



Law Council
OF AUSTRALIA

Review of the Franchising Code of Conduct

**Dr Michael Schaper, Independent Reviewer
The Treasury**

29 September 2023

Telephone +61 2 6246 3788
Email mail@lawcouncil.au
PO Box 5350, Braddon ACT 2612
Level 1, MODE3, 24 Lonsdale Street,
Braddon ACT 2612
Law Council of Australia Limited ABN 85 005 260 622
www.lawcouncil.au

Table of Contents

About the Law Council of Australia	3
Acknowledgements	4
Introduction	5
Responses to the consultation questions	5
General questions	5
The scope of regulation.....	6
Before entering into a franchise agreement.....	7
Enduring obligations in franchise relationships.....	8
Ending a franchise agreement.....	9
Enforcement and dispute resolution	10
Additional Comments	13
Evergreen or perpetual franchises.....	13
Independent legal advice.....	14
Site selection.....	14
Private enforcement	14

About the Law Council of Australia

The Law Council of Australia represents the legal profession at the national level; speaks on behalf of its Constituent Bodies on federal, national, and international issues; promotes and defends the rule of law; and promotes the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts, and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world. The Law Council was established in 1933, and represents its Constituent Bodies: 16 Australian State and Territory law societies and bar associations, and Law Firms Australia. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Law Society of the Australian Capital Territory
- New South Wales Bar Association
- Law Society of New South Wales
- Northern Territory Bar Association
- Law Society Northern Territory
- Bar Association of Queensland
- Queensland Law Society
- South Australian Bar Association
- Law Society of South Australia
- Tasmanian Bar
- Law Society of Tasmania
- The Victorian Bar Incorporated
- Law Institute of Victoria
- Western Australian Bar Association
- Law Society of Western Australia
- Law Firms Australia

Through this representation, the Law Council acts on behalf of more than 90,000 Australian lawyers.

The Law Council is governed by a Board of 23 Directors: one from each of the Constituent Bodies, and six elected Executive members. The Directors meet quarterly to set objectives, policy, and priorities for the Law Council. Between Directors' meetings, responsibility for the policies and governance of the Law Council is exercised by the Executive members, led by the President who normally serves a one-year term. The Board of Directors elects the Executive members.

The members of the Law Council Executive for 2023 are:

- Mr Luke Murphy, President
- Mr Greg McIntyre SC, President-elect
- Ms Juliana Warner, Treasurer
- Ms Elizabeth Carroll, Executive Member
- Ms Elizabeth Shearer, Executive Member
- Ms Tania Wolff, Executive Member

The Chief Executive Officer of the Law Council is Dr James Pople. The Secretariat serves the Law Council nationally and is based in Canberra.

The Law Council's website is www.lawcouncil.au.

Acknowledgements

This submission has been prepared by the Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (**SME Committee**) with additional input from the Law Society of NSW's Business Law Committee (**LSNSW**).

The SME Committee has as its primary focus the consideration of legal issues affecting small businesses and medium enterprises in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs.

Introduction

1. The Law Council of Australia welcomes the opportunity to make a submission in response to the *Review of the Franchising Code of Conduct, Consultation Paper*, dated August 2023 (the **Consultation Paper**).
2. In particular, the SME Committee is also grateful for the opportunity to meet virtually with Dr Michael Schaper, Independent Reviewer, on 12 September 2023 to discuss its views on the issues raised in the Consultation Paper.
3. Many of the members of the SME Committee have extensive experience in the franchising sector, acting for both franchisors and franchisees. The consensus view of the SME Committee is that the Franchising Code of Conduct (the **Code**) has met the needs of both franchisees and franchisors in terms of regulating interactions between the two groups and fostering productive and mutually beneficial working relationships. However, there are some areas where improvements to the Code could be made.

Responses to the consultation questions

General questions

Question 1

Are there any general observations you want to make about the regulatory framework?

