**EXPLANATORY STATEMENT**

**SELECT LEGISLATIVE INSTRUMENT NO. 169, 2014**

**Issued by the authority of the Minister for Small Business**

*Competition and Consumer Act 2010*

*Competition and Consumer (Industry Codes—Franchising) Repeal Regulation 2014*

Section 172 of the *Competition and Consumer Act 2010* (the CCA) provides, in part, that the Governor-General may make regulations, not inconsistent with the CCA, prescribing matters required or permitted by the CCA to be prescribed, or are necessary or convenient to be prescribed for carrying out or giving effect to the CCA.

Section 51AE of the CCA allows the Government to prescribe an industry code to regulate the conduct of participants in an industry towards other participants in the industry. Under the CCA, being bound by a prescribed industry code may be on either a mandatory or a voluntary basis.

**Purpose**

The object of the CCA is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.[[1]](#footnote-1) One way it does this is by providing for the establishment of industry codes. An industry code is defined as:

…a code regulating the conduct of participants in an industry towards other participants in the industry or towards consumers in the industry.[[2]](#footnote-2)

Industry codes are

…co-regulatory measures, designed to achieve minimum standards of conduct in an industry where there is an identifiable problem to address. Industry codes can be used as an alternative to primary legislation in instances where a market failure has been identified.[[3]](#footnote-3)

The *Trade Practices (Industry Codes—Franchising) Regulations 1998* established the Franchising Code of Conduct (the 1998 Franchising Code), a mandatory industry code.

The purpose of the *Competition and Consumer (Industry Codes—Franchising) Repeal Regulation 2014* (the Regulation) is to repeal the 1998 Franchising Code from 1 January 2015, which is when the Regulation commences. The Regulation also provides for the continuation of outstanding obligations that arose under the 1998 Franchising Code after 1 January 2015.

**Context**

An independent review by Mr Alan Wein (the Wein Review) was tasked with inquiring into the efficacy of amendments to the 1998 Franchising Code, as well as certain issues of particular importance to the franchising sector—good faith in franchising, the rights of franchisees at the end of the franchise agreements and the enforcement of the 1998 Franchising Code. The Wein Review reported on 30 April 2013. [[4]](#footnote-4)

On 2 April 2014, the Government released *The Future of Franchising*[[5]](#footnote-5) statement, which supported the majority of Mr Wein’s recommendations.

The Government has decided to introduce a new Franchising Code of Conduct, established under the *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*. This decision necessitates the repeal of the regulation that established the 1998 Franchising Code.

**Application**

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003* and commences on 1 January 2015.

**Details**

An overview of the Regulation is set out in Attachment A.

**Consultation**

There was extensive consultation with stakeholders during the Wein review and the subsequent drafting of the new Franchising Code of Conduct, which led to decision to repeal the 1998 Franchising Code.

* The Wein review received 73 formal submissions from a wide range of stakeholders including government bodies, academics, professional advisers, industry associations, and individual franchisors and franchisees, and Mr Wein held 25 face-to-face meetings with stakeholders across Australia.
* 169 responses were received from a range of stakeholders to a consultation paper released in June 2013 to elicit feedback on Mr Wein’s recommendations.
* 31 submissions were received from a cross-section of the franchising community in response to the exposure drafts of the new Franchising Code and the Competition and Consumer Amendment (Industry Code Penalties) Bill 2014 (later enacted as the *Competition and Consumer Amendment (Industry Code Penalties) Act 2014*), which were released for comment in April 2014.
* There has been targeted consultation with key industry stakeholders, on the likely impact of proposed changes to franchising regulation, following the release of the exposure drafts.

**REGULATION IMPACT STATEMENT**

**Policy objective**

The Regulation, by ensuring that only one industry code will apply to the franchising sector, has the effect of an overall reduction in red-tape for franchisors, franchisees and other persons involved in franchising.

This facilitates the Government’s policy objective of refining the 1998 Franchising Code to strengthen its effectiveness, improve its responsiveness to the sector’s unique commercial characteristics and to guard against additional state-based regulation.

A copy of the Regulation Impact Statement approved by the Office of Best Practice Regulation in relation to the Regulation is in Attachment B.

**ATTACHMENT A**

**Details of the *Competition and Consumer (Industry Codes—Franchising) Repeal Regulation 2014***

Section 1 ‑ Name

This section provides that the name of the Regulation is the *Competition and Consumer (Industry Codes—Franchising) Repeal Regulation 2014* (the Regulation).

Section 2 ‑ Commencement

This section provides for the Regulation to commence on 1 January 2015.

Section 3 ‑ Authority

This section specifies that the Regulation is made under the *Competition and Consumer Act 2010*.

Section 4 – Schedules

This section provides for the repeal of the instrument in Schedule 1 of the Regulation, and for other items in the Schedule to have effect according to its terms.

Schedule 1 – Amendments

Item 1 of Schedule 1 of the Regulation repeals the *Trade Practices (Industry Codes—Franchising) Regulations 1998* (the 1998 Franchising Code).

The repeal of the 1998 Franchising Code is necessary so that the new Franchising Code of Conduct established under the *Competition and Consumer (Industry Codes‑Franchising) Regulation 2014* can apply, as far as constitutionally allowable, in relation to ‘conduct occurring on or after 1 January 2015 … in relation to a franchise agreement entered into on or after 1 October 1998.’[[6]](#footnote-6)

Item 2 of Schedule 1 of the Regulation contains transitional provisions to ensure that obligations under the 1998 Franchising Code that remain outstanding after 1 January 2015 continue despite the repeal of that Code.

This is an important transitional provision that makes it clear that there is no civil penalty for non-compliance with an outstanding obligation that arose under the 1998 Franchising Code, where there is a comparable obligation under the new Franchising Code of Conduct. In this context an obligation includes an outstanding response to a request.

|  |
| --- |
| Example  On 10 December 2014, a franchisor, Tollbooth Toys, enters into a lease with Juster Village for a shop at Juster Village’s Pfeiffer Shopping Village, in anticipation of it entering into a franchise agreement with a franchisee. After signing the lease on 10 December 2014, Tollbooth Toys sends the lease to Juster Village’s head office for its signature.  On 15 December 2014, Tollbooth Toys enters into a franchise agreement with Milo Tock. Milo occupies the premises at Pfeiffer Shopping Village without a sublease from Tollbooth Toys.  Subclause 14(3) of the 1998 Franchising Code requires Tollbooth Toys to provide Milo Tock with a copy of the lease it has with Juster Village within one month of it being signed by both it and Juster Village. Aware of its obligations under the 1998 Franchising Code, before entering into the franchise agreement with Milo Tock, Tollbooth Toys makes inquiries with Juster Village about the lease. Juster Village advises Tollbooth Toys that it signed the lease on 14 December 2014 and will send it to Milo Tock as soon as possible.  However, Tollbooth Toys has still not received the signed lease by 15 January 2015.  Tollbooth Toys is in breach of subclause 14(3) of the 1998 Franchising Code, however, because of the operation of item 2 of Schedule 1 of the Regulation, this is an outstanding obligation that arose under the repealed 1998 Franchising Code.  Therefore, Tollbooth Toys would not be liable for a civil penalty under the new Franchising Code but will be liable for a breach of the 1998 Franchising Code. |

Item 3 of Schedule 1 of the Regulation provides that the repeal of the 1998 Franchising Code ‘does not affect any right, privilege or liability acquired, accrued or incurred under [the 1998 Franchising Code]’ before 1 January 2015.

The terms ‘right’, ‘privilege’ and ‘liability’ should be given as wide as possible an application.

**Statement of Compatibility with Human Rights**

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

***Competition and Consumer (Industry Codes‑Franchising) Repeal Regulation 2014***

The *Competition and Consumer (Industry Codes—Franchising) Repeal Regulation 2014* (the Regulation) is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

**Overview of the Legislative Instrument**

The Regulation repeals the 1998 Franchising Code, so that only one industry code will apply to the franchising sector.

**Human rights implications**

This Regulation does not engage any of the applicable rights or freedoms.

**Conclusion**

This Regulation is compatible with human rights as it does not raise any human rights issues.

**ATTACHMENT B**



**Regulation Impact Statement**

Proposed changes to franchising regulation

**March 2014**

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1. **Executive summary**

The franchising sector is primarily regulated by the *Competition and Consumer Act 2010* (CCA). The Franchising Code of Conduct (Franchising Code) is a mandatory industry code prescribed by regulation under the CCA. The Australian Competition and Consumer Commission (ACCC) is responsible for taking enforcement action under the CCA and/or the Franchising Code in appropriate cases.

Amendments to the Franchising Code and the CCA are prepared by the Office of Parliamentary Counsel (OPC) on instructions from the Treasury. Treasury advises the Minister for Small Business, who is primarily responsible for provisions of the CCA relating to industry codes, including the Franchising Code.

The purpose of this Regulation Impact Statement (RIS) is to inform the Australian Government’s decision with regard to amending the CCA and the Franchising Code to:

* Provide the ACCC with additional enforcement tools, to deter parties from breaching the Franchising Code and allow the ACCC more flexibility in pursuing breaches; and
* Implement the Government’s commitment to refine the Franchising Code, including by acting on recommendations made following an independent review conducted in early 2013, and pursuing other opportunities to reduce compliance costs and remove unnecessary regulation.

These amendments will have the effect of strengthening national franchising regulation.

This RIS provides a detailed analysis of the regulatory impacts of proposed changes that underpin the policy development process. It is the culmination of a multi‑stage consultation process which considered a range of policy options. This RIS is a single stage impact analysis and is intended to be read in conjunction with exposure drafts of legislation showing the detail of changes to:

* The CCA; and
* The Franchising Code.

These documents are included at **Attachments A** and **B** respectively.

1. **Background**
   1. **The Franchising Sector**

The franchising sector is an important component of Australia’s small business sector, with approximately 73 000 franchises and approximately 1180 franchisors in Australia, and an annual turnover in the order of $131 billion.[[7]](#footnote-7)

An important underpinning of the franchise sector is the relationship between franchisors and franchisees. The interdependent nature of a franchise arrangement makes it a unique business relationship. The success of a franchisor relies on that of a franchisee and vice versa.

A number of laws support participants in the franchising sector. In particular, the CCA includes a number of requirements aimed at promoting competition and fair dealing, and protecting consumers. Part IVB of the CCA provides an additional framework to promote fair dealing where there may be a need for additional measures to improve the functioning of an industry, for example, due to unequal bargaining power. Part IVB allows the Government to make industry codes which are legislative in nature and may be either voluntary or mandatory.

* 1. **The Franchising Code of Conduct**

To address particular concerns in the franchising industry, in 1998 the *Trade Practices (Industry Codes — Franchising) Regulations 1998* came into effect. These regulations prescribe the Franchising Code as a mandatory industry code of conduct under the CCA.

The purpose of the Franchising Code is ‘to regulate the conduct of participants in franchising towards other participants in franchising’.[[8]](#footnote-8) When the Franchising Code commenced in 1998, the Explanatory Statement stated that its objectives were to:

* ‘address the imbalance of power between franchisors and franchisees;
* raise the standards of conduct in the franchising sector without endangering the vitality and growth of franchising;
* reduce the cost of resolving disputes in the sector; and
* reduce the risk and generate growth in the sector by increasing the level of certainty for all participants.’[[9]](#footnote-9)

Broadly, it seeks to achieve this by prescribing certain rules with respect to the interaction between franchisors and franchisees, requiring franchisors to disclose specific information to franchisees to assist them in conducting due diligence prior to entering into a franchise agreement, and setting out a procedure for dispute resolution which can include invoking the assistance of a Government‑appointed mediation adviser.[[10]](#footnote-10)

The ACCC enforces compliance with the Franchising Code.

* 1. **Review of the Franchising Code**

During early 2013, an independent review of the Franchising Code was undertaken by Mr Alan Wein (the Review). The terms of reference for the review focused on 2008 and 2010 amendments to the Code, in addition to:

* good faith in franchising;
* the rights of franchisees at the end of the term of their franchise agreements; and
* provisions for enforcement of the code.

Mr Wein presented his report, *Review of the Franchising Code of Conduct* (the report) on 30 April 2013. The report was made publicly available on 17 May 2013 and can be accessed via the Department of Industry website.[[11]](#footnote-11)

Subsequent to the Review, small business policy officials, formerly in the then Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education and now located within the Treasury, have been engaged in ongoing consultation with the sector on the issues raised by the report recommendations. This consultation has been comprehensive and is outlined in further detail in part 6 of this RIS.

* 1. **Commitment to refine franchising regulation and reduce red tape**

The Government has committed to refine the Franchising Code with a view to strengthening its effectiveness, improving its responsiveness to the sector’s unique commercial characteristics and tensions, and guarding against additional state‑based regulation.

As part of this, the Government has said it is looking for opportunities to reduce red tape imposts, while improving knowledge about commercial expectations and risks, rights and responsibilities under agreements governed by the Franchising Code.[[12]](#footnote-12)

1. **What is the problem being solved?**

The Franchising Code has previously been identified as addressing a range of problems. Regular reviews of regulation such as the Franchising Code can reveal whether they are still addressing the problems they were originally brought in to address, and to identify whether new problems have emerged and warrant action.

