectified the problem and either closed the store, because it was not working, on-sold it, or something else. Rather, they just sat there and waited for it to fall over so that they could get hold of our other two profitable stores.

Ms OWENS—Is there another franchisee in the Shellharbour store?

Ms de Leeuw—They closed the Shellharbour store. On two separate occasions after we were out of the system, Bakers Delight representatives said that they knew the store would fail, but they still let us buy it. They still signed a franchise agreement with us.

CHAIR—Does Bakers Delight now run the other two stores?

Ms de Leeuw—No, they on-sold those stores. That is another part of our argument against the fact that they do not operate in good faith. They manipulated those sales processes basically by offering better deals to the current franchisees. One of them, Debbie Wilson, was my manager in the Kiama store. Both of the women who ended up buying my stores were negotiating with me to purchase the stores, but Bakers Delight went in behind my back and offered them a lease-to-buy deal. They could lease it for four months, pay nothing and they then signed an agreement

and bought it for a much reduced price, which prevented us from getting a fair price on our two stores.

CHAIR—At any point did you seek mediation through the Office of the Mediation Adviser?

Ms de Leeuw—We did. When we got our breach notices with seven days notice we went and hired some lawyers and they issued a notice of dispute in accordance with the code. Richard Taylor, the CFO of Bakers Delight, sent an email back to my lawyer. The email, which came back on 6 December, stated:

Please be advised that your client has not remedied the breach notices and we will move to termination without further notice.

They totally ignored our notices of disputes. The week after that email came through we were called to a meeting with Bakers Delight. We believed that we would sit down at the table and sort out what was going on. Rather, they told us straight out that there would be no mediation. They gave us two choices: we could put the stores on the market for sale—they would control the sale and we could continue to operate them until March 2005—or we could be immediately terminated on the spot.

CHAIR—What option did you take?

Ms de Leeuw—We decided to keep trading over the Christmas period, as it was a high turnover period, especially in the Vincentia store. It was our busiest time of the year so we thought we could use that to try to pay down some of the debt before we were out. Vincentia and Kiama were profitable stores in beautiful areas. We thought that potentially we might be able to get a sale. There was quite a bit of interest, in particular, in the Kiama store.

CHAIR—Did you try to sell the stores on the open market and also to two of your staff?

Ms de Leeuw—We were not allowed to advertise. They did not want any communication with us whatsoever. They made us appoint a broker and my accountant stepped into that role because they told me that they did not want to speak to me personally after that meeting in December. Basically, they were going to advertise it; they would put the sales packs together; and they would approve potential purchasers. Once they approved those purchasers we could enter into negotiation.

CHAIR—Did they sell the stores?

Ms de Leeuw—They sold the stores after we had been terminated.

CHAIR—What does that mean? Does that mean that you received no benefit from the sale of those stores because you no longer owned them?

Ms de Leeuw—That is right. We were also kept right out of the process. In particular, the Vincentia store had been valued at $750,000. We do not know the exact amount for which they sold the stores because they still will not give us that information. We cannot put a figure on it to say, ‘That is how much we lost’, because we do not know for what amount those stores were

sold. However, we believe that the first store was sold for $450,000—$300,000 off the bank value; the bank valuation, mind you, that they used to lend us the money to buy the other two stores.

CHAIR—Had those stores sold before the termination? Just to get it clear, that process had begun during termination?

Ms de Leeuw—Yes.

CHAIR—At the point at which you were negotiating with them they said, 'We will sell the stores and we will control the sale'?

Ms de Leeuw—Yes.

CHAIR—What was the arrangement? Obviously it was your property and you were selling your business. You should then have reaped the benefit of that sale to pay down your debts and so forth.

Ms de Leeuw—That is what we understood it to be.

CHAIR—But you are saying that once you were terminated they told you that you no longer had any claim over the property, or you would have to dispute that claim in a court, and they realised all the gain out of that sale?

Ms de Leeuw—The way that they do it is in accordance with their franchise agreement. If you are terminated they have the option to purchase your fixtures, fittings, plant and equipment at their own written-down values. For the Vincentia store they sent us a letter and said, 'Okay, it is worth $116,000. That is what we will pay you.' Because they had the lease on the premises we would have been trespassing, even though effectively we believed it was our business. They could lock us out by paying $100,000 for the equipment. Effectively, they had bought—

CHAIR—The whole business.

Ms de Leeuw—The whole business.

CHAIR—Is that what took place?

Ms de Leeuw—That is what took place. There is a step in the middle, in between the period when you are terminated and they sell the store. If you go into liquidation, you become bankrupt, or whatever, they do not have to pay you anything else. Therefore, as you said, they can keep the bulk of the business.

CHAIR—Did they make any payments to you as a result of the sale?

Ms de Leeuw—They did.

CHAIR—You said, for example, $116,000 for one store.

Ms de Leeuw—Yes.

CHAIR—But you believe that they sold that store for substantially more?

Ms de Leeuw—They did. We received some extra money on top of that.

CHAIR—But not the full amount.

Ms de Leeuw—We do not know.

CHAIR—You do not know.

Ms de Leeuw—Certainly not what the value was.

CHAIR—You are saying that you did not get what you should have if you had been able to sell your store?

Ms de Leeuw—Exactly.

CHAIR—And then you had paid them and termination had taken place after that?

Ms de Leeuw—That is right. In regard to the Kiama store I have an email that shows Richard Taylor wrote to the bank stating he had a buyer for the Kiama store for $380,000. It was on the market for $680,000. He said he had a buyer for $380,000 and that they would sign the agreement as soon as possible after termination. They did this deal whilst we were still franchisees, but we were not a party to it. We had no say in it whatsoever. We owned the assets but we had no control over the assets.

CHAIR—At what point did you go to the ACCC?

Ms de Leeuw—We went to the ACCC soon after we were terminated the first time. Basically, they said to us: 'You are the only people who have ever complained about Bakers Delight. This sounds like an issue. You should pursue private litigation.' So we did.

CHAIR—Who did you see at the ACCC?

Ms de Leeuw—I cannot remember his name.

CHAIR—Was it an officer of the ACCC?

Ms de Leeuw—Yes, in the Sydney office.

CHAIR—And you spoke to him over the phone?

Ms de Leeuw—Yes. We sent them a whole heap of information and they sent it all back and said that it was not an issue they could pursue; we should pursue it ourselves. It was only when we to Joanna Gash and asked for her assistance and she made the speech in parliament that we

got some media from that and franchisees from all over Australia started ringing me and saying, 'That is exactly what happened to me.' All our stories were the same, so obviously it was systemic. We went back to the ACCC with a number of statements, including our own, and said, 'Here you go. It is not just us.'

CHAIR—But even if it were just you, what do you believe the ACCC should have done anyway?

Ms de Leeuw—I do not think that a certain number of people should have to fall over before the ACCC takes notice. I do not know whether the ACCC is set up to look at individual complaints. I am sure you are aware that they investigated Bakers Delight.

CHAIR—Yes.

Ms de Leeuw—I do not believe that they fully understand unconscionable conduct. Every argument on which they would come back to us was about the contract rather than the conduct. Yes, we all knew that we had signed a contract, but the contract that we signed did not cover the conduct we all experienced once we were franchisees. There are no protections to protect you once you have signed.

CHAIR—Because you had a contract you went to the ACCC and to your lawyers. Did the contract actually meet the code of conduct?

Ms de Leeuw—I believe so. I am not 100 per cent sure, but I believe so.

CHAIR—Were you assigned a case officer from the ACCC, or somebody specifically to look at your case?

Ms de Leeuw—Yes.

CHAIR—What were your dealings in those meetings?

Ms de Leeuw—My husband and I had three meetings with the ACCC—one of them went for five hours—and we provided them with a substantial amount of information, including emails between the ANZ Bank and Bakers Delight which showed them making deals between them that was totally to our detriment and that they knew would financially destroy us without our knowledge. I know that a number of other former franchisees of Bakers Delight also met with the ACCC and provided them with a whole heap of information. The point I would like to make about the ACCC is that we buy a franchise because we are not experienced businesspeople. A lot of the time we do not know what to give the ACCC. We do not know what is important that they need to be able to put forward an unconscionable conduct case. We are sitting there on our own at the table trying to explain what has happened to us. Because it is an emotional issue a lot of the time you are not focused on what issues amount to what could be held up in court, whereas the franchisors are sitting with their lawyer, who is a trade practices expert, who knows all the ins and outs, and who can put up an argument.

CHAIR—This was the process you went through with the ACCC? They sat in on meetings or negotiations between you and the franchisor?

Ms de Leeuw—No.

CHAIR—Describe the ACCC process. How did those meetings proceed and what took place? Who was there and what took place?

Ms de Leeuw—We always had just the two case officers.

CHAIR—ACCC case officers?

Ms de Leeuw—Yes, senior enforcement people. It was those two people with whom we dealt.

CHAIR—Were you there representing yourself, or did you have legal advice or anyone else?

Ms de Leeuw—No.

CHAIR—You were representing yourself?

Ms de Leeuw—Just us, yes.

CHAIR—What were the outcomes of those meetings?

Ms de Leeuw—Initially we told them what had happened to us and we went backwards and forwards with them asking us, 'Can you provide this information? Do you have copies of that?' We then had that five-hour meeting when we basically walked through the story. At the last meeting we had with them the questions they were asking us revolved around contract law. We are not legal experts but we were sitting there saying, 'It is not about the contract; it is about the conduct. These are conduct issues.' If there had been a good faith provision within the code we might have had a better chance of getting somewhere.

CHAIR—Did they advise you at any time to seek out the Office of the Mediation Adviser?

Ms de Leeuw—No.

Ms OWENS—Did you know about it?

Ms de Leeuw—Initially I contacted the OMA when all this happened, but then we went to the meeting with Bakers Delight and they said, 'There will be no mediation. We do not have to, so we are not going to.'

CHAIR—Were you aware of any specific rights that you had at that point or not?

Ms de Leeuw—No. We were going through this whole process and scrambling to try to work out what we could do and where to go. The ACCC have not shut their door. We went to the FCA.

CHAIR—That is the Franchise Council of Australia?

Ms de Leeuw—Yes, the Franchise Council of Australia. They said to me on the phone that they could not assist me unless I was a member. So we joined, paid the $100, or whatever to join, and when I called back and said, 'Now I am a member and this is my problem', they said 'We cannot help you. You need to talk to your franchisor.' When I said, 'This is the situation. We have been terminated. The franchisor will not talk to us now', they said, 'We cannot help you.' It seemed as though everywhere we went to look for assistance we were not getting it.

CHAIR—What advice did the ACCC give you to deal with this or to try to negotiate, mediate or find some settlement?

Ms de Leeuw—In the beginning? Are you referring to the first occasion?

CHAIR—At any time.

Ms de Leeuw—They did not. They did not give us advice.

CHAIR—What role do you think they played? You went to the ACCC. I am trying to establish an understanding. I was not there, so I am trying to understand what took place. You went to the ACCC. Obviously you sat down for some lengthy discussions with them?