4. The SME Committee believes that the regulatory framework for franchising is working effectively. Of particular note, the role of the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) in dispute resolution has been a significant change which has improved the timeliness and effectiveness of resolutions of franchise disputes. The SME Committee still holds concerns as to the low level of ACCC enforcement of contraventions of the Code, and significant impediments to private enforcement, especially in the form of class actions. This issue is discussed further below.

Question 2

Is the Franchising Code fit for purpose? Should it be retained? If so, should it be remade prior to sunseting?

5. The SME Committee believes that the Code is fit for purpose and should be retained in its existing form beyond 2025. It would improve business certainty if the Code were to be remade well before sunseting.

Question 3

Are there any emerging trends, such as technology or cultural innovations, which would affect the operation of the Franchising Code?

6. It is apparent to the members of the SME Committee that particular cultural groups are heavily represented in the franchising sector. Accordingly, the Committee suggests that additional educational activities by the Australian Competition and Competition Commission (**ACCC**) and ASBFEO should be specifically directed and tailored to these cultural groups, given their representation in the sector.

The scope of regulation

Question 4

Is the scope of coverage flexible enough having regard to the diversity of the franchising industry?

7. The SME Committee believes that the general scope of coverage of the Code remains appropriate. However, consideration should be given to extending the current provisions concerning motor vehicle dealerships to other dealerships which exhibit similar characteristics to the motor vehicle dealership sector. The SME Committee also believes that the scope of coverage is flexible enough to deal with the diversity of the franchising industry.

Question 5

Have the amendments regarding the exclusion of cooperatives from the provisions of the Franchising Code effectively clarified that they fall outside the scope of the Code?

8. The SME Committee has not identified any specific impacts of the exclusion of cooperatives from the provisions of the Code. However, the rationale for the exclusion of cooperatives is appropriate.

Question 6

What evidence is available to suggest additional protections in the Franchising Code for new car dealerships should be extended beyond new car dealerships (for example to truck, motorcycle and farm machinery dealerships)?

9. As a matter of principle, the SME Committee believes it is appropriate for the additional protections introduced for new car dealerships to be extended to truck, motorcycle and farm machinery dealerships. This is due to the existence of significant disparities in bargaining power between manufacturers and importers of these products and the dealerships that sell such products. In fact, the disparity of bargaining power between truck, motorcycle and farm machinery importers/manufacturers and dealerships may in some cases be greater than the disparities that exist in relation to new car dealerships.

Question 7

Should agreements between automotive manufacturers and dealerships that relate only to service and repair work (which do not cover matters relating to vehicle sales) be considered as franchise agreements and covered by the Franchising Code protections? Why or why not?

10. Given the principles behind the extension of protections to motor vehicle dealerships, the SME Committee considers that protection should also be extended to service and repair work. This is due to the obvious significant disparities in bargaining power between manufacturers and importers of motor vehicles and dealerships. Motor vehicle dealerships are also becoming increasingly dependent on revenues from service and repair work due to changes in industry structure: namely, the move to agency models and even direct online selling by manufacturers, especially in the electric vehicle sector.

Question 8

Has the amended definition of *motor vehicle dealership* effectively clarified that agency sales models remain within the scope of regulation under the Franchising Code?

11. The SME Committee agrees that the amended definition of motor vehicle dealership is appropriate.

Before entering into a franchise agreement

Question 9

How effective are the requirements of the Franchising Code that ensure franchisors make information available to franchisees prior to entry into a franchise agreement? If possible, please comment on the effectiveness and content required for inclusion in each of the Franchise Disclosure Register, Information Statement, Key Facts Sheet and Disclosure Document.

12. The SME Committee considers that the current requirements under the Code to ensure that franchisors make information available to franchisees prior to entry into any agreement are appropriate. The main problem that remains in relation to such disclosure is ensuring that franchisees carefully read the information prior to entering into the agreement. The reality is that some franchisees will diligently read all such information and seek appropriate professional advice, while others will not.

Question 10

How have changes to unfair contract terms laws impacted franchise agreements? Is the approach in the Franchising Code to regulating certain types of contract terms still appropriate?