In absolute terms, franchisees and franchisors total 74,180 businesses[[13]](#footnote-13), out of a total number of 2,016,800 businesses in operation in Australia.[[14]](#footnote-14) This means that franchise businesses account for 3.6 per cent of the Australian business community. The problems identified as requiring changes to the Franchising Code of Conduct examined in this RIS must be viewed in this context.

The Review made 18 recommendations for changes to the Code. Mr Wein noted that ‘the recommendations are not overly conservative, nor do they advocate an unduly interventionist approach from the government.’[[15]](#footnote-15)

It is not possible to identify the extent of the prevalence of any single problem within the franchising sector with certainty. However, statistics relating to the number of disputes and enquires to the ACCC support the belief that problems in the franchising sector are moderate to low. For example, in 2013, the ACCC received 595 complaints and 189 enquiries relating to franchising.[[16]](#footnote-16) Similarly, the Office of the Franchising Mediation Adviser reported 504 enquiries from 1 July 2012 to 30 June 2013. Some examples of these include:

* 60 related to exit;
* 50 related to misrepresentation/deception;
* 43 related to monies owed by franchisor;
* 40 related to termination/renewal; and
* 32 related to inadequate support.[[17]](#footnote-17)

These statistics show that while there are complaints and disputation in the franchising sector, they are not of a level that indicates a large problem. As Mr Wein observed, ‘We have a good franchise industry model in Australia and I have sought to improve upon that model with the recommendations put forward in this review. Generally, the Code operates effectively within a very dynamic and difficult economic environment. However, like most industries, there are changes that could be made to improve upon which is already a robust model.’[[18]](#footnote-18)

One problem which has emerged in prominence since the Franchising Code was introduced in 1998 is the problem of ‘red tape’ and the cumulative compliance burden which emerges because businesses are required to comply with such a wide range of laws.

Set out below is a discussion of this evolving problem and of the key problems the Franchising Code was introduced to address. Against these broader contexts, specific issues which have emerged in the franchising sector are identified.

* 1. **Red tape and unnecessary complexity in regulation**

The Franchising Code was first introduced in 1998. Since 1998 significant amounts of new regulation and law has been introduced. Often characterised as ’red tape’, this growth of regulation and law can be damaging and costly to business – particularly small businesses.

A recent inquiry by the Productivity Commission noted that small businesses feel the burden of regulation more strongly than other businesses, and that almost universally, their lack of staff, time and resources present challenges in understanding and fulfilling compliance obligations.[[19]](#footnote-19) Most franchisees are small businesses. A significant number of franchisors may also be classified as small businesses on the basis that they employ less than 20 people.[[20]](#footnote-20)

The Franchising Code is accepted by the sector as a necessary piece of regulation, the costs of which are outweighed by the benefits. It is also part of a regulatory environment including tax laws, occupational health and safety regulations and laws relating to intellectual property. The regulatory burden of the Franchising Code on the franchising sector should be viewed as part of a broader regulatory framework. Reviews of regulation such as the Franchising Code may identify areas which can be simplified or removed and it is important to act on such findings to ensure minimum effective regulation. With a total of 15 years’ experience with the Franchising Code (and a voluntary code before that), the sector is in a position to provide feedback on what works and what does not.

One of the major problems that has been identified in this respect is over‑disclosure in franchise systems with multiple tiers. In such systems, the Franchising Code currently requires all entities in the position of franchisor to provide disclosure to all entities in the position of franchisee – which is burdensome for franchisors and leads to franchisees receiving multiple, or very complex, disclosure documents. The result is that the important information required to be disclosed may not be prominent and could be overlooked among the large body of paperwork the franchisee receives. This over‑disclosure also exacerbates a problem identified during the Review – not all franchisees fully read or understand the disclosure documents. Given that there is very little benefit for franchisees in receiving multiple disclosure documents, this has been identified as an unjustified compliance cost. This is particularly the case for master and foreign franchisors that do not have a practice of regularly granting franchises in Australia, instead putting in place subfranchisors that enter into franchise agreements with subfranchisees.

* + To address this problem, it was recommended that the disclosure obligations be reduced to ensure that master and foreign franchisors are not subjected to unjustified disclosure burdens, and franchisees are not overwhelmed by information of only marginal relevance to their decision whether to enter into the franchised business.

Additionally, some parts of the Franchising Code have been identified as redundant. Redundant regulation which remains in force can cause confusion for participants in the sector. This can contribute to the regulatory burden.

* + Currently, the Franchising Code sets out two different formats for disclosure documents. The first is the commonly used ‘long‑form’ disclosure document. The second is a ‘short‑form’ disclosure document which is a truncated version of the long‑form disclosure document designed to be used in systems where the expected annual turnover for the franchised business is less than $50,000.[[21]](#footnote-21) The Review could not find any evidence that the ‘short-form’ disclosure document (Annexure 2 of the Code) is used in practice, and the sector felt that it was redundant.

Consultation following the Review has also identified other provisions of the Code where the regulatory burden does not appear to be justified by the benefit conferred on prospective franchisees.

* + The disclosure document requires franchisors to provide franchisees with a summary of certain provisions of the franchise agreement.[[22]](#footnote-22) The disclosure document is essentially summarising and cross referencing another document (the franchise agreement) that must be given in conjunction with the disclosure document. However, reading the disclosure document and its description of the franchise agreement should not be a replacement for reading, understanding and receiving advice in relation to the franchise agreement itself. Accordingly, in the context of concern about the growth and complexity of disclosure documents, this summary of provisions in the franchise agreement would appear to be an unnecessary aspect of disclosure.

Additionally, it has been noted that the policy intent of the Franchising Code is not always clear from the language used, and the uncertainty this produces can lead to increased legal costs, and inconsistency of practice among the industry.

* + To address this, it was recommended that the Franchising Code be amended to clarify the policy intent of its provisions and remove ambiguities, where necessary. It was also recommended that the requirements in relation to transfer and novation be clarified to reflect industry practice, which is that franchisees wishing to sell or transfer the franchised business to a new franchisee must provide franchisors with the information required under the franchise agreement to allow the franchisor to evaluate their request. There is a concern that franchisors might be deemed to have consented to a transfer or novation without sufficient information regarding the incoming franchisee in the absence of this amendment.

Another compliance problem identified with the Franchising Code is that it has been regularly amended since first being introduced in 1998. Since 1998, four rounds of amendments have been made to the Franchising Code (1999, 2001, 2007 and 2010). These amendments have typically responded to reviews, and there have been eight reviews at federal and state levels since 2006. While such reviews are necessary to identify whether the Franchising Code is working effectively, they can also be disruptive and costly as the sector’s participants incur one‑off costs in engaging with review processes and understanding the implications of subsequent legislative changes. This can contribute to the red tape and sense of compliance burden felt by industry, as well as a level of ‘review fatigue’, identified by stakeholders during the review.

* + The Review recommended a moratorium on further reviews of the Franchising Code for a period of five years from when the current review process is concluded and any subsequent legislative changes take effect.
  1. **Information asymmetries**

Franchisors possess a range of information that is relevant to franchisees in deciding whether or not to enter into an agreement to operate a franchised business. Some of this information may be positive and encourage prospective franchisees, however there is also likely to be information which may present the business in a negative light. Where the information is positive, there is an incentive for the franchisor to provide it to the franchisee because this will make the franchisee more likely to enter into the franchise agreement which will in turn create financial reward for the franchisor and help them grow their business. However, where the information is negative, the incentive for the franchisor to provide the information is reduced and in some circumstances they may withhold relevant information from the franchisee. This is particularly problematic where the information cannot be gathered independently by the franchisee.

This is known as ‘information asymmetry’ and it is a recognised type of market failure where one party (in this case the franchisor) knows more about the product than the other (in this case the franchisee). It is a problem because it may result in an inefficient pricing and allocation of resources – if franchisors can conceal negative information, they may be able to inflate the price at which they sell franchises since the true value will not be apparent to the prospective franchisee. For their part, franchisees may waste resources by purchasing franchise businesses that are not viable or not suited to them.

The Franchising Code already addresses this particular problem to a large extent. One of the main functions of the Franchising Code is to require franchisors to provide a ‘disclosure document’ to prospective franchisees. The disclosure document is required to contain a range of information which is relevant to the prospective franchisee’s decision regarding whether to enter into the franchise agreement, and which the franchisee may not otherwise have access to.

* + For example, low turnover in the ownership of franchised businesses in the system is a positive thing, and something the franchisor may voluntarily disclose to the franchisee. On the other hand, high levels of turnover within the system may not reflect well on the franchisor, the franchise system or the particular franchised business and would be unlikely to be voluntarily disclosed by the franchisor. As this is not something the franchisee can easily discover independently, it is appropriate for the law to respond to this market failure by requiring franchisors to provide information about franchisee turnover to prospective franchisees.[[23]](#footnote-23)

The Franchising Code also provides mechanisms for ongoing, or continuous, disclosure to be provided to franchisees, where it is important that the franchisee has access to particular information which is materially relevant to their relationship with the franchisor and the franchised business but was not available at the time the disclosure document was prepared. The failure to provide certain types of information to franchisees throughout the life of the franchise agreement can generate distrust. Further, transparency in relation to certain key information increases the incentives for the franchisor to operate the franchise system according to best practice and ensures franchisees are engaged and informed regarding the broader franchise system.

* + For example, franchisors are required to disclose to franchisees any change in majority ownership or control of the franchisor, and various types of legal proceedings against the franchisor such as civil proceedings commenced against the franchisor by a group of its franchisees. [[24]](#footnote-24) Franchisors are also required to provide basic information regarding the use of marketing and other cooperative funds to franchisees annually. This ensures the franchisor is accountable to the franchisee for monies collected from franchisees for a specific purpose.[[25]](#footnote-25)

The Review of the Franchising Code identified areas in which refinements can be made to address new or emerging problems caused by information asymmetry. The Review received evidence of concern and disputation within the sector based on a lack of information being available to franchisees. The fact that franchisees and their representatives raised this during the Review indicates the information is not always being voluntarily provided by franchisors.

* + It was recommended that there be further disclosure and transparency in relation to marketing funds. For example, the Review suggested that there needs to be additional disclosure around the types of expenses marketing funds are being used for, due to evidence that franchisors may be using these funds for expenses which are not traditionally considered to be ‘marketing’ expenses. The Review has also recommended improved audit requirements and that franchisors separate marketing funds from other monies of the franchisor.

Additionally, over time, there are changes in the economy and business environment which may mean that new types of information are relevant to franchisees which were not originally envisaged when the Franchising Code was introduced, or during previous reviews.

* + It was recommended that the Franchising Code be amended to require franchisors to disclose details of the respective rights of the franchisor and franchisee to conduct and benefit from online sales. Evidence was presented to the Review that in some cases franchisors are conducting sales online and in this sense are competing with their franchisee. This is relevant to a franchisee’s assessment of the viability of the business they are proposing to operate, and so it is problematic where the franchisee was not aware of this prior to entering into the franchise agreement. A change to the Franchising Code is proposed to address this problem by requiring the disclosure documents prepared by franchisors to include information about the respective rights of the franchisor and franchisee to conduct and benefit from online sales.

Franchisor failure was identified as part of the Review as an area where the information and rights of franchisees could be improved.

* The Review recommended measures to address the potential for inequitable outcomes between the parties in the event of franchisor failure or insolvency, which can often lead to the interests of the franchisee being compromised. It was recommended that the Franchising Code be amended to confer a specific right for the franchisor and franchisee to terminate the franchise agreement in the event of the other party’s insolvency. It was further recommended that the franchisee be given unsecured creditor status by allowing their franchise fees to be notionally apportioned across the term of the agreement instead of being paid up front.

Accordingly, information asymmetry and lack of transparency are ongoing problems in franchising. Although addressed largely by the existing provisions of the Franchising Code, evidence of those problems has been brought forward relating to gaps in current disclosure requirements relating to marketing funds and online sales. As discussed above, while the Franchising Code largely deals with information asymmetry through the provision of the disclosure document, the recommendations that were made deal with issues remaining in the franchising sector which result from the problem of information asymmetry.

* 1. **Inability to understand documents and lack of adequate due diligence**

During the Review, there was consistent evidence suggesting that franchisees do not read all the information presented to them in a disclosure document. This limits the ability of the disclosure document to facilitate due diligence so that the franchisee may make an informed decision about whether to enter into a franchise agreement. Further, despite the benefits of seeking professional advice as an important aspect of due diligence (e.g. from lawyers and accountants), there was evidence suggesting many franchisees do not obtain such advice before entering into a franchise agreement. Alternatively, even if they do obtain advice, they may not follow that advice.

The insights of behavioural economics are relevant in this respect and suggest that individuals do not always make decisions in their best interests based on all the information provided. Given a large number of franchisees operate as individuals or partnerships (such as a husband and wife team), these small businesses often make decisions in the same manner as individuals. This is sometimes termed ‘bounded rationality’, which is a concept that recognises that decision making is affected by the amount of time available to make a decision, and the limited capacity of the human mind to evaluate and process information that is available. Franchisees may not appreciate the relevance of information in a disclosure document until after they are operating the business.