Ms de Leeuw—Yes.

CHAIR—What feedback did you get from them about what you could do?

Ms de Leeuw—They really did not give us a lot of feedback. It was just really questioning our experiences, or our story. The thing that disappointed us the most about the investigation was that they did not interview any of the third parties that we put forward to show that a certain person was at the meeting and could verify my statement.

CHAIR—Was the verification of your statements an issue?

Ms de Leeuw—Yes. Basically, the ACCC conducted a comprehensive investigation but they have only gone back to Bakers Delight; they have not gone outside and spoken to my accountant who was at the meeting when they said that there would be no mediation. He was told that the Shellharbour store was worthless and that they always knew it would go under. They should have been verifying that information. If Bakers Delight knowingly sold me a store that they knew was going to fail, that is unconscionable conduct. That is what they were looking for. Right up to February 2008 this year the ACCC gave us the impression that they were going to move on Bakers Delight for unconscionable conduct. But the last meeting we had with them was more about the confidentiality clauses within mediation and within the franchise agreement.

CHAIR—Whose confidentiality—yours or Bakers Delight?

Ms de Leeuw—We signed something that said that the bank and Bakers Delight could discuss different issues. The franchise agreement states that Bakers Delight can speak to our suppliers about different things.

CHAIR—When you signed these documents at different times was this part of a package of documents rather than individual documents?

Ms de Leeuw—Yes.

CHAIR—Were you told, 'Here is the complete agreement. Sign this and you therefore agree to everything'?

Ms de Leeuw—Pretty much.

Ms OWENS—Did you have independent advice at that point?

Ms de Leeuw—We went and saw a lawyer and we got advice.

CHAIR—Precontractual?

Ms de Leeuw—Yes. I believe that most of the franchisees that I have spoken to have gone and got advice. It was not necessarily the right advice because franchising is a complex issue. I do not think that a lot of advisers understand.

CHAIR—Sure.

Ms OWENS—You mentioned good faith provisions and said that if there had been good faith provisions what you are going through now might be different.

Ms de Leeuw—Yes.

Ms OWENS—What you are going through now is property settlement—it is post-divorce.

Ms de Leeuw—It is now.

Ms OWENS—If there were good faith provisions at that point, maybe at this point in the property settlement that would make a difference. Do you know of anything that might make a difference to the path that you followed? Was there a point at which you needed support, apart from the ACCC, which was not there, or where some change in regulation could have made a difference to that path?

Ms de Leeuw—I believe that franchisees have nowhere to go. Once you go to mediation and go through that process and you do not get a settlement, the only option that is then available to you is to go to court. At that point most franchisees do not have the financial resources to do that. We have been going through it for three years and we are no closer to a hearing. There should be an ombudsman. The other day I read Associate Professor Zumbo's submission. I really liked his idea of a separate franchising corporation with an ombudsman and an expert determination process.

If mediation fails and there is good faith within the contract, which I would think would cover the obligation to mediate in good faith, and if they cannot come to an agreement perhaps it could be referred to an expert determiner who could say, 'These are legal issues', or, 'This is conduct.'

Perhaps they could help to facilitate some sort of settlement at that level rather than sitting across the table from a franchisor who has already decided, 'You have been terminated. I do not have to pay you anything. We are protected by the franchise agreement and we do not have to, so we will not.'

CHAIR—We have heard evidence to the effect and we have received submissions that suggest that most, if not all, these issues would not exist if people went in with a bit more education and a bit more due diligence, better read their documents and understood what they were getting into. Can you describe your experience relating to your due diligence, the level of education you undertook, and the advice you got before entering into this contract? How well prepared do you believe you were and would that have made any difference?

Ms de Leeuw—At the time I thought we had done enough. We spoke to a number of franchisees from within the Bakers Delight system. We got legal advice, we got accounting advice, we looked at our own financial position, we did our own risk analysis and we said, 'If we buy this franchise and it does not work, in the worst case scenario we would probably have to sell one of our properties.' That was okay because that was our risk profile and we were happy to do that. We did not think for a second that we would end up losing everything and be $1 million worse off than when we started.

I understand now that it is very hard to do due diligence on a company that is providing the information. You cannot really check it because there is no independent process. They are providing you with the information; therefore, they can give you inaccurate or irrelevant information. The documents can be really thick and full of inaccurate data but you cannot verify it.

CHAIR—In the end what information would you have needed to prevent this, or is it ever possible to get that sort of information?

Ms de Leeuw—I believe that a risk statement should be attached to the franchise agreement so that people with no business experience will have the risks explained to them. In our franchise agreement we believed that we were buying a 10-year agreement. What we did not understand and what was not explained to us was the fact that they could terminate at will or that they could terminate you on seven days notice. That really meant we were paying a hell of a lot of money for a seven-day contract. If we had known that in the beginning I doubt very much whether we would have entered into the franchise agreement.

CHAIR—You said that you sought legal and accounting advice?

Ms de Leeuw—Yes.

CHAIR—At the time, or even afterwards, do you believe that that was good advice? Was it sufficient advice?

Ms de Leeuw—I do not think it was sufficient. An ombudsman or something like that should be set up—a list of franchise attorneys—who specifically understand franchise contracts. We are from Nowra so you go to see the local regional business attorney who might not have seen a lot of franchise agreements before. I also think that a public register would be of great benefit. All

franchise agreements and disclosure documents could be placed on public display so that if you are looking to buy a franchise you can compare different contracts to see whether the one you have contains some unfair provisions.

People really need to educate themselves about what is out there. When you are brand new, off the street like we were, you are just handed a contract and you have nothing with which to compare it. You do not know what questions to ask. Your questions are based on what is in the document because you are not experienced enough to know what is not in the document.

CHAIR—I put forward a suggestion. Would it have made a difference if, prior to going into the contract, somebody advised you and said, 'By the way, do you know that they can terminate you at any time? That is standard in every contract.' After you had done all your research and you had spoken to a number of franchisees—I suspect that you spent months doing so—you might have said at the last minute, 'I did not know that. I am not going to do it.' After all the advertising and the meetings I am sure that you would have liked to have been given that final bit of advice, 'This in every contract.'

Ms de Leeuw—You must remember that we were emotionally taxed.

CHAIR—Would a risk statement have made any difference? I am trying to deal with the risk statement stuff. If the risk statement were compulsory, if we put it in the code—a typical risk statement would be, 'You must understand that the business could fail, this could happen, that could happen and you could lose everything'—it would be in every contract. In the end would that make any real difference?

Ms de Leeuw—If it were written in general terms I really do not know. Having that there would then make me think about it and I would then ask questions about it. As I said before, what is missing in things? If you have no experience you do not know what is missing, so you cannot ask questions.

Ms OWENS—But you said before that it was not the contract, it was the behaviour. You could have two companies with exactly the same contract and two completely different experiences?

Ms de Leeuw—Yes.

CHAIR—I am asking you whether the contract is really the problem here, or the power within that relationship when things break down to have a process that works?

Ms de Leeuw—A process that works, yes.

CHAIR—I am not making any judgment about whether or not a risk statement would help. If we were to codify a risk statement—it would be pretty similar in all contracts—in the end you would see that in every contract. It may not change. It does not oblige people to do anything.

Ms de Leeuw—No, it does not.

CHAIR—It does not oblige behaviour. All it does is state, 'You need to understand that the system could fail and we have the right to do all these things, which are already contained in the contract anyway.' It is almost restating what is in the contract.

Ms de Leeuw—Yes.

Ms OWENS—The disclosure laws came in after 2006. Back then you did not know how many times those stores had churned information?

Ms de Leeuw—No.

Ms OWENS—But you do now?

Ms de Leeuw—That sort of data is quite hard to understand. They have a figure of how many times stores have transferred within their system.

Ms OWENS—And you cannot compare it to other information?

Ms de Leeuw—Unless you know why.

Ms OWENS—You would want to be able to compare it to the histories of good franchisors?

Ms de Leeuw—That is right.

Ms OWENS—To put it into context?

Ms de Leeuw—Yes. You do not know whether it is high, low or normal. I believe there should be a registration system so that we know how many franchise systems there are in Australia.

Ms OWENS—Your franchise registration is the answer for which you are looking. What is the problem that you are trying to solve?

Ms de Leeuw—Basically that—

Ms OWENS—That you could not compare?

Ms de Leeuw—Yes.

Ms OWENS—Even if you had been given a figure, unless you had a place to go to do research you do not have what your need?

Ms de Leeuw—That is right.

Ms OWENS—The answer you are putting forward for that is a registration system?

Ms de Leeuw—Yes, with a public register attached to it.

CHAIR—Would it be fair to say that, in the end, even with all that information, until the relationship breaks down you really do not know that you are going to be out. You will not face the situation that you faced—

Ms de Leeuw—That is right.

CHAIR—until the relationship breaks down. The problem might not just generally be: how much more information is disclosed?

Ms de Leeuw—But if there is more information for you to look at before you go in, you just might not go in. You might not find yourself party to this contract because you might look at it first.

CHAIR—If you did not go into that particular contract and you went into another franchise system, you had already made a commitment that you would go into a franchise system. You were looking for the one that suited you the best. Eventually you would have found one. I am assuming that you were determined to build yourself a business and that you would do it through a franchise.

Ms de Leeuw—Yes.

CHAIR—If you got more information it would have meant that you might not have picked Bakers Delight. You might have picked some other franchise system—perhaps McDonald's, from whom we heard earlier. There is no difference in the code, in the Trade Practices Act, or anything else. It was not so much a lack of information, although there is more disclosure now. The problem that you faced was really the breakdown of the relationship at some point, and you had no remedy?

Ms de Leeuw—Yes.

Ms OWENS—In hindsight, now that you know more about the process that you went through and as that relationship broke down, can you identify points where assistance or some other system might have stopped it, allowed you to get out, or changed your response to it?

Ms de Leeuw—If the good faith provisions had been in there, I potentially could have used that to say, 'We need to be dealing with each other honestly and reasonably and this is my problem. Can we sort it out?' If those things are acceptable to the franchisor who wants to help you build your business, I think that would be enough.

Ms OWENS—There is an old saying that you do not stop law-breaking with laws. People who want to break the law will break the law regardless of what the law is. You will still have—I am not suggesting that Bakers Delight is one because I am hearing only one side of the story—companies that will stretch it and find a way to exploit it. Again, for you as the franchisee, is there some level of support that might have caused you to make different decisions?

Ms de Leeuw—The biggest problem was that we felt there was nowhere to go and that the ACCC was useless. There should have been an ombudsman to whom we could have gone to get advice and to say, 'This is what has happened; what are our rights?' because we did not know.

That potentially could also have helped. The cost of the legal remedy allows franchisors to act in the way that they do. I am not saying that they all do that. If the cost factor can be taken into account and legal remedy is accessible that would have been okay.

CHAIR—I think we have covered everything. Thank you, Ms de Leeuw, for your submission.