13. In the SME Committee's view, the changes to the unfair contract terms (UCT) laws have had a profound effect in relation to compliance in the franchising sector. Franchisors are particularly aware of the potential for unfair terms to be declared void. Furthermore, franchisors are aware of the impending changes to the UCT laws, which will result in such terms being illegal and subject to very significant penalties.

Question 11

Do you have any other comments on how the Franchise Code regulates the relationship between franchisors and franchisees at the point of entry into a franchise agreement?

14. The SME Committee notes that there are effective courses in terms of educating prospective franchisees about the Code (for example, the free franchise courses offered through Griffith University's Asia-Pacific Centre for Franchising Excellence). However, in the SME Committee's view, franchisees learn in different ways. Some franchisees are very comfortable using online resources, whilst others prefer face-to-face instruction. Accordingly, it would be beneficial for the ACCC and the ASBFEO to jointly host face-to-face seminars for franchisees for the purposes of explaining how the Code operates, and franchisee's rights and obligations under the Code.

Question 12

What impact have the 2021 changes relating to compensation and return on investment had on franchisors and franchisees entering into new vehicle dealership agreements? Where possible, please provide detail on the costs and benefits the new car dealership sector has experienced because of these changes.

15. No comment.

Enduring obligations in franchise relationships

Question 13

How well does the Franchising Code support franchisors and franchisees during the term of the franchise agreement? In particular, does the Franchising Code provide adequate minimum standards relating to structural and/or operational change management?

16. The LSNSW agrees with the Review that unilateral variation of franchise agreements can undermine franchisees' due diligence prior to entering into a franchise agreement. At the same time, flexibility is required for franchisors to adapt and innovate their business model to respond to rapid market changes and remain competitive.
17. The LSNSW notes that the substantive franchise agreement may contain subsidiary documents, such as the operations manual. The operations manual enables the franchisor to impose standards on the way that businesses are operated under its brand (including to ensure appropriate quality standards for goods/services sold under that brand) and gives the franchisee information on how the business is to be operated. This is intended to shortcut the time it would take for the franchisee to develop these practices or this information independently.
18. A franchisor can make significant operational changes by way of variations to the operations manual. Clarification of the circumstances in which the franchisor can vary the operations manual is recommended. It would also be useful if the Review could consider the interaction of the Code with the UCT regime in the *Australian Consumer Law*,¹ particularly as it relates to a franchisor's ability to unilaterally vary the operations manual. This is important, as the operations manual is frequently incorporated by reference into the franchise agreement, and the ACCC has in the past expressed the view that a unilateral variation of the operations manual may be considered an unfair term in certain circumstances.
19. A common theme to recent changes to the Code has been to increase the level of disclosure a franchisor is required to provide before a franchise agreement can be entered into. The LSNSW acknowledges the importance of certainty for franchisees as to unilateral contract variations which may, in some cases, amount to an extension of the scope of a franchise agreement. However, it does not consider that the multiple, and often duplicative levels, of disclosure required² lend themselves to effective communication of that information to potential franchisees. In addition, the LSNSW is of the view that the density and prescriptiveness of the form of disclosure

¹ As set out in Schedule 2 of the *Competition and Consumer Act 2010* (Cth).

² Disclosure Document (cl 8, the Code); Key Facts Sheet (cl 9A); Information Statement (cl 11); Franchise Disclosure Register (sch 1, pt. 5A).

document means key information is not necessarily highlighted or fully appreciated by franchisees.

20. While the LSNSW supports the continuation of the Code, it also notes that the accretion of regulation³ is disruptive and adds significant additional regulatory burden on franchisors. In the LSNSW's view, these reforms have resulted in limited appreciable difference to the power dynamic and information asymmetries that exist between franchisors and franchisees / potential franchisees.

Question 14

How effective are the 2021 reforms which restricted the franchisors' capacity to require a franchisee to undertake significant capital expenditure?