Further, individuals may have a bias towards taking an optimistic view of the chances of success, particularly when this affirms the emotional and psychological commitment they have made to an opportunity. For example, even though they may have received professional advice suggesting they do not enter into the franchise agreement, they might be persuaded by other sources of information such as the franchisor to think *’it won’t happen to me – I am willing to work hard and that will mean I succeed’.*  There may also be other factors which persuade a prospective franchisee to conduct limited due diligence; for example, they may have been made redundant from their previous employment and be desperate to secure an income stream. This might cloud their judgment and ability to objectively evaluate a franchise opportunity.

Accordingly, one problem identified during the Review is the common failure of franchisees to conduct adequate due diligence and obtain and follow professional advice in order that they appreciate the risks involved in franchising – such as the risk of franchisor failure – and have realistic expectations prior to entering into a franchise agreement.

* + To encourage franchisees to conduct better due diligence, it was recommended that franchisees should be provided with a short, high level, generic statement which detailed some of the key risks of franchising and explained the benefits of a thorough approach to due diligence. This was recommended in preference to more burdensome options such as mandating professional advice or creating onerous obligations around education prior to entering into a franchise agreement. It was recommended that the summary should be provided to a franchisee before formal disclosure – at the earliest practicable opportunity when discussions between a franchisor and franchisee begin.

Information can also be a problem for franchisees whose franchise agreements are due to expire, and they are considering whether or not to seek to renew the franchise agreement so they can continue to operate the business. Franchisors are required to provide franchisees with formal disclosure at least 14 days before the renewal or extension of a franchise agreement. In reality, however, most franchisees will have already made up their mind at this point about whether or not to continue as a franchisee. Accordingly, evidence to the Review indicated a problem that franchisees may be making decisions regarding renewal without the benefits of disclosure.

* + To address this, it was recommended that disclosure to franchisees be provided at least six months before the actual need to renew the franchise agreement arises – at the same time the franchisor is required by other provisions in the Franchising Code to state whether the franchisor is willing to renew the franchise agreement.[[26]](#footnote-26)

Similar to the recommendations for changes to address information asymmetry, the concerns relating to franchisees not undertaking due diligence have largely been addressed through free education[[27]](#footnote-27), educational material developed by the ACCC and a requirement for franchisees to certify they have received legal advice. As such, the problem is relatively small. The recommendations discussed above deal with relatively minor issues remaining which can be caused by a lack of due diligence undertaken by a franchisee. To some extent, there will always be a minority of business operators who make poor decisions. The effect of a competitive market is that often these business operators will not be successful and their businesses will fail. This in itself is not market failure and there should be some reluctance to suggest that the failure of some franchisees based on poor decisions relating to due diligence and lack of business judgment reflects a ‘problem’ within the franchising sector. It is important to distinguish between the specific problem identified during the course of the Review, and this feature of any competitive market. That is, even if the recommendation, or any reasonable alternative, is adopted, failures or disappointments may continue to be experienced by some franchisees due to inadequate due diligence.

* 1. **Onerous contractual requirements**

Effective information disclosure alone may not be sufficient to address imbalances of bargaining power. In some cases, franchise contracts may be offered on a ‘take it or leave it’ basis, with no or minimal scope for negotiation of the terms of the agreement. In such cases, even if a franchisee is well advised and understands the agreement, they may lack the capacity to effectively advocate in their own interests. Although prospective franchisees have the option to not go ahead with the transaction, this may not be a realistic reaction, particularly if most franchisors are offering similar terms. Alternatively, if the problematic term is not one of the key terms such as the price or length of the agreement a franchisee may be less inclined to walk away from the deal.

Many commercial transactions contain some degree of imbalance of bargaining power. However, this can become a problem in a sector such as franchising where the stronger party may use this imbalance of bargaining power to the detriment of the efficient functioning of the sector by distorting incentives to manage risk, or extracting concessions which go beyond their reasonable business interests. Where this problem arises in franchising, the costs can be significant due to the long term relationship between a franchisor and franchisee.

Specific contractual terms that have been identified as problematic follow.

***Contractual terms relating to the end of the franchise relationship***

* + Imbalance of bargaining power is problematic in the context of end of term arrangements. Franchise agreements are generally offered as fixed term agreements and their average duration is 5 years.[[28]](#footnote-28) If the franchisee wishes to continue operating the business after its term expires, and the franchisor is satisfied with their performance, it is usual practice for franchisees to be offered a renewal of the franchise agreement, whether this was contemplated in the original agreement as a contractual right or not.[[29]](#footnote-29) If a franchise agreement is not renewed, franchisees are not usually offered any form of compensation or exit payment for the ‘goodwill’ they may have generated in the business. This is despite the fact that the franchisor may be able to sell the franchise at a higher price to a new franchisee because it is an established business and may have a positive reputation. Further, a franchisee is usually restrained by the franchise agreement from operating a similar business nearby for a period of time. These circumstances reflect the contractual bargain which the parties have struck.

However, problems can arise where the franchisee is effectively managing the franchised business and wishes to renew the franchisee agreement, but the franchisor wishes to end the relationship and enforce a restraint of trade. The commercial success of the franchise system benefits from strong incentives for the franchisee to invest in developing their expertise to run the business efficiently. In such circumstances, the franchisee is unable to benefit directly from the goodwill they have generated in the business by continuing to operate it or being compensated for it. They are also unable to benefit indirectly by drawing on the experiences and skills they have gained to operate a similar business. Accordingly, in this specific circumstance, clauses which restrain the franchisee from operating a similar business may be considered imbalanced. The restraint of the franchisee also limits the franchisor’s exposure to competition, and competition is an accepted driver of efficiency and innovation among businesses.

To address this, it was recommended that a restraint of trade clause should not be enforceable if certain, well defined conditions are met and the franchise agreement does not allow a franchisee to make a claim for compensation in the event that the franchise is not renewed.

***Imposition of unreasonable capital expenditure***

* + Another area in which imbalance of bargaining power has been identified to be a problem in franchising is in relation to franchisors requiring franchisees to incur significant capital expenditure. If a franchisee does not anticipate a large capital expense – such as an upgrade to a point of sale system or a refurbishment of retail premises – then this could have a significant impact on the expected income from the business. The Review also received evidence that, in some instances, the term of the franchise agreement did not give franchisees sufficient time to recoup capital expenditure.

For any business, it is essential to invest where it is productive and warranted by commercial considerations. However in a franchise relationship problems can arise if the franchise agreement provides the franchisor with a very broad discretion to require the franchisee to undertake capital expenditure, without guidance as to the amount, frequency, or purpose for which the expenditure might be required. This makes it very difficult for the franchisee, before entering into the franchise agreement, to assess the costs and likely benefits of operating the business. In deciding whether to undertake capital expenditure, an independent business would usually consider whether the costs of the expenditure outweighs the likely benefits by generating increased profits. As it is not the franchisor making the investment, it may not always be subject to the same considerations.

It was recommended that the Franchising Code be amended to prohibit franchisors from imposing unreasonable and significant capital expenditure where such expenditure was not explicitly disclosed prior to the franchisee entering into the business, and there is no business case for the franchisee incurring the expense.

***Dispute resolution***

* + Another area where onerous contractual terms and imbalance of bargaining power is problematic is dispute resolution. The Review identified two practices in the franchising sector relating to dispute resolution which are problematic.

The first is franchisors using the franchise agreement to require the franchisee to resolve any dispute in the state where the franchisor’s headquarters are based (even when the franchisee may be based in another state). This may act as a disincentive to franchisees raising genuine disputes, since they will disproportionately bear the costs of resolving the matter. This is problematic given that, even without this advantage being conferred on the franchisor by the franchise agreement, franchisees are likely to be less well-resourced for dispute resolution than franchisors.

The second is franchisors using the franchise agreement to require franchisees to cover all costs of dispute resolution – including paying the franchisor’s costs. Again, this is likely to act as a disincentive to franchisees raising genuine concerns with franchisors, since they will disproportionately bear the costs of resolving the matter. Additionally, this may remove the natural incentive for franchisors to incur the minimum necessary costs since they will not be paying, which may result in an inefficient allocation of resources.

It was recommended that both these practices be prohibited.

For the issues identified above, it is important to distinguish between the scope and the impacts of the problem. Although the scope of the problems are not widespread, as Mr Wein observed ‘we have a good franchise industry model in Australia and I have sought to improve upon that model with the recommendations’[[30]](#footnote-30), the impact of some of the problems outlined above can be significant on some parts of the industry.

* 1. **Concerns about conduct within the franchising sector**

Consultation during the Review presented consistent anecdotal evidence of questionable behaviours in franchising. Franchisors are usually in a more powerful economic and contractual position than the franchisee, and poor conduct by franchisors can have a disproportionate effect on franchisees. On the other hand, due to the network nature of franchising, poor conduct by isolated franchisees can affect the reputation of the system as a whole.

The Franchising Code sets out a number of prescriptive and clear rules to guide parties to a franchising relationship, however it does not provide parties with guidance as to the general standard of conduct required of them in the relationship.[[31]](#footnote-31) This role has largely been left to the unwritten law, and the generic protections in the Australian Consumer Law, such as prohibitions on misleading, deceptive or unconscionable conduct.[[32]](#footnote-32) However, these protections are considered insufficient because poor conduct may not necessarily amount to ‘unconscionable conduct’, and may not necessarily be misleading or deceptive. It is usually accepted that, under the general, unwritten law, parties to a franchise agreement are under an implied contractual obligation to act in good faith toward one another. However, there is still some uncertainty regarding this.

The Review stated that ‘In considering the need for an obligation to act in good faith, the review cited a number of “examples of anecdotal concerns or possible problematic conduct”. Examples included problematic behaviour by both franchisors and franchisees. These included:

* + the franchisor imposing unsafe practices for workers or customers;
* forcing franchisees to promote the franchisor’s products in a way that diminishes the sale of other products sold by the franchisee;
* representations inconsistent with the terms of the franchise agreement;
* extreme pressure to meet sales targets with repercussions for not meeting them;
* collecting marketing budgets based on prices at which goods are never sold – that is, reducing the advertised price of goods after invoicing for marketing;
* franchisees leaving franchise systems, de-branding their businesses and then using the franchisor’s intellectual property to compete with the franchisor;
* franchisors setting unrealistic standards for work without regard to the franchisee’s expertise (for example, a small regional franchisee who does not see as much of a particular kind of work may take longer than a city franchisee who regularly performs the same work but has to meet the same work or time standards);
* cost shifting to the franchisee or not maintaining the franchisee’s margin;
* franchisees using social media to post negative comments about their franchisor or their dispute with their franchisor; and
* franchisees indicating they have received advice as required under clause 11(2) of the Code (giving comfort to the franchisor) only to later allege that no such advice was obtained.

Further to this, in their submission to the Review, the South Australian Law Society cited examples of conduct where it would be difficult to prove misleading, deceptive or unconscionable conduct which indicates a need for a good faith obligation:

* differential treatment of a franchisee, which while isolated to that franchisee, could be justified under contract law but is taking place because a franchisee has raised matters of potential embarrassment to a franchisor;
* cases of bullying where numerous minor and immaterial breaches are constantly raised in an aggressive and intimidatory manner designed to extract concessions of various kinds, or cessation of complaint;
* responding to complaints in a dilatory manner and not within reasonable time frames; and
* when participating in mediations not providing any or only bare reasons in refusing proposals to settle a dispute. This response in mediations most often stifles and reduces mediations to a waste of time and money.’[[33]](#footnote-33)

As with the issues identified under ‘onerous contractual obligations’, the conduct that causes concern in the franchising industry can be isolated to a small number of people but can have a significant impact. For example, if a franchisee makes negative comments about a franchise brand on social media before a dispute resolution process has been finalised, this could have a negative impact not only on their franchisor but on the brand as a whole, including other franchisees.

To address this problem, it was recommended that a broad and explicit statutory obligation to act in good faith be introduced into the Franchising Code. This obligation would apply to both franchisees and franchisors. This is consistent with previous recommendations made to Government in relation to the Franchising Code.[[34]](#footnote-34) Mr Wein noted ‘seven out of nine processes and legislative attempts [to address the issue of good faith in franchising] appear to support action in relation to good faith’.[[35]](#footnote-35)

In addition to the need to address poor conduct in a general way through the introduction of an obligation to act in good faith, the Review identified some particular forms of poor conduct which warranted being specifically addressed.

***Circumventing disclosure of contact details of ex‑franchisees***

* + The disclosure document requires disclosure of the contact details of franchisees (including ex‑franchisees). The only exception to this is if the franchisee or ex‑franchisee has stated that they do not wish for their details to be disclosed.[[36]](#footnote-36) The specific problem identified in the course of the Review was franchisors circumventing this requirement by procuring from franchisees a request that their contact details be withheld from incoming franchisees. It was recommended that the Franchising Code be amended to ensure that a written request from a franchisee that its details not be disclosed to prospective franchisees has in fact been initiated by the franchisee, for example by prohibiting a franchisor from initiating, procuring or encouraging such a request from a franchisee.