Ms de Leeuw—Thank you.

Proceedings suspended from 12.43 pm to 1.29 pm

BALADI, Mr Albert, Managing Director, Yum Restaurants Australia

BRYDEN, Mr Nick, Chief Legal Officer, Yum Restaurants Australia

CHAIR—I welcome everybody back to what is now a subcommittee. Welcome, Mr Baladi and Mr Bryden. I remind you that witnesses giving evidence to the committee's inquiry into the Franchising Code of Conduct are protected by parliamentary privilege. Any act that may disadvantage a witness on account of their evidence is a breach of privilege and may be treated by the parliament as contempt. It is also contempt to give false and misleading evidence to a committee.

Witnesses should be aware that, if in the giving of their evidence they make adverse comment about another individual or organisation, that individual or organisation will be made aware of the comment and be given a reasonable opportunity to respond to the committee. The committee prefers to hear evidence in public, but may agree to take evidence confidentially. The committee may still publish confidential evidence at a later date, but it would consult the witness concerned before doing that. The witnesses are more than welcome to make some brief opening remarks.

Mr Baladi—Thank you very much for allowing us to appear today. I have a line in my notes saying that we appreciate that the entire committee is present on a Friday afternoon, but I will skip that line! I would like to make a few opening remarks and then I will hand over to Nick to drill into some of the details of the submission that has been made. I am new to Yum—I have been with the company for only 18 months. I joined after 13 years as a senior executive with PepsiCo. In my last role in PepsiCo I was in charge of some famous brands that you would know, such as Lipton Ice Tea, Gatorade and so forth, on a global basis. A few things attracted to me to Yum. First, the power of the brand, the growth story line of Yum as a company and, probably more importantly, the people and the culture that are behind this business.

I first joined in Dallas in a global role. I was absolutely struck by the power of Australia in the Yum world and how Australia leads the way in many ways. We really have the A-team in Australia in terms of a centre of excellence for innovation. There is also people development. Of the senior executives running Yum internationally, 22 are Australians. This country is very much an exporter of talent and it is part of the raison d'être of the division.

When the opportunity came up to be the managing director in Australia, I did not hesitate. I joined here in January 2008. Having come from a franchised company before with PepsiCo—as you know it is also one of largest franchisors working with bottlers—I was struck by a few things when I joined the business. The first one is that I would say there is a deep-rooted partnership spirit in the system here. We talk about one system operation between us and franchisees. The relationship between us as the franchisor and the franchisees is very, very close. There is very tight partnership where we decide jointly about the direction of the business and we jointly spend money advertising. There is a body call ATCO, which regulates that and which has franchisee representatives.

There has also been incredible wealth creation on the franchisee side. A couple of weeks ago I was not far away from here visiting with one of the franchisees who in 20 years had transformed

his store from an Ollie's franchise to a KFC franchise. He was telling me how he was pretty much struggling as the general manager of a restaurant, having difficulty making ends meet. KFC acquired the business, we rebranded the store, and overnight the sales doubled. Over the past 20 years it has been nothing short amazing progress as a result of very hard work. The guy went from having one struggling store to a network of 13 stores—and he will have 16 within the next six months—and a net worth of more than $50 million. He is very active at the community level. Every store employs more than 50 team members and contributes a lot to local charities and all kinds of other things. Incredible wealth has been generated by the system.

The other thing that struck me is that, at the end of the day, this is a people business. We talk a lot about cooking and making pizzas. But it is really a people organisation. When we think about this, we have 30,000 employees in Australia, 80 per cent of whom are under the age of 21, and for 80 per cent of them this is their first job. We employ students and give them training as they get ready for full-time employment. We build life-long skills.

We are a nationally recognised and accredited training organisation and we are RTO as well. This year alone we will have trained 1,000 young people in retail certificates II, III and IV. Those people will be able to have a career in the retail area. This year alone we have trained and developed 20,000 team members and we have spent over $12 million on training. Women are 50 per cent of our workforce and we have all kinds of very progressive work/life balance programs. We are a strong supporter of people with disabilities, and we have also been recognised and nominated in various employer of year awards over the years. I will not go through them.

What really struck me was the fact that my management team and leadership team in this business have folks who started 10, 15 or 20 years ago as delivery drivers and cooking chicken in the back of house and who have made it. It is the kind of business that offers those kinds of opportunities.

This business has clearly known world-leading growth over the past 10 years. We have been growing at a very healthy rate. But we are certainly not sitting on our hands. The mission I have been tasked with here is to nearly double the size of the business in the next five years. That is a massive task. In light of the economic turmoil going on, we are certainly not stopping. We are going to step up our investments in 2009. We are making massive investment in capital—spending more than $80 million on innovation, store design, development, training programs, you name it. We want to keep those brands extremely vibrant and relevant to today's consumers. Despite all the noise in the economy, we are going to take a very proactive posture in the industry.

It is really in this light that I think it is absolutely critical that the formula that works around the world is not over-regulated and that we do not start adding additional hurdles. Otherwise we will have to reprice the contracts. All the jurisdictions around the world that have regulated have seen a significant slowdown, whereby the owner of the business starts investing in themself as opposed to appointing franchisees, which reduces the spread of the wealth and makes the system much weaker because there is much less accountability on both sides. With that, I will turn to in Nick to take us through the rest of the submissions.

Mr Bryden—I want to leave as much time for questions as possible.

CHAIR—Please do, otherwise I will pull you up very shortly.

Mr Bryden—I will leave the submissions, which are brief, for members of the committee to digest. However, I will discuss the main points in those submissions. We have attended to the terms of reference as they appear. Given that, we commence with a long discussion about the relationship between the franchisor and the franchisee. We did this because we think it is an area that would benefit from more understanding.

The key points that we draw to the attention of the committee are, firstly, that franchising is a business arrangement rather than an industry. That creates complexity that needs to be taken into account. Secondly, the basic nature of the arrangement is that the franchisor owns the intangible assets—that is, the brand system, the reputation and the know-how. It licenses the franchisee to use that brand at an assigned location for a period of time. In our case, that is up to 20 years. The franchisee in our system owns and controls the tangible property, which is the land, building, equipment and access to people.

We have spent a lot of time looking at self-regulatory factors in our submissions. The appropriateness of that has been recognised by the regulatory taskforce committee. The basic point we make is that franchisors and franchisees both have power. In our case, it is from owning the brand and the system. In the case of the franchisees, it is from the ownership of the physical assets. The practical consequence of that, notwithstanding that the contract appears to be one-sided, is that the parties do in fact discuss, negotiate, compromise and agree on most significant decisions made about the business. The evidence of that in our system are the things that Albert has referred to, such as advertising cooperatives. There is a number of collaborative forums between franchisee and franchisor that have voluntarily emerged. If the relationship were one-sided, you would not see that.

We are not opposed to regulation of franchising at all. But we believe it should be directed towards preventing abhorrent behaviour and also at ensuring that parties are informed of the nature of the agreements they are entering into. Of course, that is the thrust of the regulation and intervention so far. We are interested in good faith. We have seen the development of it in common law. We believe an appropriate definition could provide clarity. Of course, whether it does that or creates uncertainty depends very much on the form it takes. As one of larger franchisors Australia, we would be happy to participate in that discussion.

Although it is not directly in the terms of reference, we expect the committee to take submissions about and deal with the end of contractual relations. Our basic position is that the contract deals with it, and it does so clearly and appropriately. The franchisee has 20 years in which to enjoy the use of the brand and to achieve an appropriate return. We do not hide from this and we want franchisees to understand it and factor it into their decisions.

In our system, the end of contract issues are nearly always dealt with successfully, either by negotiation of a new agreement, by the franchisee not choosing to renew an agreement, which happens often, or by the transfer of the assets to us or to a third party. This is consistent with the industry data. The only criticism that we believe can be made is that the franchisee does not understand the nature of the arrangement. That is a pre-contractual disclosure issue, an education issue, or there is not sufficient notice.

It is necessary for me to address the elephant in the room. Of course, that is our franchise arrangement with Competitive Foods Australia Pty Ltd, our Western Australian franchisee. We understand the inquiry has a broad purview and that it goes well beyond this private issue, which we see very much as a private issue. Unfortunately, through the media and other means, our Western Australian franchisee has prosecuted the issue and made it of direct relevance to the inquiry.

The two points of relevance are, firstly, that there is evidence of franchisor opportunism here and that that justifies regulatory intervention. We have dealt with that in our submissions. We have acted reasonably, honestly and appropriately. We have provided a 20-year term in which to use the brand and our Western Australian franchisee has generated an exceptional return on that investment. The two questions really should be: did Competitive Foods know what it was entering into? As a large organisation, we can assume that it did. Secondly, did it have sufficient notice? We gave it over four and a half years' notice prior to the expiry of the first agreement, at not inconsiderable commercial risk to ourselves.

Our Western Australian franchisee would make out that there is something more here and that we have acted opportunistically. Again, we rely simply on the facts. In addition to the notice that was given, we invited our franchisee either to dispose of the assets to a third party or to sell them to us. In the time—the four and a half years—it was unable to do so. In other words, it was unable to do that which every other franchisee in our system has managed to do successfully over the past 40 years to our knowledge.

The decision itself should really remain the decision not to remain with Competitive Foods. That should be the end of the inquiry. But we also have nothing to hide as far as our reasons are concerned. There has been an irreparable breakdown in trust, a major element of which is noted in Competitive Food's submission. There was an agreement in 1999 that it and its principal would not own pizza businesses that competed with our brand, Pizza Hut. We subsequently discovered that, through a complex trust arrangement, members of the principal's family did in fact retain a 75 per cent interest in Domino's Pizza, the largest pizza chain in Australia.

This is not the only reason, but it is central. To many it will appear compelling and to some it will not. I think therein lies the rub for us. An examination of our subjective intention, which is essentially what this proposed by Competitive Foods when it talks about good cause, is fraught. It will create uncertainty. It is not necessary in light of the evidence, which shows there is not much of an issue at all, and it will have conversely very significant costs far outweighing any potential benefit. That is the specific issue.

The second reason that this is of interest and is relevant to the inquiry is that the outcome of this inquiry is now being viewed as a factor in assessing our most recent offers. To this end, we would ask the committee to make a statement that whatever the outcomes of the inquiry, and without prejudicing in any way its full examination of the issues, any recommendations will not have retrospective effect. That would have the effect of bringing the parties together and stopping the inquiry being used as leverage in this and other negotiations. We have views on many things and we would like to explore those with the committee now. Thank you for your patience in hearing our oral submission. We are pleased to take any questions.

CHAIR—Thank you, Mr Bryden and Mr Baladi. There is no doubt from your presentation and history that Yum Foods is a quality brand and you have been very successful in Australia. I do not think there is any question about that. I thank you for your extensive submission, including the summary of the relationship. That is helpful to gain a broader understanding of the relationship within franchise systems. I will go straight into the identified key points you are trying to address in your submission, particularly with regard to the dispute you have with Competitive Foods Australia Pty Ltd. Can you give us an explanation of why you want to terminate that agreement after 20 years? What is the reason for the termination?