21. The SME Committee believes that the 2021 reforms, which restricted the franchisor's capacity to require the franchisee to undertake significant capital expenditure, have had a positive impact in the sector. Members of the Committee have seen greater levels of consultation undertaken by franchisors when contemplating significant capital expenditure, particularly in relation to IT expenditures.

Question 15

What impact have the 2021 amendments to the obligation to act in good faith in relation to new car dealerships had? Where possible, please provide detail on the costs and benefits the new car dealership sector has experienced because of these changes.

22. No comment.

Ending a franchise agreement

Question 16

How effective are 2021 reforms to the Franchising Code which created a process for franchisees to formally request early exit from their franchise agreements?

23. The LSNSW notes that the 2021 reforms were intended to go some way to address a view that the Code reinforced an asymmetry of power in the franchisor's favour. The early termination process was one of a number of measures introduced⁴ in an attempt to adjust the balance of power in favour of franchisees, and was not intended to give an automatic right to terminate for any reason. Rather, it was designed to provide an avenue for franchisees to commence negotiations for early termination.
24. On one view, the early termination request process may be considered ineffectual, given that the franchisor retains the power to refuse a request, albeit with reasons. On another view, the parties' interests are sufficiently balanced, as a franchisor refusal may amount to a breach of the Code's good faith obligations or constitute unconscionable conduct. The development of guiding principles to assist parties in determining reasonable circumstances to make and refuse requests for early

³ Following reforms in 2020, 2021 and 2022.

⁴ Competition and Consumer (Industry Codes – Franchising) Amendment (Fairness in Franchising) Regulations 2021 (Cth)

termination might go some way to alleviate concerns that the process does not allow for an equitable exit.

Question 17

Where possible, please comment on the impact, or expected impact, of reforms to the Franchising Code which seek to ensure franchisees are paid compensation if the franchisor terminates a new vehicle dealership agreement early. Where possible, please provide detail on the costs and benefits (or expected costs and benefits) to the new car dealership sector resulting from these changes.

25. No comment.

Enforcement and dispute resolution

Question 18

Is the current role of the ACCC in relation to enforcement of the Franchising Code appropriate?

26. The SME Committee believes that the ACCC's role in enforcement of the Code has improved in recent years. However, in the SME Committee's view, investment in such activity still remains below the level required to ensure compliance across the sector. The following table (which has been taken from the ACCC's website) sets out the level of ACCC enforcement action in relation to the Code over the last fifteen years:

Year	Enforcement actions	Matter
2009	4	Narnia Investments Pty Ltd Personalised Chocolates 4U Pty Ltd G.J. Gardner Homes, Netdeen Pty Ltd Australian Loans Management Pty Ltd and Active Money (Aust) Pty Ltd
2010	4	Mailpost Postie Network Pty Ltd Seal-A-Fridge Pty Ltd Ray White (Real Estate) Pty Ltd Allphones Retail Pty Ltd
2011	0	
2012	0	
2013	0	
2014	1	Taxsmart Group Pty Ltd
2015	2	Coverall Cleaning Concepts South East Melbourne Pty Ltd Electrodry Carpet Cleaning business, A Whistle & Co (1979) Pty Ltd
2016	0	

Year	Enforcement actions	Matter
2017	2	Morild Pty Ltd Domino's Pizza Enterprises Ltd t/a Pastacup West Aust Couriers Pty Ltd t/a Fastway Couriers (Perth)
2018	1	Husqvarna Australia Pty Ltd
2019	2	Ultra Tune Australia Pty Ltd Geowash Pty Ltd
2020	3	Bob Jane Corporation Pty Ltd General Motors Holden Australia NSC Pty Ltd Back In Motion Physiotherapy Pty Ltd
2021	2	Megasave Couriers Australia Pty Ltd Jump Loops Pty Ltd
2022	3	Honda Australia Pty Ltd Jim's Group Pty Ltd Retail Food Group Ltd
2023	0	
Total	24*	

