



Suite 6/137 Main St
Osborne Park WA 6017
Ph: (08) 9444 5100, Fax (08) 9444 5122
Email: admin@australianfranchising.com.au

Australian Franchise Consultants Pty Ltd (ACN 001 832 168) t/a Australian Franchising Systems ABN 48 001 832 168

20 January 2011

Mr Timothy Hughes (Principal Research Officer)
Economics and Industry Standing Committee
Level 1
11 Harvest Terrace
West Perth WA 6005

Submission to the Economics and Industry Committee in relation to the Inquiry into the Franchising Bill 2010

On 18 November 2010 the *Franchising Bill 2010* was referred to the Economics and Standing Committee for consideration. That committee subsequently invited submissions to their Inquiry into the Franchising Bill 2010. The following constitutes my submission to the Inquiry.

I will address your specific terms of reference in the format that they have been drafted however I am not legally qualified to comment specifically on some of the legal items.

In my capacity as a franchise consultant, I assist many franchisors and their franchisees. My clients collectively have over 500 individual franchisees. This represents almost 10% of franchisees in Western Australia. I am not aware of any client or their franchisees having been consulted on the proposed Bill.

National laws introduced in 1998 and amended as recently as July 2010 are the outcome of considerable consultation with the franchising sector including expert panels, national enquiries and perhaps most importantly franchisee input. The proposed new laws seek to replace a framework that is world's best practice and creates certainty and stability within the franchising sector.

The franchising sector in Western Australia contributes greatly to our economy. It contributes over 75,000 jobs and \$10 Billion in revenue.

It is likely that franchisor investment in the Western Australian economy will decrease significantly. I have spoken to several franchisors who intend to move their

national offices interstate should this Bill be passed. One already has. Further, interstate based businesses will avoid entering or expanding into the Western Australian market as will international franchisors. In fact, I am currently assisting 4 international franchisors who would like to enter the Australian market. It would be a significantly less attractive proposition if I was forced to advise them that they need to be aware of two (or perhaps even more) sets of legislation i.e. the laws will be different depending on where they are based. My recommendation would have to be to avoid establishing their headquarters in Western Australia as the legislation in that state is less conducive to business growth and will be problematic for them. Also, I would encourage them to enter the Western Australian market last in their development plans. This is sad but true and as a proud Western Australian is contrary to my usual support of, and allegiance to, the state.

The Franchising Bill 2010 should not be passed. It is not going to offer any further protection for franchisees, in fact it will ultimately decrease the value of their businesses. It will cause a retraction of the franchise sector and consequently affect all of the suppliers who have established businesses or divisions to service franchise businesses. It will also result in the loss of thousands of jobs as franchisors move their operations from Western Australia. Brands who have their national headquarters in Perth such as Chicken Treat, Red Rooster, Chooks Fresh and Tasty and Snap have already indicated this intention publicly.

Should the national laws need review or state based laws introduced surely consultation with the franchising sector, including the franchisees who it seeks to protect, would be a prerequisite to this form of legislation.

I now address the Terms of Reference of the Inquiry.

Terms of Reference

“... Whether the passage of this bill, in its current form, would:”

(a) Be directly inconsistent with the *Trade Practices Act 1974* and the Franchising Code of Conduct, with particular reference to the inclusion of provisions for:

(i) The requirement to “act in good faith”

There is already an implied requirement to act in good faith within the franchise agreements and the definition of good faith is already contained within the *Trade Practices Act 1974*. This is all that is required. Introducing an ambiguous definition of good faith creates uncertainty and gives rise to opportunistic litigation to test the definition.

(ii) Civil Monetary penalties

Imposing civil penalties could ultimately lead to the failure of a franchisor's business. Some franchisors are relatively new to the market or not of significant size to absorb a significant monetary penalty. This would result in franchisees losing their franchise business along with the jobs of the franchisees and franchisors employees. To not have a right of appeal against a judgement offers little opportunity for a franchisor to avoid monetary penalties even though it may not ultimately be justified.

(iii) Injunctions

I am not legally qualified to comment on this point however I would support the Franchise Council of Australia's position.

(iv) Redress orders

I am not legally qualified to comment on this point however I would support the Franchise Council of Australia's position.

(v) Damages

I am not legally qualified to comment on this point however I would support the Franchise Council of Australia's position.

