ECONOMICS AND INDUSTRY STANDING COMMITTEE

INQUIRY INTO THE FRANCHISING BILL 2010

Report No. 7
in the 38th Parliament

2011

Published by the Legislative Assembly, Parliament of Western Australia, Perth, June 2011.

Printed by the Government Printer, State Law Publisher, Western Australia.

Economics and Industry Standing Committee

Inquiry into the Franchising Bill 2010

ISBN: 978-1-921865-17-6

(Series: Western Australia. Parliament. Legislative Assembly. Committees. Economics and Industry Standing Committee. Report 7)

328.365

99-0

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INQUIRY INTO THE FRANCHISING BILL 2010

Report No. 7

Presented by:
Dr M.D. Nahan, MLA
Laid on the Table of the Legislative Assembly
on 23 June 2011

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COMMITTEE'S FUNCTIONS AND POWERS

The functions of the Committee are to review and report to the Assembly on: -

(a) the outcomes and administration of the departments within the Committee's portfolio responsibilities;

(b) annual reports of government departments laid on the Table of the House;

(c) the adequacy of legislation and regulations within its jurisdiction; and

(d) any matters referred to it by the Assembly including a bill, motion, petition, vote or expenditure, other financial matter, report or paper.

At the commencement of each Parliament and as often thereafter as the Speaker considers necessary, the Speaker will determine and table a schedule showing the portfolio responsibilities for each committee. Annual reports of government departments and authorities tabled in the Assembly will stand referred to the relevant committee for any inquiry the committee may make.

Whenever a committee receives or determines for itself fresh or amended terms of reference, the committee will forward them to each standing and select committee of the Assembly and Joint Committee of the Assembly and Council. The Speaker will announce them to the Assembly at the next opportunity and arrange for them to be placed on the notice boards of the Assembly.

INQUIRY TERMS OF REFERENCE

On 18 November 2010, the Franchising Bill 2010 was referred to the Economics and Industry Standing Committee for consideration and report no later than 26 May 2011.

The Committee will consider 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";
   ii. civil monetary penalties;
   iii. injunctions;
   iv. redress orders; and
   v. damages;

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

(c) result in a cost impact on the state or participants in franchising.

On 14 April 2011, the Legislative Assembly agreed to extend the reporting date to 23 June 2011.

ABBREVIATIONS AND ACRONYMS

ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law
CCA	*Competition and Consumer Act 2010*
COAG	Council of Australian Governments
CFAL	Competitive Foods Australia Limited
DoC	Department of Commerce
FCA	Franchise Council of Australia
FTE	Full Time Equivalent
IFA	International Franchise Association
MES	Master Education Services
OFMA	Office of the Franchising Mediation Adviser
QSRH	Quick Service Restaurant Holdings Pty Ltd
RTA	Retail Traders' Association of Western Australia
SA	South Australia
SAT	State Administrative Tribunal
SBDC	Small Business Development Corporation
TPA	*Trade Practices Act 1974*
VCAT	Victorian Civil and Administrative Tribunal
VSBC	Victorian Small Business Commissioner
WA	Western Australia

EXECUTIVE SUMMARY

In most instances, franchising is a mutually rewarding and successful business model; but it is not without risks. One such risk surrounds the ongoing and variable nature of a franchise contract (or franchise agreement) and the inherent imbalance of power this generates. Part of the reason legislation has evolved to regulate the conduct of all franchise participants is to reduce the incidence of abusive practices that can occur due to this imbalanced relationship.

In 1998, the Franchising Code of Conduct (the Code) was introduced as a mandatory industry code applicable to franchise participants. Parties to franchise agreements are also subject to the general conduct provisions of the *Competition and Consumer Act 2010* (CCA).[1]

Inquiries at the federal and state level since 2006 have considered how to improve the conduct of franchise participants under this legislative regime and have made a host of recommendations. Many of these have been wholly or partly adopted by the federal government in a series of amendments made to the Code and the CCA in 2008, 2010 and 2011. Yet despite continued calls from most of these inquiries, the federal government has not introduced civil monetary penalties for breaches of the Code or inserted a general provision requiring parties to act in good faith.