* Matters recorded based on date of outcome, rather than date matter commenced

27. Based on the above table, the ACCC has taken 24 public enforcement actions in the franchising sector over the last 15 years, which is less than two enforcement actions a year. Furthermore, a number of the enforcement actions were taken against businesses with low brand recognition in the franchise community, which reduces the likely level of general deterrence which would have been achieved through the action.
28. The level of ACCC enforcement action appears particularly low when one considers that 'ensuring that small businesses receive the protections of the competition and consumer laws and small business industry codes of conduct' has been an ACCC Enforcement and Compliance Priority since 2019.
29. There has been one example of the ACCC refusing to act where as many as 90 franchisees were aggrieved in relation to alleged egregious breaches of the Code, and where private action was blocked by a successful application to the Federal Court for \$2 million in security for costs. This was a serious failure of the Code and resulted in more than 60 franchisees going out of business.

Question 19

How useful and effective are the educational resources provided by regulators (such as from the ACCC)? Do they ensure prospective entrants to the franchising sector are sufficiently aware of their rights and responsibilities? Is the level of industry engagement appropriate?

30. The educational resources currently provided by the ACCC and the ASBFEO are useful and effective in assisting franchisees in understanding the way the Code operates and their rights and obligations under the Code. However, as stated above, the primary problem is ensuring that prospective franchisees actually access these resources and understand the content. In this regard, the SME Committee believes that online resources need to be supplemented with face-to-face instruction, given that many perspective franchisees are not comfortable with using online resources. We note that other federal regulators, such as the Australian Taxation Office, provide face-to-face seminars which are very helpful in explaining to small business their rights and obligations under the law.

Question 20

What has been the impact of 2022 reforms which increased certain penalties available under the Franchising Code? Particular comment is sought on penalties which were increased to the greater of \$10 million, three times the benefit obtained, or 10 per cent of annual turnover?

31. The SME Committee is of the view that the increase of particular penalties under the Code in 2022 from 300 to 600 penalty units and the introduction of penalties for providing and updating disclosure information required by the Franchise Disclosure Register were appropriate. However, the SME Committee did not agree with the increase in penalties for some contraventions of the Code to the greater of \$10 million, three times the benefit, or 10 per cent of annual turnover. In the SME Committee's view, these penalties were much too high, given the composition of the franchise industry. Many franchisors are small businesses which are simply unable to pay such large penalties. Indeed, faced with litigation by the ACCC in relation to a franchise matter, many small business franchisees would have no option but to place their business into liquidation. Such an outcome would not be beneficial for either the franchisor or the franchisee, the latter of which would lose the opportunity to continue running their franchise business.

Question 21

Is the role and activity of the ASBFEO in relation to supporting dispute resolution under the Franchising Code appropriate?

32. The ASBFEO's role and activity in supporting dispute resolution has been highly effective in terms of improving the timeliness and appropriateness of the resolution of disputes. The SME Committee strongly believes that the ASBFEO should be further supported in this role through additional funding.

Question 22

Do the dispute resolution provisions in the Code provide an effective framework for the resolution of disputes? In particular, are you aware of whether 2021 reforms relating to multi-party dispute resolution and voluntary arbitration have been utilised by participants in the franchising sector? If not, why not?

33. The dispute resolution provisions of the Code provide an effective framework for the resolution of most disputes. The changes in 2021 to introduce multi-party dispute resolution and voluntary arbitration were positive developments. However, the SME Committee does not believe that the voluntary arbitration option has been utilised to a great degree by participants in the industry. Accordingly, the Committee continues to advocate for mandatory arbitration of those franchise disputes that cannot be resolved through mediation or conciliation. We are aware that there may be constitutional obstacles to implementing mandatory arbitration. However, mandatory arbitration has been introduced in relation to financial complaints under the Australian Financial Complaints Authority (**AFCA**) by making membership of AFCA a licence condition for financial service providers. We believe a similar approach could be taken in relation to the franchise sector.