(b) Enhance the purpose of the Franchising Code of Conduct, which is to regulate the conduct of participants toward each other

The Franchising Code of Conduct is national legislation and is regulated nationally by the ACCC. It was purposely developed this way to ensure that the franchising sector was adequately regulated with requirements for all franchisors to follow the same methods of granting franchises including adequate disclosure and then in the management of the ongoing franchise relationship including compulsory mediation and common sense grounds for resolving disputes.

The national laws involved considerable consultation prior to being introduced and the current Government and the ACCC both have stated and agree that national laws should be the mechanism through which franchising is regulated and that the Franchising Code of Conduct should not be changed further until the recent changes have had a chance to be bedded down.

(c) Result in the cost impact on the State or participants in franchising

There will certainly be increased compliance costs as a result of this legislation. Franchisors will be required to review all of their legal documents, recruitment processes, ongoing franchise and legal relationships and disclosure documents will also need to be changed at considerable legal expense. There will be a significant cost on the state also as it is likely that many franchisors will relocate

their head offices interstate to avoid the state based legislation. This will result not only in a cost impact but will also affect employment levels within the state as administrative staff are laid off and local interstate staff hired instead. Litigation costs will also increase as the uncertainty created by the good faith definition will result in the opportunistic legal action by franchisees and possibly even by franchisors.

The proposed Bill has possibly been introduced as a knee jerk reaction to specific lobbying by self-interested individuals and is certainly not representative of the majority view both inside and outside of franchising. The introduction of this Bill would require very close scrutiny and I suggest if that occurs you will see that the Bill should not be adopted.

Many respected authorities such as the International Franchise Association (IFA) and the Law Society of Queensland have previously submitted documents highlighting the deficiencies of the Bill.

The IFA wrote to Premier Barnett on 9 November 2010 providing commentary on the Bill (I have attached a copy of that letter).

The IFA states in that letter that:

“When legislatures go further to impose an explicit duty of good faith upon parties to a contract by defining “good faith” with words such as fairly, honestly, reasonably and cooperatively; it is our experience that more uncertainty and additional litigation are the result”

And also states:

“The franchise relationship is a contractual agreement between business partners. When governments impose new obligations, the experience of the United States is that the most common result has been to slow the growth of franchise business opportunities. For example, after Iowa passed a very burdensome post-sale relationship law in 1992, more than 130 franchise companies eliminated or significantly reduced their franchise operations in that state, costing the state approximately \$226 million in lost tax revenue. Since its passage, parts of the Iowa law have been declared unconstitutional, and the legislature has amended it twice to make it less onerous.”

In relation to renewal of agreements the IFA concludes:

“the proposed bill defines a duty to act in good faith as the obligation “to act

fairly, honestly, reasonably and cooperatively”, and makes it clear that that duty applies in any dealing or negotiation in connection with renewing the agreement. In short, it appears that the proposed legislation in Western Australia is exceptionally broad in its treatment of renewal, and, if enacted, it would far exceed any similar statute in the United States”

Surely the experiences of other countries who have introduced similar legislation with negative consequences is a predictor of the likely result in Western Australia and cannot be disregarded.

Given that the IFA represents franchisors, franchisees and suppliers, it would be unlikely that they would have taken the position they concluded that Bill was likely to have a positive outcome for the franchise sector. In line with the representation role, the IFA would have supported the Bill if it was in the interest of further enhancing regulation within the sector – they have clearly not done this.

I encourage you to read the attached letter from the IFA in order to be provided with an understanding of their role within franchising internationally and their commentary on the proposed legislation.

Locally, the Bill is at odds with the Federal Government’s position on the appropriate legal framework. This is evidenced by the following extract from a recent news article quoting the Honourable Nick Sherry, Federal Small Business Minister:

“Sherry says the Federal Government has introduced a set of franchise reforms, which will come into effect on January 1, 2011. These include:

- *The ACCC will have more authority to investigate and take action against breaches of the national Franchising Code of Conduct, including increased power to source information and the authority to issue public warning notices about rogue operators and to seek redress for franchisees affected by a breach of the code.*
- *The new Australian Consumer Law, which will also take effect on January 1, 2011, will grant power to the ACCC and the State consumer bodies to take action against misleading and deceptive conduct and unconscionable conduct towards small businesses, including franchisees.*
- *Earlier this year, amendments to the code also came into effect to increase franchisor disclosure so that parties are more informed before they enter into a franchise agreement.*

Sherry says the changes will need time to “bed down” and the government should allow an extended period to assess their impact.

