

## **Government's Expert Report<sup>1</sup> Endorses Franchising and Suggests Code Improvements**

The Franchise Council of Australia has welcomed the outcomes and recommendations of the review of the Franchising Code of Conduct conducted by franchising expert Alan Wein. Many of the recommendations reflect suggestions we have made in our submission, or supported in our discussions with Alan Wein during the review.

Importantly it appears the Wein Report has bi-partisan support at Federal level, and makes it extremely difficult for State Governments to justify any regulatory intervention at a State level. The Wein Report noted that submissions to the Review were overwhelming in their support for the retention of a single, national regulatory scheme, commenting that "evidence clearly indicates that a national system reduces duplication, red tape, uncertainty, compliance costs and ensures franchisors are in the best position to develop and maintain an effective national business model".

The Report has rejected calls for mandatory extension of franchise agreements, and compensation at end of the franchise term. Similarly the Report has adopted the FCA's suggestion for the incorporation of the common law duty of good faith into the Code rather than some new and different definition of good faith.

Alan Wein also expressed his desire to see franchisors and franchisees have the benefits of pre-entry and ongoing education, noting that he saw a strong role for the industry to play in this respect. The FCA has championed franchising education, and is keen to have Government support to extend our pre-entry and ongoing educational initiatives.

The review of the Franchising Code of Conduct was the most comprehensive since its introduction in 1998. Pleasingly, it found that the Australian franchise sector operates well, and the Franchising Code of Conduct is "a robust model" and "generally operates effectively within a very dynamic and difficult economic environment."<sup>2</sup> The Report notes the relatively low levels of complaint and disputation in the sector.

The Wein Report has suggested a range of improvements aimed at "ensuring outcomes that all reasonable parties would agree produce fairness and enhance confidence in commercial dealings" and "simplify some aspects of the industry's regulation, to ensure less red tape and improve clarity in compliance requirements." The FCA supports these aims, and is keen to continue to work with Government and the ACCC to ensure these aims are realised.

The review of the Code honoured a commitment by the Government to review in 2013 the effectiveness of the amendments to the Code made in 2008 and 2010. Alan Wein was also asked to inquire into good faith in franchising, franchisee rights at end of the term of their franchise agreements and the operation of the Competition and Consumer Act in the context of enforcement of the Code.

The Wein Report contains a total of 18 recommendations to government, including the insertion of an obligation to act in good faith into the Code, and the introduction of civil pecuniary penalties for breaches of the Code. There are also a number of recommendations aimed at addressing specific problematic areas such as the issue of franchisor failure, simplifying compliance and improving regulatory certainty. Wein notes that "No recommendation has been made that franchisees receive

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<sup>1</sup> "The Wein Report" is the Alan Wein Review of the Franchising Code of Conduct: Report to the Hon Gary Gray AO MP, Minister for Small Business, and the Hon Bernie Ripoll MP, Parliamentary Secretary for Small Business.

<sup>2</sup> Letter from Alan Wein 30 April 2013 to the Minister and Parliamentary Secretary, Wein Report, page i

an exit payment or goodwill payment at the end of the term of their franchise agreement,” as “this would interfere with fundamental principles of contract and property law. However, a recommendation has been made relating to the use of restraint of trade clauses in the context of franchisors not renewing franchise agreements in certain circumstances.”<sup>3</sup>

The Franchise Council of Australia has cautiously supported the vast majority of 18 Recommendations, noting that it is important that the actual amendments to the Code are carefully drafted to reflect the reasoning contained in the Wein Report and avoid any unintended or unreasonable consequences. The FCA still considers that there would be value in enabling the Australian Competition and Consumer Commission to grant exemptions from strict Code compliance or modify Code compliance requirements, as the franchise model is applied across a vast array of different businesses and industries. The FCA is also concerned to ensure that any ACCC enforcement is fair, measured and cognisant of the fact that most franchisors and almost all franchisees are small businesses.

The FCA is keen to continue to work with Government on the detail of the Code amendments, including the recommended clarifications and changes to the Code included in Appendix D to the Wein Report. These clarifications and changes largely reflect contributions made by the FCA’s Legal Committee as part of the FCA’s submission.

#### Summary of Recommendations and FCA Comments

The Recommendations of the Wein Report are summarised below. The full Report, and the detailed Recommendations, will be made available on the FCA’s website [www.franchise.org.au](http://www.franchise.org.au) in due course.