***Allowing franchisees to bear the costs of marketing corporate owned stores***

* + Among a number of concerning practices relating to marketing funds was a concern that a franchisor’s corporate owned units are not necessarily contributing to marketing funds on the same basis as franchised units, or at all. Because of this, a franchisor’s own store or unit could be benefiting from outlays from the marketing fund even though they are not contributing on a fair basis with other stores. It was recommended that a franchisor with corporate owned stores should ensure that those stores contribute on the same basis as franchisees to any marketing fund for the franchise system.
  1. **Overall effectiveness of the Franchising Code**

At present, there are a range of possible consequences for a breach of the Franchising Code. It is possible for the ACCC and private parties (principally franchisees) to take action in the courts. Generally, however, the types of orders that a court can make are limited to providing a remedy to address a harm that has been suffered. This can mean that, in practice, there may not be a realistic threat of consequences in many instances where the Franchising Code is breached. This has been identified as a problem by many participants in the sector, and by the ACCC, in recent years. It may encourage a less diligent approach to compliance with the Franchising Code – the flipside of this being that introducing more punitive consequences for breaches would be likely to act as a deterrent.

As discussed above, conduct that causes concern in the franchising industry can be isolated to a small number of people but have a significant impact in those isolated circumstances. A respondent to the consultation process made the point that just because poor conduct is uncommon; it doesn’t mean there should not be a consequence of engaging in poor behaviour. Stakeholders have argued that additional powers for the ACCC will ensure the policy intent of the Code is adhered to.

The need to improve compliance and enforcement outcomes through a range of flexible tools for use by the regulator is also consistent with more general findings in relation to the relationship between regulators and small businesses. The Productivity Commission’s recent research report, *Regulator Engagement with Small Business*, noted that:

… better outcomes for small businesses and the community are achieved when regulators have a range of tools that enable them to tailor their responses to breaches (or potential breaches) of regulation in a proportionate way, rather than having to rely solely on combative approaches such as initiating legal proceedings. Some 30 per cent of regulators reported to the Commission that they have an insufficient range of enforcement tools. For the most part, these regulators saw the need for more tools in the mid-range of sanctions, such as improvement notices and enforceable undertakings. Accordingly, the Commission recommends that governments ensure their regulators have a sufficient range of enforcement tools available for their activities.[[37]](#footnote-37)

Accordingly, there have been calls for additional enforcement tools in relation to the Franchising Code, including allowing the ACCC to address breaches without having to initiate court proceedings.

* + Among other enforcement measures, it was recommended that the ACCC be given new powers to seek pecuniary penalties from a court for breaches of the Franchising Code, and also that the ACCC should be able to issue infringement notices for breaches of the Franchising Code. Infringement notices allow parties who have breached the Code to make payment of a small amount (relative to the amount of a pecuniary penalty that could be awarded by a court), in return for immunity from court proceedings. It was also recommended that the ACCC be able to use its audit powers to assess a franchisor’s compliance with all aspects of the Franchising Code. The ACCC already has access to these tools when enforcing other provisions of the CCA.

1. **What is the objective of franchising regulation?**

The purpose of the Franchising Code is to regulate the conduct of participants in franchising towards other participants in franchising.[[38]](#footnote-38) The Explanatory Memorandum for the Bill introducing the power to prescribe industry codes stated that the regulatory objective of industry codes generally was to address, or ameliorate, the effect on small business of:

* information asymmetries in negotiation of contracts;
* inability to understand documents;
* unfair contract terms;
* unfair conduct within commercial relationships; and
* difficulties in resolving disputes in a time and cost‑efficient manner.[[39]](#footnote-39)

It is intended to achieve these objectives in a way which interferes minimally with freedom to contract. All of these objectives apply to the Franchising Code, which was the first industry code to be prescribed under these provisions.

The Franchising Code is intended to enhance the productivity and success of the franchising sector by ensuring efficient dealings, and minimal loss of productivity because of avoidable disputes or dissatisfaction in business relationships. Addressing information asymmetry is also intended to facilitate competitiveness in the sector. This is important because the businesses that participate in this sector are an important contributor to the economy and our communities.

Against this background, there are two immediate objectives relating to the current examination of the Franchising Code:

* Ensure that the Franchising Code is effectively responding to the original objectives it was brought in to address; and
* Ensure that the Franchising Code is not placing an unjustified compliance impost on business by identifying improvements which can be made to streamline the Franchising Code.

An overarching objective of the Franchising Code is to provide a single, nationally consistent framework for franchising regulation. In recent years, there has been discussion regarding state regulation of franchising. It is important to respond to the issues which have been raised in the states in order to ensure a single, national framework for franchising regulation.

1. **What are the options for solving the problem?**

In any reform process, it is important to consider alternative courses of action when deciding how to tackle the problem at hand. This section of the Regulation Impact Statement assesses the relative merits of three options:

* Option 1 – the status quo. No Government action is taken.
* Option 2 – reform and refine the Franchising Code.
* Option 3 – light touch or non‑regulatory responses, principally education and awareness measures.

It is important to analyse the impact of each of these options according to their costs and benefits. These costs and benefits may be both qualitative and quantitative, and both are considered below.

The business community –in particular the efficiency of the small business community – is the intended beneficiary of the proposed reforms. Improving the relationships between franchisees and franchisors can help lift productivity and incomes in this important sector. Accordingly, the impact analysis under each option is focussed on the business community.

* 1. **Option 1: Status quo/take no action**
     1. **What does this option involve?**

Under this option, there would be no changes to the Franchising Code or the enforcement framework in the CCA, and no other action would be taken in response to the Review recommendations or to implement the Government’s commitments in relation to franchising.

The Franchising Code is due to sunset on 1 April 2019.[[40]](#footnote-40) At some point in the future, the Government would need to decide whether to conduct a further review prior to that date to assess whether the Franchising Code should be allowed to sunset.

* + 1. **What are the qualitative costs and benefits of this option?**

Costs of this option include:

* The Franchising Code will not respond optimally to the problems identified in Part 3 of this RIS. As a result, franchisees and franchisors will be making economically inefficient decisions and complying with unnecessary regulation.
* Not addressing known problems (for example the failure to provide disclosure in relation to online trading activities) may mean higher than necessary levels of disputation. If parties are not fully aware of their respective rights and obligations before entering a franchise agreement, and do not consider themselves obliged to act in good faith, this may result in unacceptable levels of disputation. Resources devoted to dispute resolution cannot then be deployed to more productive outcomes within the businesses of franchisors and franchisees.
* Due to lack of action at the Commonwealth level, it is possible that duplicative franchising regulation may emerge in the states, noting that this possibility has already been explored in some states.[[41]](#footnote-41) This would increase compliance burdens for the sector as they contended with separate regimes for franchising regulation.
* Compliance burden will be higher for participants in the franchising sector due to the non‑progression of a number of reforms relating to simplifying and streamlining the Franchising Code to reduce ‘red tape’.

Benefits of this option include:

* Regulatory stability and development of case law is promoted by infrequent changes to the law. The Franchising Code was introduced in 1998 and since then has been amended 5 times, in 1999, 2001, 2007, 2008 and most recently in 2010. However, it is noted that regulatory stability will not necessarily be promoted by maintaining the current Franchising Code due to the possible emergence of state‑based franchising regulation.
* This option would allow time for other regulatory reforms to be progressed which are relevant to franchising. For example, the Government has committed to an independent review of competition laws and policy, and has further stated its preference that unfair contract terms protection be available for small business. Any regulatory changes which flow from these Government policies may be relevant to decisions regarding the Franchising Code. For example, if a franchise agreement was covered by a general rule voiding unfair contract terms, some of the specific changes to the Franchising Code proposed in Option 2 (below) may not be necessary.
  1. **Option 2: Reform and refine franchising regulation (preferred)** 
     1. **What does this option involve?**

In summary, this option would involve:

* making a number of refinements to the Franchising Code to respond to the recommendations made by Mr Alan Wein, and to implement the Government’s commitment to reduce red tape imposts on business;
* remaking the *Trade Practices (Industry Codes – Franchising) Regulation 1998*. This will promote regulatory stability by ensuring that the Franchising Code does not need to be reviewed before 1 April 2019 merely to respond to the sunsetting provisions of the *Legislative Instruments Act 2003*. As part of this process, the regulation will be renamed the *Competition and Consumer (Industry Codes – Franchising) Regulation 2014,* to reflect changes to the name of the enabling legislation; and
* amending the CCA to improve the enforcement regime for the Franchising Code by making civil pecuniary penalties and infringement notices available to the courts and the regulator respectively in the case of breaches of industry codes.

Consultation exploring the practical impact of the recommendations made by Mr Wein in the Review report indicated the costs of some recommended changes may outweigh the benefits. The following examples reveal some of the considerations that have been weighed up in coming to a preferred policy position on reforming and refining franchising regulation.

*Franchisor failure*

* It was recommended that franchisees be given additional protections in the event of franchisor failure, including the right to terminate a franchise agreement if the franchisor fails and a buyer is not found within a reasonable time.

Consultation with industry revealed that the cost of this reform may not be justified by the benefits. In particular:

* + If franchisees had the right to terminate upon the insolvency of the franchisor, some stakeholders argued this would undermine the value and viability of the franchise systems as a whole in the event of franchisor failure, leading to a negative impact on other franchisees and the creditors of the franchisor.
  + Administrators of insolvent franchisor companies may be hampered in their ability to perform other statutory functions. For example, an incoming buyer may be deterred by an impending deadline after which franchisees will be able to terminate their agreements.
* It was further recommended that franchisees should be made unsecured creditors of the franchisor by notionally apportioning the franchise fee across the term of the franchise agreement. This would mean that the fee for the unexpired portion of the franchise agreement would become a debt in the event the franchise agreement ended due to the franchisor’s failure.

Consultation with industry revealed that the cost of this reform was unlikely to be justified by the benefits. In particular:

* + Not all franchise systems require an upfront franchise fee or renewal fee so the recommendations in relation to unsecured creditors could not feasibly be implemented in such franchise arrangements. Alternatives such as a nominal debt would be equally problematic.
  + Some stakeholders considered this may in fact increase the prospect of franchisor insolvency since directors of franchisors may need to factor potential payments to franchisees into solvency considerations.
  + Some stakeholders considered the proposed debt would have a negative impact on the treatment of this income for the franchisor from a taxation and accounting perspective. This would be complicated in the event of the sale of the franchise system to a new franchisor.
  + The existence of such a right may lead franchisees to have unrealistic expectations about the prospect of recovering some or all of the franchise fee in the event of franchisor failure because in practice, if a franchisor is insolvent, the franchisee would be unlikely to actually receive the full amount (or in some cases any of the amount) notionally owed to them.

For the reasons stated above, both of these reforms were also considered to have a negative impact on the franchisor’s credit worthiness, or increase the cost of access to finance for the franchisor. Some stakeholders argued this would also increase the cost of credit for franchisees, since their access to credit is also dependent on the financials of the franchisor.

Finally, it was unclear how significant a problem franchisor failure is. During the Review and subsequent consultation, no representations or evidence was received directly from any individual franchisees that had been adversely affected by the failure of their franchisor.

Accordingly, instead of implementing this recommendation, it is proposed to highlight the risk of failure in an information statement to be provided to the franchisee before they enter into the franchise agreement (see below on page 29). It is also expected that other proposed reforms, such as introducing an obligation to act in good faith, will improve the general operating environment for franchisees including in the circumstances of franchisor failure.

*Keeping marketing funds in a trust account*

* Among other reforms to the treatment of marketing funds, the Review recommended that marketing funds be held as trust funds. Stakeholders argued requiring marketing funds to be formally treated as trust funds would be problematic. In particular:
  + Given franchisors are not required to maintain a marketing fund, the additional compliance burdens associated with keeping a trust account may deter franchisors from setting up marketing funds at all. This may deprive franchisees of the transparency provided for relating to marketing by other provisions of the Franchising Code.
  + This could have an impact on taxation arrangements and the treatment from a taxation and accounting perspective. Some stakeholders argued this would significantly increase the legal and administrative burdens on franchisors.
  + If marketing funds were held in trust, this could impact franchisors credit worthiness or the cost of credit for a franchisor.

Accordingly, while other recommendations relating to the treatment of marketing funds have been adopted, this particular recommendation is unjustified when the potential costs are considered.

*Requiring franchisors to provide disclosure six months before a renewal is offered*

* It was recommended to the Government that franchisors should be required to provide formal disclosure to franchisees at least six‑months before they are offered a renewal or extension of their franchise agreement (rather than the default 14‑day rule which otherwise would apply). However, existing franchisees already have the ability to request a disclosure document at any point during the term of the franchise agreement (as long as they don’t request more than one document per year). So in most circumstances, a franchisee could already initiate a request for disclosure six‑months before they are offered a renewal or extension of their franchise agreement.   
    
  Accordingly, given the compliance costs involved for the franchisor in providing formal disclosure, instead it was considered sufficient to simply remind the franchisee of this entitlement at the time when the franchisor is required to state whether it will renew the franchise agreement (i.e. six months before the end of the agreement). This proposed reform is noted below.

*Master franchisor disclosure*

* The Review recommended that master franchisors be required to provide a separate, short, form of disclosure that would in turn be provided by subfranchisors to subfranchisees. During consultation, a simpler way of implementing the policy intent of this recommendation was identified.

If the recommendation was adopted in its entirety, this would result in the franchisee still receiving multiple disclosure documents, and would on the other hand deprive subfranchisors of useful information from the master franchisor that would otherwise have to be set out in the full disclosure document.

As an alternative, this recommendation has been implemented by adding additional information to the existing disclosure document in relation to master franchise agreements, and relieving master franchisors of the obligation to provide disclosure to subfranchisees, since subfranchisees will now receive all relevant information from the subfranchisor in a single disclosure document.