“To do this, and to provide the sector with stability and confidence, the government doesn’t intend to review the code again until before 2013,” he says

<http://www.startupsmart.com.au/franchising/2010-11-18/wa-franchising-bill-rejected-by-liberals.html>


The foregoing clearly highlights the federal government’s position in relation to regulation of the franchise sector and clearly gives increased powers to the ACCC to enforce the national Franchising Code of Conduct.

In my opinion this approach is a sensible one and is all that is required to effectively and consistently regulate the franchise sector. As a result, the appropriate authority will handle the regulation, laws will continue to be consistent across Australia, investment in the Western Australian economy will not be at risk, jobs will not be lost and franchisees will be adequately protected.

I have attached a list of 30 further reasons summarising why the Franchising Bill 2010 is unnecessary, unhelpful and unwanted.

Please contact me should you require clarification of any of the foregoing or seek any more input to your inquiry.

Yours faithfully



Dean Franks
Director
Australian Franchising Systems



Franchising
Building local businesses.
one opportunity at a time



November 9, 2010

The Honourable Colin Barnett
Premier of Western Australia
24th Floor, Governor Stirling Tower
197 St Georges Terrace
PERTH WA 6000

Re: Proposed Franchise Legislation in Western Australia

Dear Premier Barnett:

I am writing on behalf of the International Franchise Association (IFA) regarding proposed franchise legislation in Western Australia. We have reviewed the draft legislation, and we would like to comment on certain features of the legislation based upon our experience in the United States. While our comments in this letter are limited to the issue of "renewal," we have attached a copy of our September 2008 comments to the Australian Parliament on current trends in state-based franchise regulation in the United States for your further information.

Role of the International Franchise Association

The International Franchise Association is the world's oldest and largest trade association devoted to franchising. Founded in 1960, IFA has more than 1,200 franchisor members that represent many of the leading brand names in the American economy. IFA also represents the interests of thousands of franchisees. Since 1993, when the association first invited franchisees to join, IFA has attracted more than 11,000 franchisee members, a number of whom currently serve in leadership positions with the association.

IFA's mission is to enhance and safeguard the business environment for franchising in the United States and around the world. In addition to serving as a resource for current and prospective franchisors and franchisees, IFA and its members work closely with public officials within the federal government and in states across the country to shape the laws and regulations that govern franchising. IFA is the only trade association that acts as a voice for both franchisors and franchisees throughout the United States.

Economic Impact of Franchising in the United States

Franchising has an enormous impact on the American economy and a growing role in the economies of countries around the world. According to economic analysis prepared by PricewaterhouseCoopers, U.S. franchised businesses employ more than 11 million Americans, and franchising is responsible for the creation of more than 21 million jobs. Taking into account both direct and indirect job creation, franchising generates more than one out of every seven private-sector American jobs. There are more than 900,000 franchised businesses with a total payroll nearing \$280 billion. Again, considering both direct and indirect impacts, franchising is responsible for a total economic output of more than \$2.3 trillion, representing 11.4% of the U.S. private sector economy.

Comments on Franchising Bill 2010

In our review of the proposed legislation, we find three features that create new conditions for contract renewal in Western Australia that far exceed the common elements of franchise laws in the United States. First, we note that a franchise agreement is covered “whether it is entered into before or after this Act commences.” The measure also provides for imposition of a “renewal order” with both length of the contract and new contract terms to be determined as a court deems “just.” Finally, the proposed bill defines a duty to act in good faith as the obligation “to act fairly, honestly, reasonably and cooperatively”, and makes it clear that that duty applies in any dealing or negotiation in connection with renewing the agreement. In short, it appears that the proposed legislation in Western Australia is exceptionally broad in its treatment of renewal, and, if enacted, it would far exceed any similar statute in the United States.