Mr Bryden—Hopefully I have addressed that. The points are that there has been a breakdown in trust. As in any business relationship, particularly ones that have been recognised as relying on trust, it is an essential component. The question that we have faced, and five years ago exercised our minds upon, was whether we should enter into further long-term business arrangements with Competitive Foods based upon the information we had before us. I have highlighted why there has been a breakdown of trust. It is not at the operational level; in fact, we have admiration for those members of Competitive Foods working in KFC stores. It is with the broader activities of the company and the activities of its leading minds.

CHAIR—In terms of that breakdown in trust, you are saying that the operation was very successful, in fact it produced very well. Obviously it made a good return for the franchisor, yourselves, as well as for the franchisee.

Mr Bryden—Sure.

CHAIR—It relates to the outside activities, as you said, of the franchisee and, in particular, that they set up a trust arrangement whereby members of their family had ownership of another food brand that you saw as being in competition with you. Can you explain the principle behind why that would be a breakdown in trust?

Mr Bryden—Sure. First, what we have said and what we are saying is that that was a central issue, but not the only issue. In common with all industries, we have restraints of trade in our contracts that prevent our business partners from competing directly against us.

Senator BOYCE—Does that include key employees as well as the franchisee?

Mr Bryden—It is common. As you would be aware, restraints are common across all types of arrangements, and franchising is no different. So, employment contracts would contain an element of prohibition against competition as well. I think that is recognised. They are so prevalent because it is recognised as justified as a legitimate business interest. Obviously, Competitive Foods has a number of different interests, including an involvement in Hungry Jack's. That puts it in a special position. We saw it conflicting with our legitimate ownership of Pizza Hut and, as a consequence of that, asked it to refrain from participation in that particular industry. Of course, it was free to participate still in Hungry Jack's. So, to our mind it was a legitimate restraint of trade. Bearing in mind that the law on restraint of trade is quite clear—that is, it is enforceable only to the extent that it is reasonable—there is no suggestion that it has been anything other than reasonable up until this point.

CHAIR—Does it extend to family members?

Mr Bryden—If I understand it correctly, I think the point is what were the particular terms of the restraint of trade. My answer is for the reasons that I have already identified. An examination of that particular issue is not relevant to what should be the central points of equity. The reason we have said that it is not relevant to the central points of equity is because the only two complaints that ought to be put by any person entering into a business arrangement is, first, that they did not know the nature of the business arrangement, and, secondly, that they were not given notice of what happened at the end of that business arrangement

CHAIR—The only relevance I am drawing is that you have raised it as an issue, not me. That is why I am asking. If there is a breach and the trust broke down because of that breach, does your anti-competitive clause include family members? The answer is either, yes, it does, or, no, it does not.

Mr Bryden—To put the question in its context, which is what I was doing, it is not strictly relevant to a situation of equitability. We have nothing to hide on the issue.

CHAIR—You said there were other issues and that this one is not necessarily central or relevant. What other issues are central and relevant?

Mr Bryden—Clearly, those are matters of some complexity.

CHAIR—We are more than capable here of dealing with complexity. Please give us a go.

Mr Bryden—I understand that, but you may not have the time—

CHAIR—We have plenty of time.

Mr Bryden—or the patience to deal with all the issues of complexity because we have only an hour. This was a long-term relationship. It is not unlike the dissolution of a marriage. There is going to be a lot of finger pointing and debate on either side.

CHAIR—I am conscious of the time and I want to get something significant out of this, otherwise it will be you who misses the opportunity to put yourselves forward in a fair way and actually present a case. Otherwise your evidence will be meaningless.

Mr Bryden—Sure.

CHAIR—Tell me what it is rather than just the generalities. If you want to raise it as an issue, and you have done that both in the written submission and orally, then just give me what it is that is central and key as you have identified.

Mr Bryden—I think we rest and stand on our written submissions and the oral submission we have already made. The compelling points should be the points we have already raised. We are not hiding anything, but it would take a long time. As we have said, we could debate for hours or days on this issue and the rub really lies there. Two reasonable people can probably get into a room and have a debate about it. The point is that we acted absolutely consistently, reasonably and appropriately under the contract that Competitive Foods clearly agreed to.

CHAIR—In the end, what you are saying is that there was a determination that a contract would end at a specific time. I am not questioning that that is the case, because obviously that is the case. It is quite common and it just ends at a particular point. I am trying to determine the process you use at the end point to actually either negotiate or come out with a reasonable outcome and a settlement if one party decides they can no longer live with the other party. I am trying to do two things: firstly, to establish what was the reason behind it so that we can understand what took place; and, secondly, apart from simply saying we made an offer—

Mr Baladi—The trigger point was the issue of Competitive Foods' nondisclosure of what other businesses it was involved in. None of us was there at the time, but there is a long trail of communication where there was clearly hiding of the facts and it took four or five years of digging into that until the truth came out. This led to a breach of trust. Whether or not it is a black-and-white breach of contract under the law does not really matter. It led to a breach of trust. At the point where we were able to exit the business—meaning at the end of the 20 years—Yum has elected not to renew the contract because of that breach of trust.

CHAIR—Some people might argue—I am not saying I would—that if you were to say that in the end there was no black-and-white breach of any law, you just did not like it, that that poses a conundrum for you and for me. The conundrum for you is that if you just did not like it and you decided to act in a harsh manner in relation to what you just did not like but there was no breach that could be used in reverse for a franchisee using that very same principle in response. That is what I am trying to establish. Trust has broken down because basically they breached an agreement. If the agreement they breached is because they allowed a family member to own a competing business, I wonder how far the law stretches in your view in terms of family member ownership. Whether there is trust in place or not is irrelevant, because that is legal and proper. We are not questioning the validity or credibility of trust. If people make arrangements, where is there a breach? I am just trying to establish the pattern, because it is relevant to all franchise systems in that if you breach a contact there are some serious consequences.

Mr Bryden—That proposition is fine and if this had ever been a matter about simply what the law is and the what the contract is, we would not be entering into a inquiry about what our modus is after terminating. The point is that the contract is absolutely clear. Not only that, we provided four and a half years of notice that it would end. If it is just a matter of strict reliance on contract, then our motivations, intentions, whether it is lack of trust or anything else, are absolutely irrelevant.

Senator BOYCE—But very relevant to this inquiry, because others would argue that it should be a matter that is covered by contract.

Mr Bryden—They would. That is why we have entered into a discussion about what we consider to be very strong, legitimate and compelling reasons for lack of trust. We cited one of them. One needs to make a distinction and we are. We are in a forum that is making a distinction between legality and, in a sense, morality. To argue on the one hand that we can only rely in advancing that we lack trust and that there was no apparent breach of a technical aspect of that contract—

CHAIR—It is just that the same argument seems to be used by franchisors, whether yourself or others, when they say, 'No, in the end, if a dispute comes back, we go back to the contract.

Here it is in black and white.' That is why it has presented me with a conundrum. You are saying the same but in reverse; you are using the same principles in reverse. For the first time in this inquiry that has presented me with a very legal and different view in terms of how you are applying the contract, the code and the underlying principles that are generally accepted by courts with regard to good faith.

Mr Bryden—My response to that is perhaps frustrating. The only reason we are in the position of arguing that is because it has been put to us that there needs to be some other reason to end the contract.

CHAIR—What?

Mr Bryden—There needs to be some ancillary reason other than just relying on the clear terms of the contract. If we do not have to answer that, and if no franchisor has to answer that, we do not need to enter into an ethical debate about trust. That is the only point we are making.

CHAIR—In a sense, you are saying that you need to find a reason to otherwise justify where you do not really need to anyway because the contract is black and white.

Mr Bryden—I am not sure that that is what I am saying. I will take it on faith that it is.

CHAIR—That is fine. I need to get some sense of your philosophy or view in terms of why you might terminate. We have had different evidence in terms of contracts. There is a general expectation by everybody that you can terminate—it is usually contained in contracts—at any point. It is certainly in plenty of contracts that you can terminate at any point. The expectation is that, when you go into a relationship—a bit like a marriage, as we have said—it will be ongoing and that, therefore, the only time you might terminate it would be at a point of disputation or for some breach. That is well established. I am trying to get to the point of what processes you undertake to deal with that and how that works. Unless you want to make another comment, we will move on.

Mr Bryden—That is fine. We deal with that particular issue in our submissions. That is a separate issue. You are talking about whether there is a legitimate expectation of a new contract. We work with our franchisees as they come up to the time when their original franchise expires—

Senator BOYCE—So they are generally 20-year contracts?

Mr Bryden—Yes. In our system we have an initial 10-year term—

Senator BOYCE—And at 15 years you would say to me—

Mr Bryden—Correct, and in fact we do.

Senator BOYCE—When would you do that?

Mr Bryden—We talk to our franchisees as they come up to their 15-year term about whether they are happy to meet a bunch of investment criteria. If the relationship between us has been

good and we see a future for them to be in system with us and to expand and grow, then we offer them a new contract provided they—

Senator BOYCE—With new terms?

Mr Bryden—With new terms.

CHAIR—A new 20-year contract?

Mr Bryden—That is right.

CHAIR—I would like to explore an interesting concept you have just raised. How would you describe the business you are in? Is it about making money?

Mr Baladi—With less worries.

Mr Bryden—That and chicken burgers.

CHAIR—This is just to set the background for my question. You are in the business of making money. You are in the business of continuing to sell franchises and to make more money. I refer to when you make a decision not to renew in your own best interests. If you have a very successful franchisee, or system, or groups of franchisees, why would you terminate them? Is it the case that you are in the business of liking or not liking people, or are you in the business of making money? Why would you get rid of your most successful franchisee? It is a foreign concept to me. Please explain it so that I can understand it.

Mr Bryden—We do not.

CHAIR—You get rid of the failing ones.

Mr Bryden—Our business relies upon its ability to attract successful franchisees. From that point, you should draw the conclusion that we have very good and compelling reasons for not wishing Competitive Foods Pty Ltd to continue to be in our system.

Mr Baladi—As a matter of perspective, this is the first contract we have terminated in 40 years.

CHAIR—In 40 years?

Mr Baladi—Yes, in 40 years in Australia.

Mr Bryden—We do not do these things capriciously; we do them for good reason.

CHAIR—There is a difference between having never done it before and not doing it capriciously. You would understand that.

Senator BOYCE—But terminating a contract is not the only way to get rid of a franchisee.

Mr Bryden—There are a couple of ways. I want to make a distinction between termination and expiry. You can terminate for breach. That would be a termination during the term. Expiry occurs. Contracts have a fixed term and at the end of that term there ceases to be a relationship between the parties, unless a new contract is entered into.

Senator BOYCE—How many have expired in the past 40 years?

Mr Bryden—I do not have the number at my fingertips. We have a 10-year initial term and we have a renewal term. A number of franchisees—

Senator BOYCE—So it is not really a 20-year contract; it is a 10 plus 10.