Examples of possible franchise structures

*Dispute resolution*

* It was recommended that the Code should be amended to make it clear that the obligation to try to resolve a dispute by mediating in a reconciliatory manner applies to dispute resolution in any forum (such as through a Small Business Commissioner), not just through the Government‑funded Office of the Franchising Mediation Adviser.   
    
  However, this obligation has been superseded by a comprehensive obligation to act in good faith, which will extend to dispute resolution. Accordingly, it would create unnecessary duplication in the Franchising Code to retain the requirement to mediate in a reconciliatory manner.

However, it is proposed to implement the bulk of the Review recommendations and this is reflected in the proposed revised Franchising Code, and amendments to the CCA, which are set out at **Attachments A** and **B** respectively. Key changes include:

*Improvements to reduce red tape and complexity*

* Simplifying disclosure in multi‑tiered franchise systems by removing the requirement that master franchisors provide disclosure to franchisees even where there is no direct relationship with the franchisee, and the franchisee has already received disclosure from the intermediate party (the subfranchisor). In addition to reducing compliance costs in multi‑tiered systems, this will improve disclosure as franchisees will receive more targeted information.
* Ensuring that foreign and master franchisors are not obliged to maintain a disclosure document if they are not actively involved in franchising. This will reduce expenditure on legal and compliance activities where there is no benefit to be gained by franchisees from those activities.
* Removing the redundant short‑form disclosure document format from Annexure 2 of the Franchising Code. This will streamline and simplify the code.
* Removing disclosure obligations in relation to summarising provisions of the franchise agreement in the disclosure document. The disclosure document is not meant to be a substitute for closely reading the franchise agreement, and these provisions make the disclosure document unnecessarily lengthy and complex.
* Making a range of other drafting improvements to the Franchising Code to address ambiguity and improve consistency of practice among the industry.

*Improvements to disclosure to address information asymmetry*

* Ensuring that franchisors remind franchisees of their entitlement to a current disclosure document when notifying them that they intend to renew the franchise agreement. This promotes informed decision‑making by franchisees relating to renewal or extension of the franchising relationship.
* Requiring franchisors to provide disclosure in relation to the respective rights and obligations of the parties to conduct and benefit from online trading activities. This change responds to the growing importance of online trading in the economy, and the way this is impacting on traditional sales models in franchise systems.
* Requiring franchisors to provide an information statement to prospective franchisees regarding the risks and rewards of franchising as early as possible. The information statement will be generic across the franchising industry. It will be included as an Annexure to the Code and has been drafted in consultation with both franchisee and franchisor representatives to ensure that it achieves a balance between the risks and rewards of franchising. It covers issues such as due diligence, what franchising is, why someone would consider franchising, what is involved in a franchising relationship, unexpected expenses, the risks of franchising and where to find more information. The provision of this statement will help franchisees to understand the pros and cons of the franchising model at a formative decision‑making stage, which may precede formal disclosure and entry into the franchise agreement.
* Ensuring that franchisees receiving meaningful information about expenditure of marketing and other cooperative funds. This will encourage a more transparent relationship in an area which can cause conflict between franchisees and franchisors.
* Requiring franchisors to disclose materially relevant facts about their associates to franchisees, such as if an associate has civil proceedings in Australia brought against them by franchisees in the system. This will promote transparency and support the original policy intent of this provision, particularly for franchise systems with complex corporate structures.

*Improvements to address concerns about conduct within the franchising sector*

* Requiring both franchisors and franchisees to act in good faith in their dealings with one another. This is an important change that will underpin the Franchising Code as a whole and improve standards of conduct within the sector.
  + The efficiency and commercial success of a franchising system relies on co-operation between a franchisor and franchisee. As outlined above in the problem section, while the scope of problematic behaviours in the franchising sector is not large, the impact of certain behaviours can be significant in isolated cases. For example:
    - Cost shifting to the franchisee or not maintaining the franchisee’s margin – if a franchisor engaged in this behaviour to the extent that it was impacting on the profits of the franchisee.
    - Another example is the broad impact that the behaviour of one ‘rogue’ franchisee can have on the brand of a franchise system. This has become more of an issue as the spread of information via social media has escalated, meaning that potentially incorrect and damaging information can spread quickly, and the damage can be difficult to undo.
  + While the notion of good faith exists in common law relating to contracts generally, there is not a consensus on whether the concept applies to all aspects of a contract. The proposed obligation to act in good faith in relation to franchising agreements will apply in respect of any matter arising under or in relation to a franchise agreement and the Code. This will extend the application of good faith to the negotiation of a franchise agreement, performance of the franchise agreement and the termination of that franchise agreement.
* This obligation will require parties to a franchise agreement to act honestly, not arbitrarily and to cooperate to achieve the purposes of the franchise agreement. These principles have been discussed and considered relevant in the case law to the consideration of whether a party has acted in good faith. This does not prevent a party acting in their own commercial interests. For example, if a franchise agreement does not include a clause allowing the franchisee to seek its renewal, this does not mean that the franchisor has not acted in good faith in negotiating the agreement. Additionally, the proposed obligation does not limit the obligation imposed by the common law. The ACCC will provide educational information on the changes to the Franchising Code. Preventing franchisors from unduly interfering with prospective franchisees’ ability to speak with ex‑franchisees to enable franchisees to conduct due diligence of this nature wherever possible.

*Improvements to address concerns about onerous contractual terms in the franchising sector*

* Addressing concerns regarding the imposition of significant and unforeseen capital expenditure by prohibiting franchisors from imposing such expenditure on franchisees subject to a number of exceptions. This will help franchisees make an informed assessment about the viability of the franchised business.
* Ensuring that franchisors cannot enforce restraints of trade clauses against franchisees in certain circumstances. This will promote competition and ensure that franchisees have sufficient options available to them if the franchisor chooses not to offer them a renewal of their franchise agreement.
* Ensuring that franchisors cannot impose their costs of dispute resolution on franchisees through the franchise agreement, to ensure franchisees are able to raise disputes without unfairly bearing the costs this may result in for the franchisor.
* Ensuring that franchisors cannot use the franchise agreement to require the franchisee to resolve disputes in a state other than the state in which the franchisee’s business is based. This will promote access to affordable dispute resolution for franchisees.

*Improvements to the overall effectiveness of the Franchising Code*

* Improving the enforcement options available to the ACCC for breaches of the Franchising Code. These include pecuniary penalties, infringement notices and a modest increase in the scope of documents the ACCC can request, including to substantiate the information in a disclosure document. This will encourage compliance with the Franchising Code and improve standards of conduct within the sector.
  + 1. **What are the qualitative costs and benefits of this option?**

It is envisaged the most tangible impact of the proposed changes will only be significant in the areas where a specific problem has been identified. The problem section of this paper discusses in detail the size and nature of the issues identified in the franchising industry. Extensive consultation with the franchising sector has occurred to ensure the impacts of the proposed changes have been thoroughly explored. This section extensively discusses the views of stakeholders and then the costs and benefits of the proposed changes.

*Views from stakeholders obtained through consultation*

*The provision of a generic risk statement:*

Submissions to the Review, from groups representing both franchisors and franchisees, called for a short document to be provided to franchisees to improve their understanding of the franchise relationship at the earliest possible time.

Some of the arguments raised in response to the consultation paper favouring implementation of a generic risk statement were that it would:

* make for better decision making by prospective franchisees by providing prospective franchisees with knowledge of franchising and an understanding of the need for due diligence;
* have the potential to reduce friction between franchisees and franchisors as a result of franchisees better assessing the risks of entering a franchise agreement; and
* deter unsuited persons from entering into franchising.

Other responses suggested some negative impacts to implementation of the recommendation:

* creating more statements and disclosure would not address the problem of franchisees not seeking professional advice;
* the statement would not cover all possible issues a prospective franchisee might face;
* it is unfair to ask a franchisor to state, up front, the negatives of franchising;
* the existing system adequately protects franchisees and additional disclosure would not put them in a better position;
* a generic statement would be too general to provide useful information, particularly as each franchise network can be structured differently; and
* it may lead franchisees to ignore the disclosure document.

Mr Wein envisaged that this recommendation would assist prospective franchisees with a simple snapshot of some of the pitfalls and benefits of franchising without requiring them to read a lengthy contract. A contract may be provided to a franchisee after a number of discussions with the franchisor, by which time, they may already be emotionally committed to entering the franchise.

Research undertaken by Griffith University released in 2013 indicated that over 50 per cent of franchisees surveyed made their mind up before they reviewed the available information. It also found that over 80 per cent of franchisees who did not undertake pre-entry education relied on information being given to them rather than seeking it out themselves.[[42]](#footnote-42)

Previous reviews of the Franchising Code have recommended that the industry develop this type of risk statement however this does not appear to have occurred. The objective of this recommendation is to ensure a prospective franchisee has a basic understanding of the franchise relationship before they are financially and emotionally committed to entering a franchise agreement. Consultation with groups both representing franchisors and franchisees has occurred to ensure that this document is balanced. Additionally, the compliance costs associated with this change are very low given the statement is generic and has been drafted as an Annexure to the Franchising Code.

*Improvements to onerous contractual terms in the franchise sector*:

As part of the Review, Mr Wein recommended that ‘Decisions made by the franchisor requiring franchisees to incur significant capital expenditure need to be subjected to a test of reasonableness.’ Mr Wein identified that the current item 13A of Annexure 1 is not effective. Many submitters to the Review contended that presently the regulation just results in franchisors disclosing a very long list of expenses, many of which never occur.

Responses from the consultation process also indicated that the current regime is not working effectively. One response stated **‘**A continuation of the status quo will allow this inconsistency of disclosure to continue, and the relatively bland nature of what is disclosed to be relatively meaningless.’ A number of other respondents indicated that franchisors already produce business cases to support significant expenditure and it is just a matter of these details being passed onto the franchisee.

Other responses to the consultation paper indicated that currently, significant capital expenditure is imposed on franchisees toward the end of the franchise agreement. If the franchisee is unable to recoup their capital investment in the time remaining in the franchise agreement then the expense may not be ‘reasonable’.

During the consultation process, arguments for and against defining the terms ‘unreasonable’ and ‘significant’ were made. For example, several responses to the consultation paper argued that franchisors already prepare business cases for significant capital expenditure and it would simply be a matter of providing these to the franchisee. They argued that this would not result in costs as this type of cost/benefit analysis is already available.

Another respondent indicated the status quo should not continue, arguing that the list provided to comply with item 13A of Annexure 1 of the Code in its current form is of little use to franchisors or franchisees.

To address the concerns raised in the consultation process, a ‘conditional prohibition’ on significant capital expenditure will be introduced. This will still allow expenditure to be imposed by a franchisor if:

* it is disclosed through the regular disclosure process;
* if it is agreed to, or approved by, the majority of franchisees;
* the expenditure is required to comply with legal obligations; or
* the franchisor considers the expenditure necessary and can be justified by a rationale for the investment, an explanation of the amount of the expenditure, the anticipated outcomes and benefits and the expected risks for making the investment.

*Marketing funds*:

A consistent theme in submissions to the Review was a view that marketing funds are a common source of dispute between franchisees and franchisors, are prone to improper or questionable use by the franchisor and lack transparency.

This area remains a significant source of dispute and the disclosure amendments have not resolved the problems.[[43]](#footnote-43)

… more and more issues arise with marketing funds all the time and it is an area where franchisees and franchisors are often in dispute and undoubtedly will continue to be for as long as there is franchising.[[44]](#footnote-44)

One franchisee representative group stated the proposed changes to marketing funds would result in the ‘removal of risk, uncertainty, friction costs and dispute costs in an area of significant controversy in franchising. More efficient allocation of marketing funds to true marketing expenses will be made within the sector, and removal of inappropriate practices in relation to marketing costs will contribute to the overall reputation of the industry for new franchisees.’

Concerns raised through consultation about how a franchisor spends allocated marketing funds have been addressed by a clarifying amendment to the Franchising Code specifying marketing funds can be used for expenses such as ‘legitimate marketing or advertising expenses’.

Others were concerned about some aspects of the recommended changes, particularly relating to holding the funds in a trust account. Consultation on the issue of holding marketing funds found that this would be a significant regulatory burden and have unintended consequences. Consultation with franchisor representatives indicated that holding the funds in a separate bank account is appropriate but they should not be held in a trust account as there is the potential for a number of unintended consequences and the compliance burden would outweigh the potential benefits.

Consultation raised the issue of an additional cost associated with the potential for an annual marketing fund audit. However, this is still subject to a vote by franchisees and therefore the cost imposed by an audit is still at the discretion of the industry participants.

The requirement for company-owned units to contribute on the same basis as franchisees will improve the equity in the franchise relationship. This may be an ‘opportunity cost’ for the franchisor given they may have previously used these funds for other purposes but the funds will still contribute to the business overall and would not be lost to a ‘sunk cost’ such as legal fees.

*Good faith*:

In terms of the scope of the obligation, there is a mixture of support for it to apply before, during and after a franchise agreement, but also support for an obligation to act in good faith to have a more limited application to just the exercise of the franchise agreement. It was suggested by some that if an obligation to act in good faith is extended to the negotiation of a franchise agreement, a franchisor may incur significant costs in negotiating individual franchise agreements, as a franchisor may be required to implement changes to a franchise agreement requested by a potential franchisee.