<p>1. Clause 20A of the Code be amended so that a franchisor is to provide a disclosure document to a franchisee if it is the franchisor's intention to renew a franchise agreement. This enables the franchisee to consider the disclosure information before deciding to exercise its option to renew.</p>	<p>The FCA supports this clarification to the Code, noting that many franchise systems already adopt this approach.</p>
<p>2. The Code disclosure process for a foreign franchisor or a master franchisor should be simplified by requiring a prescribed shorter form of disclosure to be provided. The reduced disclosure document should include information such as the basic contact details and background of the foreign franchisor or master franchisor, the essential obligations that have been delegated under the master franchise agreement, information regarding intellectual property including the ownership or licensing arrangements that the franchisee will have rights to and what the impact will be on the sub-franchisee if the master franchisee is terminated or not renewed.</p>	<p>The FCA supports the Recommendation in principle, but considers some additional information should be disclosed. The FCA hopes to work with the Government to settle the precise wording of the amendments to the Code.</p>
<p>3. The Code be amended to ensure that a franchisor is required to disclose the rights of the franchisor and franchisee to conduct and benefit from online sales, including any ability of the franchisor to conduct online sales.</p>	<p>The FCA supports this improvement to the Code.</p>
<p>4. The Code be amended to remove Annexure 2 (Short form disclosure document for franchisee or prospective franchisee).</p>	<p>The FCA supports this amendment to the Code.</p>

<sup>3</sup> Wein Report Executive Summary page vii

<p>5. The Code be amended to require franchisors to provide prospective franchisees with a short summary of the key risks and matters they should be aware of when going into franchising, based on the following principles:</p> <ol style="list-style-type: none"> <li>a. the summary should be generic (as per the existing warnings in item 1 of Annexure 1 to the Code);</li> <li>b. the summary should provide more detail than the current item 1 of Annexure 1 to the Code, but should not be more than one to two pages in length;</li> <li>c. the summary should be a standalone document rather than incorporated into the disclosure document; and</li> <li>d. the summary should be provided to franchisees at their first point of contact with a franchisor (that is, at the time of enquiring about a franchise opportunity).</li> </ol>	<p>The FCA has already prepared a draft Risk Statement and intends to work collaboratively with the ACCC and the Government to give effect to this Recommendation.</p>
<p>6. The Code be amended to:</p> <ol style="list-style-type: none"> <li>a. Provide franchisees and franchisors with a right to terminate the franchise agreement in the event that any administrator of the other party does not turn the business around, or a new buyer is not found for the franchise system, within a reasonable time (for example 60 days) after the appointment of an administrator. It should be made possible for the courts to make an order extending this timeframe in appropriate cases. It should also be clear that the parties can negotiate a right to terminate at an earlier stage.</li> <li>b. Ensure the franchisees can be made unsecured creditors of the franchisor by notionally apportioning the franchise fee across the term of the franchise agreement, so that any amount referable to the unexpired portion of the franchise agreement would become a debt in the event the franchise agreement ended due to the franchisor's failure.</li> </ol>	<p>The FCA believes that this Recommendation needs adjustment. It is vital to ensure that any proposed amendment to the Code does not impact on the willingness of banks to lend to the franchise sector. Similarly there needs to be broad consultation with insolvency practitioners. The FCA is also concerned that giving franchisees an express right of termination may impact on existing franchisees that wish to remain in the franchise system, and may lead franchisees to mistakenly believe they should pursue termination when it is in their best interests to continue with a proven brand and system. The FCA does not support this Recommendation at this point.</p>
<p>7. The Code be amended to prohibit franchisors from imposing unreasonable significant unforeseen capital expenditure. 'Unreasonable' and 'significant' should be defined, with a view to a franchisor being able to demonstrate a business case for capital investment in the franchised business.</p>	<p>The FCA queries the necessity of this Recommendation, and whether it is appropriate for regulation to intervene in this areas of business. It is critical that franchisors remain able to continuously improve the franchise system and introduce new technology. The FCA believes that it would be extremely difficult to draft provisions that gave effect to the intent without creating considerable and unnecessary uncertainty.</p>
<p>8. The Code be amended with respect to the administration of marketing funds. Notably the Recommendation proposes that a franchisor should separately account for marketing and advertising costs, and contributions to marketing funds from individual franchisees should be held on trust for franchisees. Although the franchisor is still to have wide discretion as to how to expend the funds, company-owned units must be required to contribute to the fund on the same basis as franchised units and</p>	<p>The FCA acknowledges the intent of the provision, but questions the introduction of a formalised trust concept. This could have undesirable taxation and other consequences. Similarly the FCA considers that the current marketing fund provisions operate effectively, and already</p>