Mr Bryden—It is. It is a 10 plus 10, but the practical effect is that if you are not in breach of the contract you effectively get a 20-year agreement. That is in our submission. I was not trying to gloss it.

Senator BOYCE—But presumably you renew it anyway?

Mr Bryden—Yes. The salient point is that a number of our franchisees have elected not to exercise that option; that is, to allow their stores to close at that 10-year point. And they do so at the 20-year point as well.

Senator BOYCE—What do they get at the end of that 10 years?

Mr Bryden—They get to retain their tangible property.

CHAIR—Which is what?

Mr Bryden—Many of them buy the land.

Senator BOYCE—I was going to ask this question. You have talked about them getting to keep the physical assets. What would be the typical physical assets?

Mr Bryden—Many of them buy the land. So they would retain that land. They would also retain a lease, which is a powerful thing. They would retain a building. Bearing in mind that the building, equipment et cetera—

Senator BOYCE—Why do they have a lease if they own the land?

Mr Bryden—I am saying that some buy and some lease. That is my point. Bear in mind that when you purchase equipment there is a capital outlay and you depreciate the value of that outlay, which you can claim off your tax, revenues et cetera. The idea would be that if you had a 10-year or a 20-year agreement, you would depreciate the assets down.

Senator BOYCE—So they would always own the building as a minimum.

Mr Bryden—Ought to be. There are exceptions, such as in Westfield, where they may not. Of course, that is nothing to do with us; that is the just the nature of that lease.

CHAIR—I would like to explore this clarity of end of term. Did you claim that this is the first one that you have terminated in 40 years?

Mr Baladi—This is the first one where we cannot agree on termination. We and the franchisee are in conflict.

CHAIR—So you cannot agree on the termination, or you have just allowed it to expire?

Mr Bryden—That is his point. With due respect, I am just making the distinction, which is probably the legal distinction. I am not sure that that suits. For these purposes I think that is the same thing.

CHAIR—So the expectation, for want of a better way to describe it, is that you are in the business of franchising and continuing those out there. I am assuming, or perhaps you can tell me, that the reason you franchise at all is that you want somebody else to take the capital risk. The reason you franchise is that you want to use somebody else's money and their time and energy and so on to build up the business. Is that the base principle? Otherwise you would do it all yourselves.

Mr Bryden—Absolutely. There is an aspect of that. They have access to capital depth that we would not be able to get by ourselves. There is a mutual benefit.

CHAIR—I am not questioning the mutual nature of the relationship. I ask because in your submission you say that there are only two things, in essence, and you state that the respective roles are:

That the franchisor creates and manages the brand and the system to ensure consistency of product and/or service.

Mr Bryden—Correct.

CHAIR—You continue:

The franchisee pays fees and royalties to acquire a licence to use system and the brands for a fixed period of time.

It is actually a bit broader than that.

Mr Bryden—I think we go on to recognise the contribution of our franchisees. Of course, they are responsible for execution at store level. The submission is very clear on that point. I do not think we are hiding anything. We recognise that we have great franchisees and they have been a tremendous participant in our success and we in theirs.

Senator BOYCE—But you have quite deliberately structured that in such a way that you are making it quite clear that you do not see there is any goodwill.

Mr Bryden—No, that is correct.

CHAIR—Let us for a moment not call it 'goodwill'. Let us just call it the market value of the business were it to be sold today. It has a value. That value would expire almost completely on the expiration of the term of the contract, because there is nothing to sell. There might be the building left, but you cannot do much with it, depending on what it looks like; that is, if it is specifically branded, shaped and designed and so forth. How does that work in principle? You say there is no goodwill, but obviously there is; everyone agrees there is goodwill.

Mr Baladi—You buy a going concern.

CHAIR—You are buying a going concern. People have said at best it is hard to give a percentage of who owns what bits of goodwill, but in the end there is a market value. So if you were to retain out of that market value your brand, licensing, et cetera, and the franchisee were to sell the business, they would gain that market value at that point. They would sell the business. If you approve a new franchisee coming in, it is a neat transfer.

Mr Bryden—Sure.

CHAIR—What I am trying to establish here is that there is a market value.

Mr Bryden—Absolutely, there is no dissent from us.

CHAIR—Regardless of whether you call it goodwill or something else.

Mr Baladi—We do not buy businesses at the end of 20 years for a penny. We value businesses and naturally that was the offer we made to Competitive Foods. This happens when franchisees exchange businesses. A new franchisee coming in gets the full tenure. We give them the assurance that over the next 20 years they can operate this business, as a result of which they value the business on the basis of 20 years.

CHAIR—Okay. That is fine; that explains it.

Mr Bryden—I would like to explain. We are not at cross-purposes at all. It is consistent with our submissions. We say that there is absolutely goodwill in a business. But, in our type of system, you have to look at it from the consumer's perspective. I am a customer and I walk into a KFC store. I go for KFC; I do not go because it is operated by Mr X franchisee or because it is in Rockingham. That is what we are saying in our submission.

CHAIR—It probably would matter where it was, but I accept the basic principle.

Mr Bryden—I think you would get some dispute about that. I take up that point about site, and this is interesting. In our Rockingham area, we have found that, while that area has gone black, which is terrible for everyone concerned, there has been a corresponding pick-up in activity in the surrounding KFC stores. I think that is a demonstration of the issue. Site goodwill really attributes to the particular location—that is, the corner that it is on. If you move it down the road or a block away, which we consistently do, and there is an immediate pick-up, I think it is demonstrated that it is not of the significance that may be said.

Senator BOYCE—But the reverse would apply as well. If you move it 20 minutes down the road and there is an immediate drop-off—

Mr Bryden—Correct. That would be rare and a bad business decision.

CHAIR—I would like to explore a couple of issues. What do you understand in terms of good faith? It relates to how you deal with people and expecting people to deal in good faith with you and vice versa.

Mr Bryden—Sure. We have made a broad statement that it is about acting reasonably and honestly in our view. That is the way we expect to conduct our business and it is the way that we believe we have conducted our business. If you look at our track record, there is no way we could be in business for as long as we have been and have attracted as many quality franchisees as we do if we went about our business in a way that lacked good faith.

CHAIR—Do you have a good faith clause in any of your contracts in any respect; that is, do they contain the words 'good faith'?

Mr Bryden—No.

CHAIR—Not that you are aware of?

Mr Bryden—No.

Senator BOYCE—Not in Australia. I understood you did in the United States.

Mr Bryden—No. I think what you are referring to is the aspect that was raised by Competitive Foods that perhaps there is a different type of contract with KFC in the United States. We have not raised that issue. If you want to explore it, we can to a degree, but obviously it is a different jurisdiction and we do not have all the facts.

Senator BOYCE—But again, given that one of your core competencies is uniformity of delivery, I am interested in why you do not use the same sorts of contracts in Australia as you do in the United States.

Mr Bryden—That is the only exception we have in an international standard, which the Australian agreement is consistent with. There are two other brands in the United States—Pizza Hut and Taco Bell—and another two, but I cannot speak to those because they are small. They have the same type of contract that we have. Taco Bell's is exactly the same. KFC's is a unique situation that is specific to the facts.

Senator BOYCE—KFC United States has a unique standard contract?

Mr Bryden—A different type of contract. I do not have all facts as to why that is the case.

Senator BOYCE—I am not particularly interested.

Mr Bryden—That is fine. There is no broad philosophical reason why that is the case. It is specifically due to that situation.

CHAIR—Aside from your contract—you have your contract and you have your agreement—do you expect your franchisees to act in good faith towards you?

Mr Bryden—Yes.

CHAIR—What does that mean to the business? What does that represent? Give me a few examples of you expectations; that is, what you expect your franchisees to do in good faith that they otherwise might not do if they just decided to do it in some other manner.

Mr Baladi—On a daily basis it is about disclosure of the business numbers, of what is going on—profit and loss—and what is going on with the customers coming into the store, the service standards they are achieving and bringing bad news and good news as they come so that we can deal with them jointly. There is also an expectation of making sure that as we plan the business forward all of this is done with the right intention for the brand and for growing the brand and the business. These are very important factors that we deal with on a regular basis. We value transparency and sharing the same objectives for the future.

CHAIR—One of the arguments that you use is that both parties have had satisfactory time for return on investment, and that that in itself means there is no further commitment, that the return has been made. Can you give me some guidance as to how you interpret that?

Mr Bryden—I am not entirely sure—

CHAIR—At section 3.3 of your submission, you talk about the franchising agreement and a range of factors that come up. You say that if you end it people have had sufficient time to make a return on their investment.

Mr Bryden—I think we would stand by that point. It is a justification and a reasonable one. It is in that respect no different from the exploitation of, say, an intellectual property licence for a piece of software. When you sign up to a fixed-term agreement, you have to work out whether you will make money over the term. If you are not going to make money over that term, provided you have all the facts available to you to make a decision, then you should not enter into that agreement. That is the relevance or justification.

CHAIR—Two issues come out of that. The first is whether you make money or not. I do not think anyone would want to prescribe success or failure in any code. It is based on a whole range of other factors whether you succeed or fail and whether you make lots of money or a little bit of money.

Mr Bryden—We would agree with that.

CHAIR—I would not expect Yum or anyone else to be in a position to say it is going to guarantee x, y and z.

Mr Bryden—And we do not.

CHAIR—No, you do not. There is no expectation of that.

Mr Baladi—Nor would we.

CHAIR—Nor would we expect that.

Senator BOYCE—We are not suggesting you should.

CHAIR—But, obviously, it is not like a software licence; it is not just for a fixed period of time, even though it is, where you make a fixed investment and you amortise that fixed investment over 20 years, make a return on your capital, and then walk away. It is much more involved than that.

Senator BOYCE—Or develop the generic model that you have to put out when the patent finishes.

CHAIR—It is much more involved than that. In fact, there is continual reinvestment into the business and a continual growing and building up of goodwill in the community. There have been examples of that. As strong as the brand is—and that is acknowledged—you are only as good as your last meal and the last bit of service. So, there is an inherent trust, goodwill and good faith based on the franchisee doing the right thing every single day, including producing good quality food and good service, and all those things that you would expect in your contracts anyway. What I am trying to establish here is that it is not just a case of using it as an explanation that after 20 years you have had plenty of time to recoup your money. It is not really like that. In fact, franchisees reinvest their profits continually in the business in maintenance, upgrades and a whole range of other things. They invest not only their profits, resources and revenue but also their time. It is not just a simple case of saying, 'It has been 20 years. You have made your money, see you later.'

Mr Bryden—I take the point. The software licence agreement might be one example. But let us use another example, exactly the same, which would be the right to distribute a product for a fixed period. I talk about this because I come from this sort of industry, as did Albert. All the same inputs apply. If I have a licence to sell a product for five years, I will make very significant investments throughout the term of that contract. I will invest in people, walls, wheels and factories and I will go out and actively push that business. I will solicit custom and build up customer lists. But there is no implication of regulatory intervention in that circumstance. When I go into the business I say to myself, 'I will invest here. It will be expected and it will be ongoing, and I will have to get a return on that investment during period of my licence agreement.' That is point we are making with regard to the relevance of this.