Experience in the United States

There is no federal law in the United States addressing the relationship between franchisors and franchisees. A number of individual states have enacted such laws, although very few have done so in recent years. In states where the franchise relationship is regulated, there are a number of different approaches to the question of renewal, and we have summarized them below:

- Four states (Arkansas, Hawaii, Indiana, and Nebraska) permit non-renewal if the contract provides for it, or if the non-renewal is in accordance with the current policies, practices and standards applied non-arbitrarily; sometimes, notice is required.
- Three states (Delaware, Mississippi, and Missouri) permit non-renewal with 90 days advance notice, and no other relevant conditions.
- Michigan requires, in the event of non-renewal, a buyback of the franchisee’s assets if: the franchise has a term of less than 5 years; and the franchisor provides less than 6 months notice of non-renewal or seeks to enforce a non-compete.
- Two states permit non-renewal with advance notice, but with other relevant conditions.¹
- Illinois requires compensating the franchisee for the diminution in value of the non-renewed franchise if: the franchisor seeks to enforce a non-compete; or the franchisor provides less than 6 months of notice of non-renewal.
- The state of Washington requires that, in the event of non-renewal, the franchisor must compensate the franchisee for the fair market value of inventory, supplies and furnishings purchased from the franchisor; and requires compensation for goodwill unless there has been advance notice of one year and no enforcement of a covenant not to compete.
- Three states (New Jersey, Rhode Island, and Wisconsin) require good cause; which must be based on a contractual default.

¹ Minnesota requires notice of six months, but requires that the franchisee operate the franchise for a sufficient time to recover fair market value of the business as a going concern. California requires notice of six months, and either (1) the franchisor must permit the franchisee to sell to a purchaser meeting the franchisor’s then current requirements; or, (2) if the franchisor offers a standard form renewal franchise agreement and the franchisee refuses to sign same.

- Similarly, Connecticut requires good cause, which is defined to “include but not be limited to” a contractual default. Iowa requires good cause, which is defined to mean “cause based on a legitimate business reason.”
- Only Puerto Rico requires “just cause.”

Conclusion

Only a minority of U.S. state statutes condition the right to refuse renewal on the existence of “good cause,” and none of those states define “good cause” as sweepingly as the obligation “to act in good faith” is defined in the proposed legislation. All of the American statutes are either silent on the issue of retroactivity or are explicitly non-retroactive. To the extent that any such statute provided for retroactivity, those provisions have since been held to be unconstitutional. Most importantly, in no case does the prohibition against non-renewal go further than to extend the terms of the old agreement itself. In no case is a court empowered to order renewal “for a period, and on such other terms, as the court decides is just”, as the proposed legislation would do. And, while that proposal does make reference to “having regard to the terms of the old agreement,” the court is left with the discretion to create a new contract between private parties essentially on such terms as the court sees fit. We are aware of no precedent in the laws of franchising, either in the United States or elsewhere, for vesting a court with such broad and sweeping discretion. We expect that many franchise companies entering the Australian market will seek to carve Western Australia from a continent-wide grant as a direct result of enactment of this measure.

The franchise relationship is a contractual agreement between business partners. When governments impose new obligations, the experience of the United States is that the most common result has been to slow the growth of franchise business opportunities. For example, after Iowa passed a very burdensome post-sale relationship law in 1992, more than 130 franchise companies eliminated or significantly reduced their franchise operations in that state, costing the state approximately \$226 million in lost tax revenue. Since its passage, parts of the Iowa law have been declared unconstitutional, and the legislature has amended it twice to make it less onerous.

Independent economic research confirms that regulation of the post-sale relationship can have a dampening effect on economic activity and employment in industry sectors where franchise businesses operate. In a December, 2006 paper entitled, *The Effect of Contract Regulation: The Case of Franchising*,² coauthors Jonathan Klick, Bruce Kobayashi, and Larry Ribstein examine the impact of contract regulation and termination restrictions upon economic activity and employment in franchise businesses. The authors conclude that the net results of such regulations are likely “negative.” Not only are the regulations not necessary because market forces exist to effectively control franchisor activities; but the existence of contract regulation limits the ability of franchisors to maintain adherence to system standards, and “preventing franchisors from efficiently disciplining those franchisees that are shirking” hurts both franchisors and non-shirking franchisees. The authors also note that “employment in franchise industries is significantly reduced when states enact restrictions on franchisor termination rights and the effect is larger when states limit the ability to contract around these restrictions.” It should be of particular interest to lawmakers in Western Australia that the authors specifically examine the impact of the 1992 Iowa statute, concluding that “the passage of this statute led to a reduction in both the number of franchised units and the total number of chain outlets. That is, the increase in the number of franchisor-operated establishments was not sufficient to offset the decrease in

² The full text of the paper is available online at <http://www.law.gmu.edu/pubs/papers/07-03>.

the number of franchised outlets caused by the franchise regulation.” In other words, not only were franchise opportunities constrained by the regulations but overall employment likely suffered as well.