<p>the marketing and advertising fund should only be used for expenses which are clearly disclosed and which are legitimate marketing and advertising expenses. A once yearly independent audit should be conducted on marketing funds over a certain threshold value, with no capacity for franchisees to vote against such an audit, and the results of the audit (where applicable) and other detailed information about the expenditure of marketing and advertising funds should be made available to franchisees yearly.</p>	<p>contain significant protections for franchisees. The FCA also considers that funds should be able to cover public relations, customer service initiatives, loyalty programs and other areas where common expenditure is desirable. The FCA queries whether such a prescriptive approach is warranted.</p>
<p>9. The Code be amended to include an express obligation to act in good faith. Such an obligation should:</p> <ol style="list-style-type: none"> <li>a. extend to the negotiation of a franchise agreement, the performance of a franchise agreement, the performance of obligations under the Code, and the resolution of any disputes between the parties whether or not there is a valid franchise agreement at the time of the dispute;</li> <li>b. not be defined, instead the unwritten law relating to good faith should be incorporated in a manner similar to the unconscionable conduct prohibition set out in section 20 of the Australian Consumer Law;</li> <li>c. apply to both the franchisor and the franchisee or prospective franchisee and the agents of these parties;</li> <li>d. not be able to be limited or excluded by any provision of the contract between the parties (such provisions should be declared void);</li> <li>e. be clearly stated as not preventing a party from acting in its legitimate commercial interests; and</li> <li>f. expressly exclude an argument that a franchisor has not acted in good faith because there is no term in a franchise agreement specifying a right of renewal.</li> </ol>	<p>The FCA suggested this amendment to address perceptions that the implied duty of good faith did not exist in all franchise agreements. It is vital that the Code wording be carefully drafted to reflect the intent of this Recommendation.</p>
<p>10. The 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.</p>	<p>The FCA supports this Recommendation.</p>
<p>11. That subclause 20(4) of the Code be amended to effectively extend the time period for a franchisor to give consent to a request for transfer to 42 days after the request was made, or all information reasonably required by the franchisor under the franchise agreement has been provided, whichever is the latter.</p>	<p>The FCA supports this clarification, which helps ensure a franchisor is not deemed to have given consent when the franchisee has not provided sufficient information.</p>
<p>12. The Code be amended to state that, if all of the following conditions are satisfied:</p> <ol style="list-style-type: none"> <li>a. the franchisee wishes to have the franchise agreement renewed on substantially the same terms;</li> <li>b. the franchisee is not in breach of the agreement;</li> <li>c. the agreement does not contain provisions allowing a franchisee to make a claim for compensation in the event that the franchise is not renewed;</li> <li>d. the franchisee abides by all confidentiality clauses in the agreement and does not infringe the intellectual property of the franchisor; and</li> <li>e. the franchisor does not renew the franchise agreement;</li> </ol>	<p>The FCA cautiously supports this Recommendation, particularly in the context of the Review's rejection of any form or end of term compensation. Although the FCA would prefer no regulatory change in this area, the FCA considers this to be a workable compromise in all the circumstances.</p>

<p>any restraint of trade clauses in the franchise agreement which prevent the franchisee from carrying on a similar business in competition with the franchisor, are not enforceable by the franchisor against the franchisee.</p>	
<p>13. The Code should be amended to provide that clause 29(8) applies to participation in any alternative dispute resolution process whether under OFMA, state small business commissioners, privately retained; court appointed or otherwise.</p>	<p>The FCA supports this Recommendation.</p>
<p>14. Amend the Code to ensure that franchisors cannot:</p> <ul style="list-style-type: none"> <li>a. attribute the legal costs of dispute resolution to a franchisee unless ordered by a court;</li> <li>b. require a franchisee to litigate outside the jurisdiction in which the franchisee’s business primarily operates.</li> </ul>	<p>The FCA supports the first part of this Recommendation, but rejects the requirement that a franchisor be required to litigate only in the State where the business is located. The FCA would support a Recommendation that litigation must be conducted in Australia, not overseas, but considers this Recommendation may inhibit a franchisor from interstate expansion.</p>
<p>15. The Competition and Consumer Act 2010 (the CCA) be amended to:</p> <ul style="list-style-type: none"> <li>a. allow civil pecuniary penalties to a maximum of \$50 000 to be available as a remedy for a breach of the Code;</li> <li>b. allow the ACCC to issue an infringement notice for a breach of the Code;</li> <li>c. allow the ACCC to use its powers under section 51ADD of the CCA (its random audit powers) to assess a franchisor’s compliance with all aspects of the Code, not just to require the production of documents created under the Code;</li> <li>d. include a breach of the Code in the contraventions for which the court may make an order under section 86E (Order disqualifying a person from managing corporations); and</li> <li>e. specify that the court can make franchising specific orders under section 87, including orders requiring a franchisor to: <ul style="list-style-type: none"> <li>i. give a royalty free period to a franchisee affected by a breach of the Code; and</li> <li>ii. pay a sum of money specified by the court into any marketing or cooperative fund applicable to that franchise system.</li> </ul> </li> </ul>	<p>The FCA cautiously supports this Recommendation, and looks forward to working with the ACCC to ensure its enforcement policies match the intentions in provided the ACCC with better enforcement powers. In discussions with the FCA the ACCC has indicated its intent only to seek to impose penalties in cases of flagrant and material breach. Similarly infringement notices will be used sparingly, and recognising that most franchisors and almost all franchisees are small businesses.</p>
<p>16. An analysis of the impact of a minimum term and standard contractual terms for motor vehicle agreements should be undertaken prior to a future review of the Code.</p>	<p>The FCA has no view on this Recommendation.</p>
<p>17. There should not be another review of the Code for a minimum of five years after any amendments to the Code take effect in response to this report.</p>	<p>The FCA supports this Recommendation.</p>
<p>18. The Code be amended to make the policy intent of the provisions clearer, remove ambiguities, and improve consistency and</p>	<p>The FCA submission contained a number of requests for clarification</p>

certainty of industry practice. A suggested list of provisions and possible changes is set out in Appendix D: Technical or minor changes to the drafting of provisions of the Franchising Code.

and improvement, and is delighted the Review has endorsed its request for legislative clarification. The FCA hopes to work with the Government to settle the precise wording of the amendments to the Code.



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