CHAIR—But would you expect that if you had a software agreement and after five years it expired your whole business would go with it just on the basis of a software agreement? If you had an accountancy firm and an accountancy licence agreement, would you just get another bit of software?

Senator BOYCE—The majority of people—

CHAIR—It is just not a good example. I am saying that if you are going to use an example, give me one that is sound.

Mr Baladi—It does not really go, it has a value that can be sold.

Senator BOYCE—The majority of people going into the sort of distributorship-type situation you are talking about would be very foolish if they allowed any one of those products to be more than 10 per cent or 15 per cent of their business. They are managing risk across the business. It would be very unusual for someone to have one product and that is it.

CHAIR—The difference here is that the agreement is for 100 per cent of the business. Without the agreement, you do not have a business. It is not like a licence for software. If you are an accountant and you have a licensed piece of software, you would just get another bit of software. There are plenty to choose from.

Mr Baladi—It is not like you leave with zero. We have established that there is a sale and there is a value at the end. At the end of the contract you can choose to be a good franchisee and renew or move on, or you want to sell on and there is a value to be realised for that. Many franchisees have sold and have become extremely wealthy afterwards.

Mr Bryden—I would like to complete my point. I did not advance the software argument or, indeed, the product distribution argument to say it is the be-all and end-all analogy. But I think there are circumstances and things that can be drawn from it. It was put as a proposition and justification for what is the purpose of saying it is a 20-year period. The point we raised is that there is no evidence. We say that what actually, practically happens is that in theory it ends at 20 years. We say, practically speaking, there are all these reasons why the franchisor and franchisee get together and work out what is going to happen. All of the evidence says that they do so and they do so effectively. There is only one example that has been proposed and that is this example in Rockingham. We say on the facts that it does not stack up. That is not just us; that is an industry perspective.

The relevance of that is then when considering regulatory outcomes you have to look at the self-regulatory factors and net benefit. In terms of net benefit, the implications of the types of things advanced about good cause, or whatever other rights of renewal, are that you will create considerable uncertainty, you will retrospectively reprice contracts. That will be the effect. We say it is already happening. Just the mere thought that it may happen is a factor in why we cannot reach agreement with Competitive Foods on our offer.

Senator BOYCE—I would like to talk about that a bit more in a minute. I want to go back and tease something out a bit further. You appear to be saying that there is very little difference in the power between the franchisor and the franchisee in these relationships. We have heard the example of software licences and patents. We were even talking about marriage earlier. I do not know if we want to take that to its final conclusion, because when a marriage breaks down I do not think the assets get split up quite the way they do when one of your contracts finishes. I have a lot of trouble with this idea that there is an equality of power between the two. I am not commenting upon whether this is a good thing or a bad thing. But it is very hard to accept the idea that there is power equality.

Mr Bryden—The proposition we are advancing was not that there is absolute equality. That depends entirely on the franchise system. If you were, for instance, to have one very large franchisor with many small franchisees, there could well be a clear imbalance. The point we are making is that in a mature franchise system like ours there is much evidence that what evolves is a system of power sharing. We know for a fact—

Senator BOYCE—What would your smallest franchisee be?

Mr Bryden—A single-unit franchisee.

Senator BOYCE—So you do have single units?

Mr Bryden—Absolutely. We have two systems. We have the KFC system, where we have some small, single units, then up to four, five and six. Then we have some very large corporate franchisees. Our Collins group in Queensland would be an example, as would Competitive Foods. There are a range of franchisees. Conversely, our Pizza Hut business is almost entirely single-unit franchises. The point I am seeking to make is that you look at the contract and if you were not aware of our system, which is what we are confident to speak about, you would say 'Wow, this puts a lot of power in the hands of the franchisor.' I agree with that. The reason it does so, and the reason that has been reviewed and supported by economic analysis, is to ensure consistency and uniformity and to prevent a single franchisee acting against the interests of the mob, if you like. So we get that.

What emerges is a power-sharing arrangement. For instance, the advertising cooperative fund was set up voluntarily by us. There is equal balance and representation between the franchisor and franchisees about how that advertising fund is used. That replicates itself over a lot of different types of—

Senator BOYCE—That is a group of franchisees telling you in some cases—

Mr Bryden—Correct. We agree. We debate and they tell us—

Senator BOYCE—how to spend the advertising budget?

Mr Baladi—That is exactly it. It is all aligned with them.

Mr Bryden—The relevance of the point and why we raise it is to say that that is consistent with the balance of power. That is all we are saying. We are not saying it is always equal and it is not necessarily equal for all things in our system. There are some areas where we have very considerable power.

CHAIR—You said before it would create uncertainty in the system. You said it is already happening now. There is no evidence of that at all. If you are going to tell me there is then that completely flies in the face of every other bit of evidence, including your own which says that franchising has been super successful and it is continuing to grow and is doing really well. What uncertainty are we talking about? What does it relate to?

Mr Bryden—The specific issue with Competitive Foods.

Mr Baladi—We have lost a lot of share in Western Australia.

CHAIR—Because of us, the committee?

Mr Baladi—No. We are saying the fact we have issued the termination and Competitive Foods has decided to take this to the last, last minute has created tremendous uncertainty in the business. They have not reinvested in the assets and they have not invested in new assets at a time when the Western Australian economy has been booming.

CHAIR—It is just uncertainty in terms of yourselves, not the sector?

Senator BOYCE—I thought you were saying for the whole sector contracts are being written differently.

Mr Bryden—Not the whole sector. This is specific to the issue we had with Competitive Foods. We have been told by them that in considering our latest offer they will need to consider the outcomes of this inquiry. That is what we say about creating uncertainty. It is creating uncertainty in this circumstance.

Senator BOYCE—I got the sense that it was happening across the sector.

Mr Bryden—Sorry. If you did, I am sorry.

CHAIR—That is the impression I got as well. It is just in terms of what you are doing, it is not sector-wide?

Mr Bryden—Not yet.

Senator BOYCE—Do you want to expand on that?

Mr Bryden—No, hopefully not.

CHAIR—If you have evidence—

Mr Bryden—We do not have any other evidence at this point.

CHAIR—I did not think so. A lot of claims are made in terms of this will affect that. We actually do not have any evidence of that. Even dispute resolution and the figures from the OMA are meaningless in the end because they do not reflect upon anything to do with the level of disputation or what disputes are about, the manner in which they were settled, or whether there was any agreement on settlement or anything else. They are just numbers and really do not point to anything. When we asked the department specifically, it could not tell us. Unless you have more information than the Department of Innovation—

Mr Bryden—We are not saying that. But I think that our point would be that we are entitled to talk about our system.

CHAIR—Absolutely. You have this issue with good faith in the sense that you do not want it in the code.

Mr Bryden—That is not our position.

CHAIR—It is not?

Mr Bryden—No. We said we are happy to have it in our oral submission and in our written submissions. We are happy to debate it. Frankly, given the Commonwealth's position, no-one is 100 per cent sure. There could be a point there. The other point we have made is that we are not at all against what can be reasonably and equitably done to assist and to prevent the Competitive Foods-type situation happening. That was the importance of the points. We have just said—

CHAIR—Just so we have it on the record, you are clearly saying that you do not have an issue with good faith being in the code?

Mr Bryden—That is fine.

Mr Baladi—We would say that it has to be in good faith. We are saying that whatever good faith is, it is something we would be comfortable with. We are totally against good cause and goodwill, but we are not against good faith. We are happy to participate with whatever industrial body and so on—

CHAIR—You are saying you are against goodwill and good cause. If you are against good cause, do you not believe that you have good cause in terms of the expiration or termination? Would you not just say you have good cause and here is it, we do not have a problem with good cause? But you say—

Mr Bryden—If that is the form it takes. The devil is in the detail, so to speak. It is difficult for us to comment because the concept of good faith is broad. A specific set of submissions has been put around good cause. We would say of that specific recommendation that it would have retrospective effect and it would reprice contracts. Good cause is not just about the termination of contracts. If it was made clear by the committee in its recommendations that whatever happens the parties have the right ultimately to rely upon the length of contract, if there was some notice period before that and some discussion, we would not have a problem. But the proposition is more than that. I can see your frustration.

CHAIR—The hour is slipping away from us very fast. I would like to explore with you what you said earlier about in the end when one store closes down and the custom is redistributed. Obviously it is a very strong, powerful brand and people do not particularly care whether they are buying their product from franchisee Joe Bloggs. So it does not really matter who your franchisee is really.

Mr Bryden—In our system?

CHAIR—As long as they are a good quality franchisee, the turnover is right and they are meeting the requirements—

Mr Baladi—Sure, if the services are right and the food is correct—

CHAIR—As long as they are meeting their obligations to you and they are not in breach, they are doing the right thing, then it really does not matter whether it is Joe Bloggs or Josephine Bloggs.

Mr Baladi—The customer does not know.

CHAIR—I agree with you completely. The customer does not know when they walk in the door.

Mr Baladi—You would be very surprised in Western Australia. You visit the stores and you feel like it is any store across the country with the KFC uniforms. They have exactly the same training manuals.

CHAIR—It is well understood. I do not have an issue with it. But—

Mr Bryden—There is a punch line.

CHAIR—What difference does it make whether it is CFL, BFL or EFL, or any other person who owns the franchise, as long as they are meeting all the requirements and providing you with a strong, steady, long-term income stream? I want to know what difference it makes.

Mr Baladi—It is all about trust. When you sit across the table and you say, 'Okay, we are going to invest $15 million over the next five years', we want to be able to shake the hand of this franchisee and know that he is going to do his side of the bargain.

CHAIR—If it is all about trust, why do we have a contract?

Mr Baladi—The relationship is about trust. If trust breaks down, you do not want to stay in business with that person.

CHAIR—That is the difficulty we all face. At the end of the day, everybody goes back to the contract. This is what has been presented to us by franchisors, by the way. In the end, good faith is fine, because it is implied in the Trade Practices Act. What is wrong with having it in the code of conduct? If there is a breach of good faith, they say, 'Show me where it is in writing.' It is the same sort of thing. I do not disagree with the trust point. If it is all about trust, when it breaks down you go back to the contract. If you have not breached the contract, you have actually done everything right, whose trust is breached?

Mr Bryden—I will try to answer very quickly.

CHAIR—We will give you more time.

Mr Bryden—You are focusing on the franchising relationship being that they comply with our system in that store and provide us with a return. Because of the size of this particular franchisee—

CHAIR—I will rephrase it. I am trying to establish at what point can someone just make an arbitrary decision that is not in the normal course of events—it is certainly not in your normal course of events because it was the first one in 40 years—that you do not like somebody's haircut—

Mr Bryden—The question would be why it would possibly be in our interests to do that. It is not.