The compliance costs (legal fees) of ensuring that a franchise agreement complies with the obligation to act in good faith are factored into the costs discussed below under compliance costs. As it is assumed that a franchisor will seek additional legal advice to ensure that their agreement complies with the obligation, a franchisor will still be able to use a standard form contract. The good faith obligation would only impact negotiations in that both parties would need to act cooperatively and honestly. It does not compel a franchisor to make requested additions to a franchise agreement made by a prospective franchisee.

Consultation also raised the possibility that there may be circumstances where a failure to renew did amount to not acting in good faith, depending on the individual circumstances. Some franchisors argued that the nature of franchising is that it is a relationship for a specified period of time. Therefore, it would not be appropriate for a franchisee to claim a breach of a good faith obligation for a non-renewal of their agreement. To address this concern, the Code will include a clause which clearly indicates that a franchise agreement is not required to include a clause which allows a franchisee to seek renewal.

Irrespective of the necessary regulatory amendments, the concept of ‘good faith’ in commercial dealings will continue to be assessed by the courts. A benefit of this is that the codification of good faith for the franchising sector participants may improve conduct in the franchising sector by setting a standard of practice and providing an educative influence. Stakeholders have indicated that the benefits of this option would include providing a minimum standard of behaviour to be adhered to by sector participants while others saw benefits in ensuring that honesty, integrity and professionalism are principles adhered to in the franchising industry.

The most common objection to the introduction of an express obligation to act in good faith into the Code is that the scope of the requirement is unclear; the common law is continuing to develop and is not sufficiently certain. Similarly, it is recognised that it is undesirable for the obligation to further complicate the common law doctrine of good faith and be inconsistent. This is consistent with the industry code framework that industry codes should reduce complexity.

Under the current arrangements, good faith may already be implied into franchise agreements via the unwritten, common law. Treasury has been told that many franchisors and franchisees are already acting in a manner consistent with a good faith obligation. This offers support for the retention of the status quo; regulatory amendments are unnecessary as the policy intent is already being achieved. However, it has also been argued by many from the different sectors in franchising that under the current arrangements, good faith obligations are unclear; not all franchisees and franchisors are acting in good faith; the obligation can be contracted out of; or, they are not aware that they have an obligation to act in good faith.

During consultation, it was raised that even though there is not a clear definition of good faith, parties generally understand it to mean acting fairly and honestly.

To address the concerns of stakeholders regarding the uncertainty of such an obligation and at the same time the need for clarity around the meaning of good faith in the Franchising Code, guidance on the meaning of good faith will be provided without limiting the obligation imposed by the common law.

Concern was also raised in consultation regarding the importance of avoiding duplicative state-based regulation, which was likely to be implemented by some states if the Australian Government does not implement an obligation for parties to a franchise agreement to act in good faith. Inconsistent regulation across state borders creates substantial costs for franchisors. Some submitters to the Review outlined the problems encountered in the USA when a business is forced to comply with different regulations in different states. A consistent national regulation means that businesses operating across Australia have one set of rules they need to abide by.

Some stakeholders were concerned about the impact this introduction might have on investment in Australia. Other stakeholders argued that rather than being a disincentive, the obligation would attract investment and additional franchisees due to the confidence they would have in the conduct in the franchising sector in Australia.

During consultation, the relational nature of franchising was raised on a number of occasions. This is seen as a main difference between a franchise agreement and other commercial agreements. The nature of franchising dictates that each party's contractual obligations are ongoing and variable, forming a contract that is fundamentally based on an ongoing relationship. These are not discreet, one-off exchanges between parties on clearly defined terms that characterise ordinary contractual agreements. The introduction of an obligation of good faith is in a way recognising the special relational nature of a franchise agreement.[[45]](#footnote-45)

On balance, the evidence to the Review and evidence received throughout the consultation process was supportive of the introduction of an obligation to act in good faith into the Franchising Code.

*Restraint of trade*

Consultation on Mr Wein’s recommendation on restraint of trade provided differing views from stakeholders. Some responses indicated that it is inconsistent with the nature of goodwill in a franchise – that goodwill is owned by the franchisor and not the franchisee.

Others disagreed and thought the recommendation did not go far enough. They felt it would not protect franchisees who are not in breach of their franchise agreement from losing their business; that it would not provide for fair and equitable compensation at the end of a franchise agreement; and restraint of trade clauses are not relevant to all franchised businesses.

The implementation of this recommendation will help to balance the rights of franchisees and franchisors at the end of a franchise agreement. It will offer some relief to franchisees who have honoured their franchise agreement and through no fault of their own, have been refused renewal by the franchisor, but wish to continue in a business similar to the one in which they have built experience. Currently, former franchisees may be prevented from doing so due to the operation of a restraint of trade or ‘no compete’ clause which can have serious consequences on their ability to earn a living and result in significant hardship. While this scenario is uncommon, it is inappropriate to put in place adequate safeguards to avoid grossly unfair outcomes for the franchisee at the end of the franchise agreement. The proposed change is that a restraint of trade clause will have no effect after the agreement has expired, if a narrow set of conditions can be met by the franchisee, including that the franchisee was not in breach; had not infringed the intellectual property of the franchisor; and has not claimed genuine compensation for non-renewal.

*Dispute resolution*

There was broad support throughout consultation for the changes proposed to the dispute resolution provisions which would mean that franchisors could not impose their costs of dispute resolution on franchisees through the franchise agreement, and that franchisors could not use the franchise agreement to require the franchisee to resolve disputes in a state other than the state in which the franchisee’s business is based.

Responses to the consultation process indicated that while concerns may be raised about litigation in a ‘foreign’ jurisdiction, if the franchisor is prepared to issue a franchise in that jurisdiction (and be subject to the relevant state laws regarding its franchisee’s business) then it is not too onerous to expect the franchisor to be subject to the laws of that jurisdiction.

*Enhanced enforcement tools for the ACCC*

Responses to consultation indicated support for an increase in the enforcement options available to the ACCC. Some respondents indicated caution regarding the scope of the powers and the way in which the ACCC may utilise them, with a view to preventing the recommended changes imposing an unreasonable burden on the sector.

These concerns have been addressed by:

* Limiting the maximum pecuniary penalty to 300 penalty units (currently $51,000);
* Setting the amount for infringement notices at 50 penalty units ($8,500) for a body corporate and 10 penalty units ($1,700) in any other case;
* Limiting the items of the Franchising Code which attract penalties; and
* Ensuring that the increase in type of documents the ACCC can obtain is more limited than contemplated by Mr Wein’s recommendation, by restricting the power to documents the franchisor is required to obtain from a franchisee, and ones that are required to substantiate statements in a disclosure document.

The proposed refinements to the Franchising Code bring with them a range of costs and benefits.

Benefits include:

*More efficient business dealings due to a clearer and less complex Franchising Code – leading to a more attractive investment environment*

* Foreign and master franchisors will not have to incur the expense of maintaining and giving disclosure documents if they are not actively involved in granting franchises. This will reduce legal expenses, and reduce the time spent by staff of foreign and master franchisor’s involved in compliance activities. This, in turn, could lead to an improved investment environment in Australia for foreign franchisors considering doing business in Australia. The sector may also attract more local investment.
* The Franchising Code will be streamlined by the removal of the redundant short‑form disclosure document currently set out in Annexure 2 to the Franchising Code.
* Franchisors will need to spend less time and incur less legal expense in complying with current disclosure requirements which merely result in repetition of the terms of the franchise agreement.
* The Franchising Code will be more consistent with industry practice by allowing the franchisor to receive information as set out in the franchise agreement before agreeing to a transfer or novation of the agreement. This will reduce uncertainty and improve consistency of practice among the industry.
* Franchisors, and franchisees, will benefit from a number of drafting improvements to the Franchising Code to address ambiguity and improve consistency of practice among the industry. This may reduce legal costs, uncertainty and improve consistency of practice among the industry.
* Re-making the Franchising Code regulation for another ten years to avoid the need for further reviews to address the sunsetting of the existing Code. In the absence of emerging policy concerns regarding the Franchising Code, this will promote regulatory stability.

*More informed business decisions due to having addressed information asymmetries*

* Franchisees will be better informed about the business opportunity being presented to them by receiving more timely and fulsome disclosure on key issues such as online trading, marketing and cooperative funds and significant capital expenditure. This, in turn, could be expected to lead to more economically efficient decisions and reduced disputation by ensuring expectations are managed, where appropriate, through the disclosure document.
* The provision of an information statement by franchisors as soon as it becomes apparent that they are likely to enter into a franchise agreement with a prospective franchisee is also expected to focus prospective franchisees’ minds before they are psychologically, emotionally and financially committed to pursuing a franchise opportunity. This will encourage better due diligence and facilitate a more rational approach to decision‑making by prospective franchisees.

*Less unfair conduct within the franchising sector*

* Amendments to the Code to improve standards of conduct within the franchising industry (e.g. the requirement for both franchisors and franchisees to act in good faith in their dealings with one another). As expressed by the results of the consultation discussed above, this should lead to reduced disputation and increased confidence in the sector (which may also enhance investment).
* Another benefit of implementing the obligation to act in good faith into the national Franchising Code is that it will assist in maintaining one consistent framework in Australia. As indicated in the Review ‘submissions to the review that address this subject are overwhelming in their support for the retention of a single, national scheme’.[[46]](#footnote-46)
* Australia is recognised internationally as having robust franchising legislation, ‘providing great clarity and protection to franchisees.’[[47]](#footnote-47) In countries comparable to Australia, such as New Zealand, Canada, the United Kingdom and the United States of America, there is no specific national franchise regulation. In these countries, there is not a general statutory requirement on parties to a franchise agreement to act towards each other in good faith; however, some jurisdictions do enforce a common law obligation for parties to act in good faith. Additionally, in some countries, franchising industry associations might require parties to exercise fairness in their dealings. As such, an obligation to act in good faith in franchising is not inconsistent with comparable international regimes.
* In Australia, the concept of good faith is not new. For example, both Western Australia and South Australia have attempted to implement state-based legislation which included an obligation on parties to act in good faith towards each other; section 228 of *the Fair Work Act 2009* (Cth) requires good faith bargaining; section 13 of the *Insurance Contracts Act 1984* (Cth) states that a “contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party … with the utmost good faith”; the *Native Title Act 1993* (Cth) incorporates the concept of good faith, including in relation to negotiation under section 31; and sections 32 and 45 of the Oilcode require good faith in the renewal of fuel re-selling agreements and mediation, respectively.

*Less onerous contractual terms within the franchising sector*

* The prohibition of terms in franchise agreements which inequitably distribute the costs of dispute resolution will reduce the cost of disputation for franchisees, who are less likely to be able to afford to formally raise a dispute. Franchisees can then use this money in pursuit of more productive outcomes for the business.
* The prohibition of significant capital expenditure, subject to some exceptions, will provide franchisees with more certainty regarding the financial commitment they are entering into, and incentivise franchisors to clearly understand and communicate to franchisees the costs involved in running the business prior to signing the franchisee onto the franchise agreement.
* Placing reasonable limitations on the use of restraint of trade clauses in franchise agreements will promote competition and facilitate franchisees utilising skills which would otherwise not be utilised.

*Improved compliance with the Franchising Code through enhanced enforcement tools for the regulator and greater sanctions for breach*

* Improving the enforcement options available to the ACCC for breaches of the Franchising Code will deter breaches and provide an incentive for an improved approach to compliance. This in turn will improve standards of conduct across the sector.

If this option is adopted, these benefits are expected to guard against state‑based regulation and promote confidence and harmony in the franchising sector for the foreseeable future.

Costs include:

*Cost of transitioning to a revised regulatory regime*

* There will be costs involved in transitioning to the revised regulatory regime, such as the need for legal advice and education of the franchisor’s staff regarding the changes. These are discussed further below where a quantitative analysis of the proposed changes is conducted. However, some costs are difficulty to quantify.
  + - Improved enforcement tools available to the ACCC need not, of themselves, result in transitional costs because parties to the Franchising Code should already be complying with the Franchising Code as a mandatory law. However, it is possible that some franchise systems will look to update and/or and enhance their compliance models based on the additional sanctions which may apply for breaches of the Franchising Code.