Finally, we would also like to provide an observation on the effectiveness of good faith requirements. The courts in some common law jurisdictions have held that there is an implied duty of good faith and fair dealing in every contract. When legislatures go further to impose an explicit duty of good faith upon parties to a contract by defining “good faith” with words such as fairly, honestly, reasonably and cooperatively; it is our experience that more uncertainty and additional litigation are the result.

Thank you for the opportunity to share the views of the International Franchise Association regarding the proposed legislation. I hope this information is useful, and please feel free to contact me if you have any additional questions.

Sincerely,



David G. French
Senior Vice President
Government Relations and Public Policy

attachment

cc: The Honourable Bill Marmion
The Honourable Barry John House
The Honourable Grant Allen Woodhams
Members of the Parliament of Western Australia

30 reasons why the Franchising Bill 2010 is unnecessary, unhelpful and unwanted

1. Existing regulation and active policing are working

The sector does not need more heavy-handed regulation. Complaints to the ACCC have remained steady in recent years at less than 1%. Disputes within franchise systems are at the same 1% level consistently over the past decade.

2. Renewal is not a problem

95% of franchisees renew for a second term; 99% of those who want renewal, get it. We don't need new laws, with big fines, to fix a non-existent problem.

3. Wrong motivation

The Bill's effect coincides with the commercial interests of one very large franchise business owner who is trying to get a new contract for his 50 fast food stores, which he has owned and operated highly profitably for the past 25-30 years.

4. Automatic renewal is against freedom to contract and leasing principles

Quasi automatic renewal of franchise agreements is against the principles of leasing and of freedom to contract. Why do the proponents not seek to have the same rules apply to leasing? Because they realise that landlords would not have a bar of it. Why then should franchising be singled out?

5. 'Good faith' is a cloak for opportunistic action

The proposed law overlaps existing obligations to act in good faith and introduces a new definition which is vague and non-specific. It is designed this way to allow for opportunistic legal action which will ultimately be at the cost of individual franchisees and franchisors.

6. Retrospectivity

The Bill will act retrospectively by applying to existing agreements. This means all existing agreements could be subject to the new laws, meaning franchisees and franchisors could face fines of tens of thousands of dollars if they are guilty of breach of agreement or breach of good faith negotiating.

7. No ability to defend yourself

The Bill does not allow the accused to have a lawyer defend them, except in extraordinary circumstances.

8. No right of appeal

The Bill does not allow right of appeal against a decision.

9. No mediation

The Bill does not require parties to try to resolve a dispute under the Bill by attending mediation and instead requires them to go straight to litigation. Mediation has been used very successfully in the franchise sector (and elsewhere) to resolve disputes quickly and inexpensively without the parties being involved in protracted and costly litigation.

10. No demonstrated need

There is no clear substantiation of the need for this Bill. The claims made about "rogue franchisors" are not backed up. No rogues are named and no pattern of "rogue"

behaviour is identified.

11. No public support by franchising sector

There has been no public support of the Bill by any WA franchisors, franchisees or suppliers apart from the franchisee referred to in point 3 above. Hundreds of franchisors, franchisees and suppliers have signed a petition and sent letters of protest against the Bill.

12. Overlap with existing law

The requirement to “act in good faith” is already required under the Trade Practices Act 1974 and the common law. Creating a new, vague definition will simply cause costly confusion and conflict.

13. Good faith requirement is being policed right now

The ACCC is actively policing the trade practices and franchising regulations. It has achieved more than 50 results correcting bad behaviour over the past decade. A number of prosecutions took place last year.

14. Increased compliance costs

State-based legislation will significantly raise compliance costs for franchisors and franchisees and is contrary to the recommendation of the Bothams Inquiry into Franchising in WA (2007/08).