CHAIR—Because you do not like them anymore. It happens every day in the industrial world.

Mr Bryden—If we did that—

CHAIR—I am talking about a breakdown in trust or in the relationship—which might be between personality A and personality B—that has no impact or bearing on the viability, success, profitability or otherwise, or anything else. It could be an employer/employee-type situation—not that it is the same—where you just turn up to work one day and they say, 'Look, Mr Bryden, I really do not like your haircut. You have your marching orders, get out.' That is unfair.

Mr Bryden—We do not have that right and we would not operate on that basis. If we did we would find it impossible to attract any franchisees.

CHAIR—I am not saying that in the course of general business you do, because this is a rare situation. I am talking about if it were to occur, even as a one-off. This is not common in your system, but it may be common in other areas. I am trying to find an efficient way to deal with these issues that are on the table.

Mr Bryden—Perhaps that is the point. We are at cross-purposes. We talk about our system and we say this is unique. We clearly understand that regulation does not regulate unique things; it regulates the rule. That is our point.

CHAIR—Unless you have anything further—

Mr Bryden—We have nothing further to say. We thank you for giving us time, particularly on a Friday.

CHAIR—Thank you.

Mr Bryden—We appreciate the opportunity to debate. We look forward to participating further.

Mr Baladi—Are you going to be producing a report at any time?

CHAIR—We are in the process of deliberations and public hearings. We have taken a bit over 150 public submissions. That is quite substantial. We go through this process and the committee deliberates and writes a report making recommendations to the parliament. That report is tabled as a public document. That will be done on 1 December, at which point it will be available to everybody.

Mr Bryden—We will look forward to it.

CHAIR—Thank you.

[2.34 pm]

RAMM, Mr Paul Damien, Manager, Retail Channel, Australia Post

STAUNTON, Mr Scott James, Deputy General Counsel, Legal Services Group, Australia Post

CHAIR—Welcome. Would you like to make a brief opening statement?

Mr Ramm—Australia Post thanks the committee for its invitation to appear at today's public hearing. Australia Post hopes that its experience and comments will assist the committee in its deliberations and findings. By way of background, Australia Post is a government business enterprise that is required to operate on commercial lines and to meet certain regulatory requirements. As at 30 June 2008, our retail network consisted of 4,453 outlets, of that 831 are corporately opened, 2,950 are licensed post offices, and 27 are what we call franchise outlets.

Senator BOYCE—Was that 27?

Mr Ramm—Yes. There are also 645 community postal agents. Broadly speaking, these numbers have not significantly altered over recent years, except that franchised outlets have grown since 2006. This is largely as a consequence of conversion of outlets previously operated as corporate offices. For the purposes of this inquiry, I note that both the licensed and franchised outlets are covered by the franchising code of conduct. This equates to around 3,000 of our outlets in total. Unlike other franchisors, it is regulated that Australia Post meets certain community service obligations to provide access to postal services to all Australians. This we achieve through our retail network.

Under these obligations, Australia Post is required to maintain at least 4,000 access points nationally, and at least 2,500 of these in rural and remote areas. Maintaining this number of outlets can prove challenging, particularly in areas where markets are insufficient to sustain a viable standalone postal business. To overcome some of these issues, Australia Post provides top-up payments and/or minimum payment levels to a number of licensees in rural and remote areas.

Our licensed post office model was introduced in 1993 to replace post office agents. Licensees are agents of our services and independent resellers of our products. Licences are granted in perpetuity, with the underlying host business being bought and sold on the open market. Around 300 to 400 of these change hands each year. Business incomes for licensed post offices vary widely depending upon location and the nature and extent of any conjunctional business. In this regard, it should be noted that over half of our licensed post offices operate in conjunction with other businesses, such as newsagencies or general stores. This method of operation has proven successful in providing a flexible model and ensures that the underlying business remains viable.

More recently Australia Post has developed a franchise model to operate alongside licensed post offices and our Australia Post corporate outlets. The franchise outlet is essentially a turnkey operation with Australia Post being responsible for the head lease, shop fitout and inventory.

Franchised outlets are required to and can only sell the full range of Australia Post products and services. Franchises are granted for a 10-year period with the licence reverting back to Australia Post at the end of that term. Franchisees pay an entry fee based on business levels for a particular site and receive an exit fee based on a predetermined formula at the end of the term. There are no territories allocated to either licensed post offices or franchised outlets.

As regards the inquiry's terms of reference, Australia Post would like to offer the following broad comments. I refer first to the nature of the industry, including the rights of both franchisors and franchisees. In terms of the franchising industry, the preceding comments provide a snapshot of Australia Post's experience and we are happy to provide further details to the committee if it wishes. Australia Post believes that the rights and interests of both franchisor and franchisee are evenly balanced and protected in the Australia Post network.

Licensed post offices have been in existence for 15 years, and they continue to be keenly sought after businesses commanding a premium in the marketplace. On average, licensees stay with us for about six years and our level of disputation is very low—well under one per cent for formal hearings in any one year. This indicates to us that licensees are also largely comfortable that their rights are protected. It is still early days for our franchise outlets, with the first outlets established in late 2006. Anecdotally, franchisees express enthusiasm for the model and there have been no disputes to date.

Point 2 states that obligations for franchisors, franchisees and prospective franchisees to act in good faith should explicitly be incorporated in the code. Australia Post does not believe that the interests of the franchisees would be materially advanced by the introduction of a separate legislative obligation to act in good faith. In this regard, Australia Post has noted and shares the view expressed in several written submissions already delivered to the committee, notably the Australian Competition and Consumer Commission, that it is not necessary to alter the code in this manner.

Point 3 relates to interaction between the code and part 4A and part 5(1) et cetera. It is well understood in the franchising sector that there are several provisions of the Trade Practices Act that provide penalties and sanctions for unfair conduct in franchising transactions. In particular, the franchising code of conduct is itself a mandatory industry code and part 4B of the act.

Section 51AC of the TPA, which deals with unconscionable conduct in business transactions, specifically states that one of the matters to be taken into account in determining whether a corporation has acted unconscionably is whether there has been adherence to the requirements of any applicable industry code. Australia Post takes the view that, when looked at globally, the provisions of the TPA provide a real and tangible measure of protection for franchisees against unfair practices. Australia Post is not aware of any demonstrated need for these provisions to be changed.

Part 4 deals with the dispute resolution process. Australia Post has operated an internal dispute resolution process since the introduction of our licence arrangements in 1993. Our experience in this area shows a very low number of disputes that are not resolved in the early informal stages, with less than one per cent of licensees requiring a dispute negotiation at what we call our state dispute resolution committee in any one year. For franchisees the disputes process is as prescribed in the code. As I have said, to date we have had no disputes.

Australia Post does not have any suggestions to improve part 4 of the code. However, we are open to any improvements that the committee may identify. Finally, with regard to any other related matters, Australia Post has not identified any other issues that it feels necessary to bring to the attention of the committee. We thank you and welcome any questions.

CHAIR—Thank you very much, Mr Ramm and Mr Staunton. I suppose Australia Post is in a unique position as Australia's largest franchise system. It is also probably the most regulated outside of the Trade Practices Act and the code of conduct in terms of what is required of universal obligation delivery.

Senator BOYCE—Could it be the only government business enterprise with this business model?

Mr Ramm—We understand that is the case.

CHAIR—You are in a unique position. While I expected that you would have very low levels of disputation and run a very good operation, it seems to me, and you are telling me, that pretty much everybody succeeds or has successful outlets, and that the levels of disputation are exceptionally low. Can you explain how low they are and how good the system is?

Mr Ramm—You are talking about a state resolution dispute resolution committee, which is the formal area. You will always have the discussions at the area and outlet level.

Senator BOYCE—Do you copy data on that?

Mr Ramm—We generally do not, because normally that discussion is held across the table with the franchisee saying, 'I think I should get this particular benefit.'

CHAIR—Can you explain why you think you are different, as a system, and what would produce such a successful outcome, such a low level of disputation and generally such a good system? What do you do that makes it work so well?

Mr Ramm—Good question. Maybe we are a bit close to it. We have been at it for quite some time. As I said, we have had post office agents for quite a long time. That particular type of operation has settled in. We reviewed it in the late 1980s and introduced a new model in the early 1990s. The 15 years of experience in remodelling it, reworking it and settling it down and for people to understand how we operate, is possibly the answer.

CHAIR—What is the core principle you apply? How do you approach the day-to-day business?

Mr Ramm—We try to work along the lines of equality, calling these people our business partners. It is a difficult task with a large corporation such as Australia Post because individual small businesses all have their own ways of thinking about how they do things. But that is typically how we try to do it. We try to resolve issues in an appropriate manner without getting into the legalistic part of it.

CHAIR—Do you set a fairly high bar or standard in terms of who you allow to take up an Australia Post franchise?

Mr Ramm—In the franchise model, yes. That is the new model.

Senator BOYCE—How do you do that?

Mr Ramm—We control the full selection process. With the licence model, with the vast majority of our outlets we often get the purchaser of the business. We do not get involved in the purchase process or receive any benefit from that. The outgoing licensee will decide when they want to leave the business. It will go through a broking process and there will be a vendor/purchaser arrangement. The purchaser will then be presented to Australia Post and we will vet that particular purchaser.

Senator BOYCE—That is for a licence?

Mr Ramm—Yes, that is for a licence. Our recruitment process from that perspective is not necessarily that we find the best person. It is probably about our training and systems or processes that we manage the business from then on that allows that business to operate.

CHAIR—How important is the concept of your system of franchising and licensing in perpetuity to the success of the overall model?

Mr Ramm—Listening to today, I think it probably assists. There is always equity in the business for the licensee. Our licence does not actually recognise, and we do not recognise, value, but we know the underlying businesses sell and they sell quite well. I think that means that the licensees always know that they have value in the business and at the end of the term they will always get that value.

Senator BOYCE—What happens if the licensed business does not make a profit?

Mr Ramm—It is a bit difficult for it not to happen. It depends on the location. You might remember that I said that about half of our outlets operate within a conjunctional model. At some point a standalone business will not work, but conjunctional models generally do. In terms of becoming unprofitable, we have very few that go—

Senator BOYCE—If I were a licensee with my perpetual licence and I am not making a profit, what do I do?

Mr Ramm—You would either walk away, which we have had happened in a small number of cases, you would represent back or you would sell.

Senator BOYCE—When you say 'represent back', is that coming back to Australia Post?

Mr Ramm—You would come back and say, 'I cannot go on. Would you like to purchase?' I do not think we have bought one back in my lifetime. There is the option there, but generally they will sell the business or they will walk away. The walk-aways are in very small places. That

is at the nether regions of our network where there are very small markets. That is our difficulty in maintaining those outlets.

Senator BOYCE—I notice you talked about a 10-year licence.

Mr Ramm—For the franchise?

Senator BOYCE—Do they have renewal options?

Mr Ramm—There is no renewal option in the franchise model. That is explicit up front.