*Ongoing costs of complying with the amended code*

* There will be ongoing costs involved in transitioning to the revised regulatory regime, for example the need to provide an information statement to all future prospective franchisees. These costs are fleshed out further below, where a quantitative analysis of the proposed changes is set out. However, some costs are difficulty to quantify, or are not appropriately characterised as compliance costs. For example:

***Good faith***

* + It is noted above that good faith may improve standards of conduct within the industry and therefore lead to reduced disputation. On the other hand, good faith could have the potential to increase disputation, as it arms parties with a flexible course of action which could be relevant to a broad range of conduct, particularly in the short term before courts have had an opportunity to interpret the language of the obligation. However, in the long term, the scope of the provision would become clearer.
  + The ACCC will provide educational information on the changes to the Franchising Code. This will be aimed at educating the sector and be of a similar form to the current educational material which exists in the franchising sector.[[48]](#footnote-48)
  + The requirement to act in good faith will apply to the negotiation of the contract and behaviour during dispute resolution; as well as the operation of the contract. It is not possible to estimate a specific addition or reduction in negotiation time that would come as a result of the introduction of an obligation to act in good faith into the Code. One view is that this obligation could extend the negotiation period as a franchisor may have to make changes to a franchise agreement based on negotiations with a franchisee. Another view expressed as part of consultation was that this obligation would provide a minimum standard of conduct in the franchise industry. This could have the effect of reducing negotiation periods as both parties could be confident of an honest discussion about the franchise agreement. The views of stakeholders on the introduction of an obligation to act in good faith are discussed in more detail above.
  + In its submission to the Review, McDonald’s Australia raised concerns about the introduction of good faith. McDonald’s discussed the introduction of good faith in Iowa in the USA, stating that following the introduction of good faith there was ‘a significant decrease in the amount of new franchises being granted, and several companies halting expansion plans for Iowa or opting for a company-owned expansion model.’ The response to the introduction of good faith in Australia is likely to be small due to a number of differences including:
    - * + Australia has a national system for franchising regulation, unlike that in the USA – there is a consistency in Australia when operating between states and territories that does not exist in the USA;
        + The approach adopted to implement the good faith obligation is different – in Iowa, good faith applied in the performance and enforcement of the franchise contract and was defined as “honesty in fact and the observance of reasoning commercial standards of fair dealing in the trade” [[49]](#footnote-49), whereas the obligation in Australia will not limit the common law that has applied and will extend its application to the negotiation, performance, termination and dispute resolution elements of the franchise relationship; and
        + A transitional cost for legal advice to ensure compliance with the proposed good faith obligation, factored into the compliance costs discussed in this document, are calculated to be offset by the reduction in regulatory burdens from the proposed changes in their entirety. Regulatory impact costs will primarily be felt during the transitional stage (the first 12 months) of the operation of the proposed amendments.  In relation to good faith, costs relate to legal advice to ensure that contracts will meet good faith requirements. [[50]](#footnote-50)

***Marketing funds***

* + - One new requirement in relation to marketing funds is that a franchisor’s corporate owned units must contribute to any marketing fund on the same basis as the franchised unit – to ensure the franchisor is not subsidising its own marketing costs from franchisees’ contributions. This will involve an opportunity cost to the franchisor, as it will be required to utilise the income from corporate owned units for the purposes of marketing, reducing the flexibility of franchisors in terms of the use of income from corporate owned units. The impact of this will be moderated by the fact that, for franchise systems who have marketing funds, it is understood around half of these receive contributions from the franchisors corporate owned units. The impact will be further mitigated by other amendments designed to ensure marketing and advertising funds are used only for legitimate marketing or advertising purposes.

***Capital expenditure***

* + - There is a new prohibition on franchisors imposing significant capital expenditure on franchisees unless such expenditure is disclosed, has been approved by and is required of a majority of franchisees, or the franchisor can justify the expenditure by reference to the costs and likely benefits. Franchisors seeking to rely on this last exemption – that the franchisor can justify the expenditure – will need to expend time and possibly receive legal advice in the course of doing so. However, it is very difficult to quantify how likely it would be that a franchisor would need to rely on this exemption. It is assumed that in the great majority of cases, capital expenditure will have been disclosed to a franchisee, or would be agreed by the franchisee or a majority of franchisees. Furthermore, consultation has indicated that franchisors are already accustomed to the practice of justifying additional expenditure required of the franchisee, given that this is sound business practice in any event.
    1. **What are the quantitative costs and benefits of this option?**

The Commonwealth Treasury has undertaken a detailed process to assist it in understanding the financial impact on businesses of adopting Option Two – a refined and revised Franchising Code. To do this, it has utilised the Business Cost Calculator available through the Office of Best Practice Regulation.[[51]](#footnote-51) Consistent with regulatory impact analysis requirements, quantification has only been undertaken in relation to those changes which are expected to result in more than a nominal or minor increase or decrease in compliance costs.

The below discussion relates to some of the working assumptions adopted in the process of quantifying compliance costs (and compliance savings) flowing from the proposed changes.

**General assumptions and parameters**

In quantifying the costs and savings associated with changes to the Franchising Code, the following general assumptions have been applied:

* The cost of legal advice is $500 per hour.[[52]](#footnote-52)
* The average cost of an owner/manager’s time is $35 per hour.[[53]](#footnote-53)
* The average cost of an employee’s time is $27 per hour.[[54]](#footnote-54)
* The average cost of a manager’s time is $50 per hour.[[55]](#footnote-55)
* Changes to the Franchising Code will only apply prospectively.
* There are approximately 1180 franchisors operating under the Franchising Code.[[56]](#footnote-56)

Costings have been prepared on the basis of a 10 year period from when the changes take effect.

**Considerations and assumptions underpinning certain changes which will result in a net compliance cost increase**

* Reviewing disclosure and other documentation as a result of recommendations relating to online activities, marketing funds, foreign franchisor details, capital expenditure, and the obligation to act in good faith. Regulatory impact costs will primarily be felt upfront during the transitional stage during the first 12 months of the operation of the amendments. In relation to good faith, costs relate to legal advice to ensure that contracts will meet good faith requirements. The additional legal costs, which will total $2,950,000, have been factored into legal advice costs in the table below (on page 45) which includes the cost of legal advice to update the disclosure document as a result of other amendments to the code. These costs are calculated over a 10 year period. More than half of the cost of the legal advice is to update disclosure documents to comply with the proposed obligation to act in good faith.
  + - The primary cost involved will be franchisors having to pay their legal advisers for the additional time involved in preparing disclosure documentation as a result of these changes.
* The provision to prospective franchisees of an information statement in addition to formal disclosure.
  + - The only cost to the franchisor would be through the additional time in sending the franchisee the document, and this would take approximately 15 minutes per statement.
    - For 2002 – 2012, there was an average of 1,890 new franchisees per year. Each franchisor takes on an average of 1.6 new franchisees per year.
    - The risk statement would most often be provided by email or in person, eliminating the cost of posting the statement to a franchisee.
* More stringent regulation of capital expenditure imposed on franchisees.
  + - The costs of this are difficult to quantify however see comments above at page [32 and 41].
* Increased ability for franchisees to vote for an audit of their marketing funds.
  + - Under the proposed change to the Code, franchisors will have to conduct the vote on an audit of the marketing fund every year as opposed to every three years. This will result in a minor compliance cost increase. Feedback to Treasury from industry representatives is that this process is straightforward. The vote is usually conducted at a regular meeting of franchisees, through voting buttons in an Outlook email or sending a form out and franchisees returning it with a yes or no vote.
    - Franchisors will have to conduct the vote an additional seven times over a 10 year period. Currently, approximately 60 per cent of franchise systems have a marketing fund.[[57]](#footnote-57)
* The imposition of a statutory obligation to act in good faith.
  + - The costs of this are difficult to quantify however see comments above at page 39 and the cost of legal advice discussed above on page 42.
* An expansion to the information the ACCC can request as part of an audit:
  + - There will be a slight increase in the time and legal costs for a franchisor complying with an audit under 51ADD of the CCA. The additional documents that the ACCC will be able to request are central to the operation of the franchise and should routinely be kept as part of the ordinary course of business by franchisors.
* Expanding the obligation to disclose materially relevant facts by ensuring this captures not only the franchisor, but also associates of the franchisor.
  + - The costs associated with this are expected to be negligible.[[58]](#footnote-58)

**Considerations and assumptions underpinning changes which will result in a net compliance cost saving**

* Simplification of foreign and master franchisor disclosure requirements.
  + - 32 per cent of systems in Australia use a master/foreign franchisor structure. This equates to 377 franchisors.[[59]](#footnote-59)
* Removal of items 15, 16, 17 & 17B of Annexure 1
  + - This will save franchisors an average of eight hours of legal advice per year.[[60]](#footnote-60)

**Conclusions regarding compliance costs**

The following table sets out the result of the costings analysis undertaken by the Treasury in relation to the Franchising Code. It shows that, based on the costs that can be quantified, there will be a net annual compliance saving to the franchising sector of $8,608,917.50.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Regulatory Burden and Cost Offset (RBCO) Estimate Table** | | | | | |
| Average Annual Compliance Costs (from Business as usual) |  |  |  | |  |
|  |  |  |  | |  |
| Costs ($m) | Business | Community Organisations | Individuals | | Total Cost |
| Total by Sector | $437,882.50 | n/a | n/a | | $437,882.50 |
|  |  |  |  | |  |
| **Cost offset ($m)** | | | | | |
| Agency | $9,046,800 | n/a | n/a | $9,046,800 | |
| Within portfolio | n/a | n/a | n/a | n/a | |
| Outside portfolio | n/a | n/a | n/a | n/a | |
| Total by Sector | $9,046,800 | n/a | n/a | $9,046,800 | |
|  |  |  |  |  | |

|  |
| --- |
|  |
| Proposal is cost neutral? yes X no |
| Proposal is deregulatory X yes 🗆 no |
| Balance of cost offsets $8,608,917.50 |

* 1. **Option 3: ‘Light touch’ regulatory option** 
     1. **What does this option involve?**

Under this option there would be no legislative changes to the Franchising Code or the CCA. Instead, the Government would take other action to address the problems identified such as initiatives to improve the education levels of franchisees prior to entering into franchising.  Equipping franchisees, through education, with improved understanding of the importance of due diligence and other key information regarding operating a franchise may address the problems that have been identified by the sector including through the Review process.

This could include such practical measures as:

* Promoting awareness of existing education programs available to franchisees and franchisors (including pre‑entry education programs);
* Developing new programs of this nature for franchisees and franchisors; and
* The ACCC taking a more active role in relation to prosecuting breaches of the Franchising Code with existing enforcement tools, and relevant provisions of the Australian Consumer Law. This will increase awareness among the sector of the Franchising Code and the role of the ACCC.
  + 1. **What are the qualitative costs and benefits of this option?**

Costs of this option include:

* The voluntary nature of participation in education, and the limited ability to reach all of the sector’s participants, means that ultimately the benefits of this approach will be less widespread than under Option 2. This is problematic given that parties who are less likely to seek out, or take up, opportunities such as pre-entry education may be the same parties who would benefit most from such initiatives.
* The Franchising Code will not respond optimally to identified problems such as information asymmetry and will therefore be less effective in meeting its policy objectives outlined at the beginning of this RIS. As a result, franchisees and franchisors will be making economically inefficient decisions and complying with unnecessary regulation.
* The compliance cost savings identified under Option 2 will not be realised by the sector. This will contribute to inefficient allocation of resources.
* While this option will lower costs for franchisors and franchisees, it will impose new costs on the Government in developing and publicising programs and administering the Franchising Code, including the high cost of enforcement.

Benefits of this option include:

* Regulatory stability and development of case law is promoted by infrequent changes to the law. The Franchising Code was introduced in 1998 and since then has been amended 4 times, in 1999, 2001, 2007 and most recently in 2010. However, it is noted that regulatory stability will not necessarily be promoted by maintaining the current Franchising Code due to the possible emergence of state‑based franchising regulation.
* This would allow time for other regulatory reforms to be progressed which are relevant to franchising. For example, the Government has committed to an independent review of competition laws and policy and has further stated its preference that unfair contract terms protection be available for small business. Any regulatory changes which flow from these Government policies may be relevant to decisions regarding the Franchising Code. For example, if a franchise agreement was covered by a general rule voiding unfair contract terms, some of the changes to the Franchising Code proposed in Option 2 (above) may not be necessary.

1. **Consultation** 
   1. **Previous consultation**

As noted above, the Franchising Code has been subject to a number of reviews since it was introduced in 1998. Most recently, in 2013, a comprehensive independent review was conducted by Mr Alan Wein, followed by extensive consultation on the implementation of Mr Wein’s recommendations. This included a concerted effort to raise awareness about the Review. The views of stakeholders expressed in consultation are detailed above in the impact analysis of the recommended option (see page 31 onwards). The consultation can be broken down into the following phases.

* + 1. **Release of discussion paper**

In January 2013, a discussion paper was released to facilitate consultation following the public release of the terms of reference for the Review and a call for submissions. The discussion paper posed a number of questions for consideration.

* + 1. **Submissions to the Review**

A call for submissions to inform the Review was made on 4 January 2013. The formal date for close of submissions was 15 February 2013. The Review received a total of 73 submissions from a range of stakeholders including government bodies, academics, professional advisers, industry associations, and individual franchisors and franchisees.

* + 1. **Meetings with key stakeholders across Australia**

From January – March 2013, Mr Wein held a number of meetings with stakeholders across Australia, including government bodies and representatives, academics, professional advisers, industry associations, and individual franchisors and franchisees.

* + 1. **Consultation paper on review recommendations**

The Review report was publicly released on 17 May 2013. On 17 June 2013, a consultation paper was subsequently released to seek feedback on the recommendations made by Mr Wein and options for addressing the problems he identified in the course of the Review. The purpose of the discussion paper was to facilitate further consultation on potential changes to franchising regulation.

* + 1. **Responses to consultation paper**

A total of 169 responses were received to the consultation paper, again from a range of stakeholders.

* + 1. **Targeted consultation**

In addition to public calls for responses to the consultation paper, targeted consultation was undertaken by government officials to further clarify the impact of particular changes to franchising regulation, where this was not clear from the submissions or responses received to the consultation paper. This involved ongoing contact with key industry bodies, professional advisers and other stakeholders over a number of months.