Additional Comments

34. The SME Committee provides the following additional comments relevant to the review.

Evergreen or perpetual franchises

35. A significant anomaly which exists in relation to the dispute resolution provisions of the Code arises from evergreen/perpetual franchise agreements.
36. Clause 22 of the Code provides:
- A franchise agreement must not contain a clause that requires the franchisee to pay to the franchisor costs incurred by the franchisor in relation to settling a dispute under the agreement, and if it does, the clause is of no effect.*
37. However, the above clause only applies to franchise agreements entered into from 1 January 2015—see subclause 3(4) of the Code.
38. As a result, many franchise agreements entered prior to 1 January 2015, including a considerable number of evergreen/perpetual franchise agreements, currently contain clauses that require that the franchisee pays all the costs of settling a dispute under the agreement, often on an indemnity basis.
39. The following is an example of such a clause, which has been taken from a franchise agreement of a large national franchise organisation with over 100 perpetual franchise agreements:

Legal Costs

Upon the occurrence of an event of default by the Franchisee, the Franchisor will be entitled to recover from the Franchisee in addition to any applicable claim plus interest, legal fees, costs and expenses incurred by the Franchisor as a result of such default on an indemnity basis.

40. SME Committee members are aware of franchisees using such dispute recovery cost clauses as a means of pressuring franchisors to resolve legitimate disputes as quickly as possible, in a manner that is highly advantageous to the franchisor. In effect, franchisees are therefore concerned at being liable not only for their own legal costs, but also for the franchisor's legal and other costs incurred in resolving a dispute.

Independent legal advice

41. An issue of concern to SME Committee members is the high incidence of franchisees obtaining franchising advice from advisors with limited or in some cases no experience in franchising matters. As a result, the advice received by many franchisees has been of limited value in terms of the franchisee being able to make an informed decision about whether to enter into the franchise agreement. In this regard, the SME Committee considers that it may be worthwhile for various Law Societies to consider introducing a franchise law accreditation scheme that would assist franchisees in identifying advisors with genuine expertise in relation to the Code and franchising matters in practice.

Site selection

42. An issue of particular concern in the franchise sector relates to site selection. While the SME Committee accepts that prospective franchisees should bear a degree of responsibility for undertaking their own research in relation to the viability of an existing franchise business, different considerations should apply in relation to a new or greenfield site.
43. In many cases, the franchisor will have selected the site or territory for a new franchise business (as opposed to being asked to approve a site or territory that a franchisee has selected) after conducting extensive market research. Accordingly, where the franchisor is responsible for site selection it should bear a higher degree of responsibility for the viability of that particular franchise.
44. Unfortunately, many franchisors seek to exclude their liability in relation to decisions to establish a new franchise business in a poor location: for example, in a shopping centre with low levels of foot traffic or at a location which is in close proximity to an existing franchise business.
45. SME Committee members are aware of large national franchisors that have made poor site selection decisions, and which have refused to acknowledge those poor decisions and to compensate the franchisee accordingly when the franchise failed. For example, one large national franchisor established a new franchise business in a centre at a substantial cost without apparently being aware that the owner of the premises had plans to undertake a complete renovation of the premises within the next 12 months.

Private enforcement

46. In cases where the ACCC declines to take enforcement action, the availability of class actions / representative proceedings has been substantially impeded by the practice of the Federal Court to require security for costs, invoking the principle that, where an action is brought for the benefit of others, security ought to be provided.⁵ The Law Council recommends that consideration be given to amending

⁵ See, eg, *St Mary's Hog's Pty Ltd v HBCA Pty Ltd* [2022] FCA 52 [upheld on appeal].

subsection 82(3) of the *Competition and Consumer Act 2010* (Cth) enabling the Court to waive that principle where it thinks fit in all cases rather than only in relation to Part IV cases. This could be achieved by the removal of the words 'in relation to a contravention of a provision of Part IV' from that subsection. Whilst it will remain a matter for the Court's discretion, the option is currently precluded in relation to matters involving contraventions of Part V, contraventions of the ACL, and contraventions of mandatory codes including, in particular, the Franchising Code of Conduct.