15. Labor and Liberal Governments have rejected the idea

Labor (2008) and Liberal (2009) Governments decided against making the changes suggested in the Franchising Bill 2010. The pressure to make changes has continued because the commercial dispute referred to in point 3 has not been resolved.

16. Positive Changes have already been made

The Federal Government adopted most of the suggestions of the WA and SA inquiries in its package of changes to the Franchising Code and the TPA taking effect from 1 July 2010 and 1 January 2011.

17. Fed Government says give changes time to take effect

The Federal Government has said there should be a pause on further changes while the latest initiatives have had time to take effect. It described the latest changes as “sweeping” and the most significant implemented since the creation of the Franchising Code of Conduct.

18. Federal Government says state based legislation is a bad idea

With Opposition support, the Federal Government is pushing for national harmonisation of State laws – not the creation of new state laws in industries which are already successfully nationally regulated.

19. State based franchising legislation is not wanted by WA systems

A number of major WA-based systems have said they will consider moving their headquarters interstate if the Bill is enacted to avoid the application of the law to all of their businesses including those located outside WA and which would otherwise put them at a significant disadvantage when compared to their east coast counterparts. Eg: Snap, Red Rooster, Chicken Treat.

20. Jobs likely to be lost

As a result of point 19, hundreds of WA jobs are at risk.

21. Franchise values will fall

The value of franchisees businesses, of which there are some 8,000 in WA, will decrease due to the uncertainty and instability within the franchise sector.

22. Financing costs will increase

The funding costs of a new purchase or capital expense will increase because of the higher risk assessed (resulting from the uncertainty and possibility of large fines). At least one major bank has addressed this point in a submission to the WA Gov't.

23. Disputes will rise

The number of disputes will rise as parties test the interpretation of the new state based laws.

24. Foreign and interstate investment will be hit

Many franchisors based interstate or overseas will reconsider their plans to expand their operations to the WA market. Investment within the WA economy will be severely affected.

25. Extraterritorial nature of Bill

The Bill seeks to apply outside WA as well as inside it. This means the Bill will apply to any franchisor or supplier engaged in a business transaction with a WA based franchise business. This will affect approximately 70,000 franchise contracts nationwide. International franchise agreements will also be affected.

26. Drafters have no experience and did not consult with those who will be affected by the Bill

The drafters of the Bill – Peter Abetz MP and academic Frank Zumbo – have no experience or expertise in franchising. They do not adequately understand the ramifications of what they have proposed. Further, neither Mr Abetz nor Mr Zumbo consulted with the WA franchising sector before writing and introducing the Bill.

27. Bill will drive businesses to licensing

Franchising provides a safety net for many aspiring business owners. Under this Bill, many business concept owners will choose a licensing model, depriving many potential franchisees of their chance to start their own businesses with the support of a franchisor and franchisee colleagues.

28. WA small business growth will stall

Franchising is the turbo motor on the small business growth engine. As a result of point 27, small business growth in WA will decrease.

29. Experts disagree with the Bill

Respected authorities such as the International Franchise Association and the Queensland Law Society have provided compelling reasons why the legislation should not be introduced.

30. Big fine could destroy small franchisor and collapse whole system

If a small franchisor is hit with a big fine (and no right of appeal), the franchisor could go broke which could result in the collapse of the whole system and therefore the other franchisees in the system. 64% of the FCA's members have less than 25 franchisees and many of these would face collapse if hit with a big fine of hundreds of thousands of dollars.

Bryden, Kristy

From: Australian Franchising Systems [admin@australianfranchising.com.au]
Sent: Monday, 24 January 2011 5:19 PM
To: Committee, Economics & Industry Standing
Subject: Submissions to the Inquiry into the Franchising Bill 2010
Follow Up Flag: Follow up
Flag Status: Red
Attachments: AFS Submission to Inquiry.pdf; Submission From Damian Barr - Cappuccino Xpress Maddington.pdf; Submission From Mark Wood - Kleenit Australia.pdf; Submission From Matthew Blackman - Kleenit Victoria.doc.pdf; Submission From Dale Burke - What Scratch.pdf; Submission From George Bartell - Cappuccino Xpress Australia.pdf

Good afternoon,

I have been asked to provide you with the attached submissions to the Economics and Industry Committee in relation to the Inquiry into the Franchising Bill 2010 on behalf of the various authors.

Kind regards
Dean Franks

24/01/2011