* 1. **Future consultation**

It is envisaged that draft legislation to implement the recommended option will be publicly exposed for comment during 2014 (see **Attachments A** and **B**). This will allow stakeholders to respond to the detail of how the proposed changes are implemented. While this consultation is not intended as an opportunity to revisit the policy behind the proposed changes, it will be a means of understanding any unintended consequences which may flow from the particular way in which the policy is proposed to be implemented.

1. **Conclusion and recommended option**

A thorough review and consultation process has resulted in a number of suggestions being put to the Government for improvements to the Franchising Code, and the provisions of the CCA which provide for its enforcement by the ACCC. These suggestions have been tested and considered according to their respective costs and benefits throughout a comprehensive consultation process. The package of changes which are put forward in Option 2, as described in Part 5, respond to problems in a manner that ensures the costs of taking action are outweighed by the benefits. The proposal in Option 2 is an opportunity to improve the Franchising Code’s consistency with its original objectives, while at the same time reducing red tape and complexity for the sector.

It is recommended that the Government reform and refine franchising regulation in accordance with Option 2 as described in Part 5.

1. **Implementation and review**

The implementation of Option 2, as described in Part 5, will be achieved by amendments to the CCA and the Franchising Code. Copies of those prospective amendments have been prepared and are included at **Attachments A** and **B**.

As noted above, it is intended to conduct a further, final round of consultation whereby Attachments A and B are exposed for a period of public comment. Subject to any minor changes resulting from the period of public comment, the amending bill and proposed regulation will then be progressed through the Parliament and the Federal Executive Council.

It is intended that the regulation prescribing the Franchising Code will be both amended and remade to facilitate a further period of 10 years before the automatic repeal provisions of the *Legislative Instruments Act 2003* take effect.

1. Section 2, *Competition and Consumer Act 2010*. [↑](#footnote-ref-1)
2. Section 51ACA, *Competition and Consumer Act 2010*. [↑](#footnote-ref-2)
3. *Policy guidelines on prescribing industry codes under Part IVB of the Competition and Consumer Act 2010*, May 2011, Commonwealth of Australia, <http://archive.treasury.gov.au/documents/2035/PDF/Policy%20Guidelines%20on%20Prescribing%20Industry%20Codes.pdf>. [↑](#footnote-ref-3)
4. *Review of the Franchising Code of Conduct*, Mr Alan Wein, 30 April 2013. [↑](#footnote-ref-4)
5. *The Future of Franchising*, April 2014, [www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Franchising-Code](http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Franchising-Code) [↑](#footnote-ref-5)
6. Clause 3 of Schedule 1 to the *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* [↑](#footnote-ref-6)
7. Griffith University, Asia-Pacific Centre for Franchising Excellence, *Franchising Australia 2012* pages 9-12. [↑](#footnote-ref-7)
8. *Trade Practices (Industry Codes – Franchising) Regulation 1998*, clause 2. [↑](#footnote-ref-8)
9. Explanatory Statement, *Trade Practices (Industry Codes – Franchising) Regulation 1998*. [↑](#footnote-ref-9)
10. The Australian Government funded Office of the Franchising Mediation Adviser (OFMA) assists franchisors and franchisees resolve disputes. It does this by providing information and advice free of charge by telephone and email about dispute resolution. In appropriate cases, this may extend to facilitating contact between a franchisor and franchisee to assist in resolving the dispute. OFMA also facilitates formal, low cost mediation for parties in dispute. [↑](#footnote-ref-10)
11. <http://www.innovation.gov.au/smallbusiness/codesofconduct/Pages/Library%20Card/ReviewoftheFranchisingCodeofConduct.aspx>. On 18 September 2013, small business policy functions transferred to the Department of The Treasury. The Treasury website will be updated to reflect Machinery of Government Changes in due course. [↑](#footnote-ref-11)
12. [The Coalition’s Policy for Small Business](http://lpaweb-static.s3.amazonaws.com/13-08-19%20The%20Coalition%E2%80%99s%20Policy%20for%20Small%20Business.pdf)*,* August 2013. [↑](#footnote-ref-12)
13. This is an addition of the number of franchisors and franchisees from the Griffith University publication, *Franchising Australia 2012*, page 2. [↑](#footnote-ref-13)
14. Counts of Australian business operators, 2011-2012, Australian Bureau of Statistics. [↑](#footnote-ref-14)
15. Mr Alan Wein, *Review of the Franchising Code of Conduct* (April 2013), p. vii. [↑](#footnote-ref-15)
16. ACCC, *Small business in focus*. It is important to note that the information reported here reflects complaints and enquiries received by the ACCC from various sources and are provided as general guidance only. On further investigation, the reported conduct may not amount to a legislative breach. Therefore, care should be taken when drawing conclusions based on this data. [↑](#footnote-ref-16)
17. Office of the Franchising Mediation Adviser, Annual Report: 1 July 2012 – 30 June 2013. [↑](#footnote-ref-17)
18. Letter presenting the review report to the then Minister for Small Business and the then Parliamentary Secretary for Small Business Minister from Mr Alan Wein dated 30 April 2013, *Review of the Franchising Code of Conduct* (April 2013). [↑](#footnote-ref-18)
19. Productivity Commission Research Report, *Regulator Engagement with Small Business,* September 2013, page 2. [↑](#footnote-ref-19)
20. Griffith University, *Franchising Australia 2012*, page 37. [↑](#footnote-ref-20)
21. See Clause 6 of the Franchising Code. [↑](#footnote-ref-21)
22. See Items 15, 16, 17, and 17B of the disclosure document (Annexure 1 to the Franchising Code). [↑](#footnote-ref-22)
23. See, for example, *Trade Practices (Industry Codes – Franchising) Regulations 1998,* Schedule 1 (the Franchising Code), Annexure 1, items 6 and 11. [↑](#footnote-ref-23)
24. See *Trade Practices (Industry Codes – Franchising) Regulations 1998,* Schedule 1 (the Franchising Code), clause 18. [↑](#footnote-ref-24)
25. See *Trade Practices (Industry Codes – Franchising) Regulations 1998,* Schedule 1 (the Franchising Code), clause 17. [↑](#footnote-ref-25)
26. See *Trade Practices (Industry Codes – Franchising) Regulations 1998,* Schedule 1 (the Franchising Code), clause 20A. [↑](#footnote-ref-26)
27. Griffith University offers a free, pre-entry franchise education course sponsored by the ACCC. See: <http://www.franchise.edu.au/home/education/for-franchisees/pre-entry-franchise-education>. [↑](#footnote-ref-27)
28. Research by Griffith University, presented in the Franchising Australia 2012 report, indicates that the average term of a franchise agreement is 5 years (see page 46). An electronic copy of the report is available from the [Griffith University website](http://www.franchise.edu.au/franchise-research.html). [↑](#footnote-ref-28)
29. Research by Griffith University, presented in the *Franchising Australia 2012* report indicates that only three per cent of agreements are terminated, not renewed or repurchased by franchisors annually, indicating that the sector is actually quite stable in this respect (see page 69). An electronic copy of the report is available from the [Griffith University website](http://www.franchise.edu.au/franchise-research.html). [↑](#footnote-ref-29)
30. Letter presenting the review report to the then Minister for Small Business and the then Parliamentary Secretary for Small Business Minister from Mr Alan Wein dated 30 April 2013, *Review of the Franchising Code of Conduct* (April 2013). [↑](#footnote-ref-30)
31. Clause 23A of the Code provides that nothing in the Code limits any obligation imposed by the common law on parties to franchising agreements to act in good faith. However, the parties to a franchise agreement may contract out of this obligation.  Clause 23A was inserted into the Franchising Code in 2010.  Key concerns with clause 23A, as identified in the review report at page 68 are: it does not prevent arguments that there is no duty to act in good faith; it can be contracted out of; it is not enforceable by the ACCC; and it can result in costly legal advice needing to be sought. [↑](#footnote-ref-31)
32. See *Competition and Consumer Act 2010* (Cth), Schedule 2 (The Australian Consumer Law), Chapter 2 (General Protections). [↑](#footnote-ref-32)
33. Law Society of South Australia, submission to the review of the Franchising Code of Conduct, p 4. [↑](#footnote-ref-33)
34. For example, see recommendation 8 of the *Parliamentary Joint Committee on Corporations and Financial Services “Opportunity not opportunism: improving conduct in Australian franchising” 2008.* [↑](#footnote-ref-34)
35. Review of the Franchising Code of Conduct, Mr Alan Wein, 2013, p. 66. [↑](#footnote-ref-35)
36. See *Trade Practices (Industry Codes – Franchising) Regulations 1998,* Schedule 1 (the Franchising Code), Annexure 1, item 6.6. [↑](#footnote-ref-36)
37. Productivity Commission Research Report, *Regulator Engagement with Small Business,* September 2013, pages 6 – 7. [↑](#footnote-ref-37)
38. See Clause 2 of the Franchising Code itself. [↑](#footnote-ref-38)
39. Explanatory Memorandum, *Trade Practices Amendments (Fair Trading) Bill 1997*, page 3. [↑](#footnote-ref-39)
40. See the *Legislative Instruments Act 2003* (Cth), section 50. [↑](#footnote-ref-40)
41. See, for example, the Franchising Bill 2010 (WA), Franchising Agreements Bill 2011 (WA), Franchising (South Australia) Bill 2009 (SA). [↑](#footnote-ref-41)
42. L. Frazer et. al, *Preparation for Franchising: A study of prospective and current franchisees*, 2013, p. 50. [↑](#footnote-ref-42)
43. Dr Elizabeth Spencer and Mr Simon Young, submission to the Franchising Code Review*,* p 6. [↑](#footnote-ref-43)
44. Alert, Bywaters Timms law firm, *Franchise Marketing and other cooperative funds*. See also Queensland Law Society Franchising Law Committee, submission to the review. [↑](#footnote-ref-44)
45. Andrew Terry and Cary Di Lernia discuss the relational nature of franchising and how this is distinct from typical contractual arrangements which involve a one-off exchange in their article ‘Franchising and the Quest for the Holy Grail: Good Faith or Good Intentions?’, Melbourne University Law Review, 2009. [↑](#footnote-ref-45)
46. Mr Alan Wein, *Review of the Franchising Code of Conduct* (April 2013), p. 18. [↑](#footnote-ref-46)
47. McDonalds submission to the review of the Franchising Code of Conduct, p. 2. [↑](#footnote-ref-47)
48. For example, in 2013 the ACCC released a three page general guidance pamphlet on supply arrangements in franchise relationships, see: <http://www.accc.gov.au/publications/competition-issues-in-franchising-supplier-arrangements>. [↑](#footnote-ref-48)
49. See, for example, Angela Hurst, ‘The Impact of the Iowa Franchise Law on Restaurant Franchisor Engagement’ [1997], p. 15. [↑](#footnote-ref-49)
50. Estimated to equal approximately three additional hours per franchisor. [↑](#footnote-ref-50)
51. Further information on the Business Cost Calculator is available from the [Office of Best Practice Regulation website](http://www.dpmc.gov.au/deregulation/obpr/bcc/index.cfm). [↑](#footnote-ref-51)
52. This figure is based on consultation with industry sources. [↑](#footnote-ref-52)
53. According to the Australian Bureau of Statistics Publication 6306.0 *Employee Earning and Hours Australia* (May 2012), the average weekly cash earnings of an owner manager of an incorporated enterprise is $1,331.10. Based on owners working a 38 hour week, this equates to approximately $35 per hour. This publication was released 23 January 2013 and is available from the [Australian Bureau of Statistics website](http://www.abs.gov.au/ausstats/abs@.nsf/mf/6306.0/). [↑](#footnote-ref-53)
54. According to the Australian Bureau of Statistics Publication 6306.0 *Employee Earning and Hours Australia* (May 2012), the average weekly cash earnings of a non-managerial employee is $1,031. Based on employees working a 38 hour week, this equates to approximately $27 per hour. This publication was released 23 January 2013 and is available from the [Australian Bureau of Statistics website](http://www.abs.gov.au/ausstats/abs@.nsf/mf/6306.0/). [↑](#footnote-ref-54)
55. According to the Australian Bureau of Statistics Publication 6306.0 *Employee Earning and Hours Australia* (May 2012), the average weekly cash earnings of a managerial employee is $1,926. Based on employees working a 38 hour week, this equates to approximately $50 per hour. This publication was released 23 January 2013 and is available from the [Australian Bureau of Statistics website](http://www.abs.gov.au/ausstats/abs@.nsf/mf/6306.0/). [↑](#footnote-ref-55)
56. Research by Griffith University, presented in the Franchising Australia 2012 report. An electronic copy of the report is available from the [Griffith University website](http://www.franchise.edu.au/franchise-research.html). [↑](#footnote-ref-56)
57. This figure is based on consultation with industry sources. [↑](#footnote-ref-57)
58. This information is based on consultation with industry sources. [↑](#footnote-ref-58)
59. Research by Griffith University, presented in the Franchising Australia 2012 report (page 85). An electronic copy of the report is available from the [Griffith University website](http://www.franchise.edu.au/franchise-research.html). [↑](#footnote-ref-59)
60. This figure is based on consultation with industry sources. [↑](#footnote-ref-60)