Mr Staunton—Just to make a correction, there is no automatic right of renewal. We have not yet got to the end of a 10-year term under our more recent franchise post-shop model. But our anticipation is that renewal may be open but it is not guaranteed.

Senator BOYCE—But you must have a business plan around that.

Mr Ramm—Our intention would be—

Senator BOYCE—Would it be to renew the good ones?

Mr Ramm—You would have heard from most people that good franchisees are very good to keep. No doubt that would be our default position.

Senator BOYCE—What about your plan to expand the franchise business?

Mr Ramm—At this stage we have 27 on the ground. In our first phase we had 31 that were going to be put on the ground. We are going to take a breath and see how that goes, because we have enough on the ground to see how that operates. We will get them bedded in and then work through how far we would extend the model.

CHAIR—You obviously have a fixed term in your contracts, but with an expectation on the part of both the franchisor or franchisee that the renewal is available. You have talked about perpetuity and default positions to renew. Do you specify the process to make it clear in your contracts what will happen in different circumstances?

Mr Ramm—Just to get it clear—

CHAIR—If somebody wanted to walk away, or not to renew or sell—

Mr Ramm—We are talking about two contracts. The large majority, which is our licences, are the best to talk about.

CHAIR—Yes.

Mr Ramm—That is the licence in perpetuity. Unless you are terminated for a breach or whatever it might be, you have the ability to on sell the underlying business. That is well known

and well understood. The terms of breaches and terminations are articulated in the contracts as well.

CHAIR—So it is quite reasonable to expect that under your model people may have a franchise system for 40 years or more?

Mr Ramm—Yes.

CHAIR—Or a happy medium.

Mr Ramm—We were just trying to work out when that might be, because we changed the model in 1993. At that time we paid some top-up fees for people to bring them over. We know we are still paying top-up fees. We know that we have had people for at least 15 years.

CHAIR—Do you expect people like in other franchise systems to reinvest in the business to ensure it is at a certain standard, that your requirements are met and so forth?

Mr Ramm—The investment would necessarily be in the shop, the fitout and the like. We do it ourselves so we know there is a requirement to get a return on that.

Senator BOYCE—That is what you are referring to when you talk about the turnkey operation. That is only for franchisees.

Mr Ramm—Franchise and turnkey arrangements are a different set-up altogether.

CHAIR—The issue of good faith has been discussed at length. Do you have it in your contracts? Do you have a clause saying that parties will act in good faith?

Mr Staunton—We have a specific reference to good faith in what we call a preliminary agreement in the franchise post-shop model, which is the more recent one, where we have 27 contracts on foot at the moment. It is not mentioned in the licensed post office agreement.

Senator BOYCE—So the preliminary agreement is an in-principle heads of agreement or something?

Mr Staunton—It is a bit stronger than that. In effect, it is the initial contractual obligation after each party has gone through the preliminaries and there is a real commitment to go further.

CHAIR—And the going further requires what sort of contract?

Mr Staunton—The franchise agreement.

CHAIR—So it is a franchise agreement, but in itself it does not contain a good faith clause?

Mr Staunton—No, it does not; it is not explicitly stated.

CHAIR—Is it implied in any particular way?

Mr Staunton—We believe it is. There are obligations stated, and this applies to the larger body of licensed post office agreements as well as to franchise agreements. There are obligations on each party to use their best efforts to maximise the sales of products and services for mutual benefit and similar clauses. But the words 'good faith' do not appear.

CHAIR—But, if it were applied through that, would you have an objection to something as simple as 'the parties shall act in good faith towards each other'?

Mr Ramm—I would not have thought so.

Mr Staunton—No, I would not have thought so. Indeed, our understanding is that that is the position now that both parties should adopt. My understanding, but it is not shared by everybody, is that it is fairly clear that at least in contracts of this nature the court will always strive to imply that term in any event.

CHAIR—Do you believe that if that principle were codified, or explicitly written into the code of conduct, it would materially change current contracts, for example, yours which does not mention 'good faith'?

Mr Staunton—I am not sure it would. I do not think we would have any objection to it being there. But I must confess, without seeing how it is defined and then implemented, I am not sure whether it would materially affect the relationship.

Senator BOYCE—You talked about having 'in good faith' in preliminary agreement. In what context—negotiating in good faith, acting in good faith, or what?

Mr Ramm—It is explicitly saying that Australia Post will act in good faith. It is not looking for reciprocals.

Senator BOYCE—We have had evidence suggesting that having a publicly available website with the full gamut of standard franchising agreements and also registered agreements available for people to compare what they are being offered with what someone else might be being offered, but also to compare across the sector, could be a useful part of educating people about better due diligence. Would you have objections to such a website? Do you have any comments?

Mr Staunton—My reaction, having heard that today for the first time, is that I think we would need some time to think about it. I believe there could well be some commercial material in the agreements which we and other franchisors would not want publicly presented. I thought I heard the proposition earlier today actually extending to disclosure documents as well. I would have slightly heightened concern about some commercial information in those documents. Perhaps I should just leave it at that rather than go into solution mode. It is potentially difficult in relation to confidential or commercial information about the models in question.

Senator BOYCE—Do you see a way in which any useful information could be presented if you were to remove what you see as the confidential information? There is very little point in having a standard contract there if every 37th word is blacked out.

Mr Staunton—Perhaps the information could be put up in a non-attributed way. In other words, to say that X number of franchisors have the following termination provisions and the others do not, or information of that nature without actually saying which are which. At least people would then arguably have the ability to say that the majority of them deal with the issue in this way, why does mine not?

CHAIR—I refer again to the end of the contract or the end of the term. Yours has the principle of perpetuity and the default position is to renew. I asked this question before, but maybe in a slightly different way. Does your agreement say what may happen? Is it a drop-dead clause? Is it that it could be just an expiry and everyone just walks away, or is it written in that something will happen at the expiry, that it is not just a drop-dead clause?

Mr Ramm—In franchise contracts?

CHAIR—Yes.

Mr Ramm—It is quite clear up front that it is for a 10-year term. It is also quite clear that an exit payment is paid to the franchisee.

CHAIR—That is a payment made in terms of exiting.

Senator BOYCE—That is what I was going to ask.

Mr Ramm—The payment is made based on a predetermined formula that is worked out on year 10. If the franchise grows, then the franchisee will participate in any growth in the business and vice versa.

Senator BOYCE—And I know that when I sign?

Mr Ramm—Yes, you know that when you sign.

CHAIR—So the expectation is that if for whatever reason at the end of the 10 years the two parties part ways there is a stipulated formula that recognises the value in the business. You could call that goodwill; you could call it whatever you like. But it is the market value.

Mr Ramm—We call it an exit payment.

Senator BOYCE—On purpose.

Mr Ramm—Yes.

CHAIR—Of course, that is why you would call it an exit payment!

Mr Staunton—It goes a little further than that because that is not the process that applies only at the end of 10 years. It applies at any time during the term should there be an end to the arrangement for any reason.

CHAIR—In effect, you recognise that mutual dependency and building up of the business. It is not just about the brand, in the end you still need people who are prepared to invest their time, capital and effort?

Mr Ramm—Yes.

CHAIR—You actually just write it down as a formula. Does the formula work?

Mr Ramm—We believe it will.

CHAIR—You expect the formula would work if you ever needed to use it.

Mr Ramm—Yes.

Senator BOYCE—As you know, some of the issues are around if goodwill was paid at the end then there would be far higher licence fees at the beginning and the like. Could you talk about some of the principles underlying how you got to the formula that you use for your entry and exit fees?

Mr Ramm—I will take that one.

Mr Staunton—I was hoping you would.

Mr Ramm—The model has been built on a specific return to the franchisee. The franchisee will pay an amount that we will calculate based on the volumes at that particular site.

Senator BOYCE—Are these new sites?

Mr Ramm—They can be. Typically they are conversions. New sites are obviously more difficult because we have no history. That amount is paid. There is a cash flow for the franchisee throughout the 10 years, which is also calculated based on a particular return. The exit payment is also calculated so that the franchisee will get an appropriate amount on their up-front investment plus their investment through the term of the 10 years. It is a reasonably conservative one because we say it is a less risky business. But it is exposed and explained and people understand it when they come in. I cannot tell you what the formula is; it is convoluted.

Senator BOYCE—No, I was not expecting you to tell me what the formula is.

CHAIR—Am I right in saying that yours would be the most regulated of any system in the market? I have evidence that yours is the largest franchisor system in Australia and it would be the most regulated, with more obligations?

Senator BOYCE—But you are not the largest franchisor in Australia, just the largest enterprise involved in franchising.

Mr Ramm—I believe we have the most number of outlets.

Mr Staunton—In terms of number of outlets, yes.

CHAIR—Given the number of outlets, it is the largest franchise system in Australia.

Mr Staunton—Yes, a shade under 3,000 are covered by the franchising code. In numerical terms it is certainly the largest.

CHAIR—Separate units?

Mr Staunton—Yes.

CHAIR—Are you in a different position from other franchise systems in terms of your profit motive or your capacity to make a profit? Does it change for you compared to everyone else out in the market place?

Mr Ramm—We cannot speak for others. Because of who we are—a government business enterprise—because we are regulated and because we have to have outlets across the nation, we certainly have an eye on how we service our community as well. So it is a balanced argument.

CHAIR—But, at the end of the day, your core principle is still to make a profit.

Mr Staunton—We are obliged to act commercially under our act.

Senator BOYCE—To make the maximum profit?

Mr Staunton—That is not specified, no.

CHAIR—But there are still commercial principles?

Mr Ramm—Yes.

CHAIR—You are having to make money?

Mr Staunton—Yes.

CHAIR—I am not saying there is anything wrong with it. I am just establishing the fact. Ostensibly, you are in no different position from any other franchise system that goes out there under the regulatory framework with the primary motivation that in the end you are in a business and it needs to make money.

Mr Ramm—No, I think from our perspective, I still say that we—

CHAIR—So you have an added layer of complexity.

Mr Ramm—Of our outlets, 2,500 have to be located in the rural and remote areas of Australia. This is regulated; we have to do that. The added complexity of that is that 85 per cent of the residences have to be within 7.5 kilometres of those facilities.

CHAIR—But none of that then prevents you from being able to operate commercially?

Mr Ramm—Absolutely not.

CHAIR—And it does not prevent you from making a profit. It does not prevent your system for failing, and it does not prevent your operations from actually being a success?

Mr Ramm—No.

Senator BOYCE—Do you think that the fact that you are a monopoly provider of some of these services could be relevant to that model?

Mr Ramm—Certainly, that part is relevant to our community service obligation. It is part of the equation that we have to be out in those areas. Lots of our profit now comes from other parts of our business, which is open to full competition.

Senator BOYCE—Such as the courier-type businesses.

Mr Ramm—Parcel services, couriers and front-of-house products.

CHAIR—Mr Ramm and Mr Staunton, I thank you very much for your contribution. We really appreciate your submission and the evidence you have given us here today.

Committee adjourned at 3.03 pm