There is widespread agreement that franchising should ideally be regulated under a uniform national legislative framework, as many franchise participants operate across multiple state jurisdictions. However, some parties are now advocating a departure from this principle and a move towards state-based franchising legislation.

It is within this context that the Franchising Bill 2010 has come before the Economics and Industry Standing Committee (EISC). Introduced by Mr Peter Abetz, MLA, this Bill seeks to maintain the Code as a law of Western Australia while inserting a defined statutory obligation requiring parties to act in good faith and imposing civil monetary penalties for breaches of this duty and of the Code.

On 18 November 2010, the Bill was referred to the Committee for consideration and report by 26 May 2011. Mr Abetz was co-opted onto the Committee six days later. By decision of the Parliament, Mr Abetz was permitted to participate in all aspects of the Inquiry, but was not able to vote on Committee deliberations. On 14 April 2011, the Legislative Assembly agreed to extend the reporting date to 23 June 2011.

To assist in its deliberations, the Committee invited comment on whether the Bill would be directly inconsistent with the Code and the CCA, with particular regard to five key clauses: the requirement to act in good faith; civil monetary penalties; injunctions; redress orders; and damages. Comment was also sought on whether the Bill would enhance the purpose of the Code (to regulate the standard of conduct) and whether the Bill would result in a cost impact to the state or participants in franchising.

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1 Formerly the *Trade Practices Act 1974* (Cth).

The Committee came to the view that the legal and logistical implications of this Bill needed to be considered against the current state of the franchising sector and the recent changes to national franchise laws. Previous inquiries have confirmed that it remains difficult to measure the true level of disputation in the franchising sector. While these inquiries have identified clear problems in franchising, it appears that actual misconduct—while serious when it occurs—is not widespread.

The Committee has found that the amendments to the Code and CCA made over the last three years will address many of the problems cited in earlier inquiries, provide the ACCC with greater investigative and enforcement powers, and are intended to lift the standards of conduct in franchising. Importantly, these have been undertaken within the existing national regulatory framework that is well-suited to franchising. The federal government has confirmed it will review the adequacy of these amendments in 2013.

Given the significance of these amendments, and the importance of uniform legislation to easing the cost and compliance burden for small businesses, the Committee is not convinced that the Bill is an appropriate measure at this time. Hence, it has recommended that the Bill be opposed.

The Committee's view was also influenced by what it sees as the potentially adverse legal implications and cost impact to the state and franchising participants from the Bill. The Committee closely examined the validity, consistency, retrospectivity and extra-territorial application of the Bill as well as the operation and effect of the duty to act in good faith and the enforcement and remedy provisions.

In the Committee's view, the Bill would not be directly inconsistent with the CCA or the Code and is not drafted to operate retrospectively, but further drafting advice needs to be sought to remove any ambiguity about its extra-territorial application.

In regards to the duty to act in good faith, the Committee believes that the proposed definition may have little deterrent effect, particularly in the short-term, while a new body of case law develops. Moreover, the Committee was not convinced that this statutory definition of good faith would reduce overall court time (and therefore costs) and may leave franchising participants unsure of their rights and obligations in the interim.

The federal government has, in-lieu of a good faith clause, targeted commonly cited problem behaviours via amendments to the Code addressing disclosure about proposed conduct during and at the end of a franchise agreement. Arguably, this should lift the standards of conduct in franchising. However, should these measures prove inadequate, the Committee is not opposed to a general duty to act in good faith being pursued as a national law when the federal government undertakes its review in 2013. If parliament wishes to proceed with the Bill in the intervening period, the Committee believes the statutory duty to act in good faith should be left undefined.

The Committee is opposed to the inclusion of a renewal order as a remedy, the prevention of the court to require a franchisee to give an undertaking as to damages, and the right to claim damages for "harm" caused by an act or omission. Additionally, the Committee is of the view that amendments to the CCA and an expanded range of investigative and enforcement powers for the ACCC should provide a more restorative and direct remedy to aggrieved parties than the civil

monetary penalties proposed in the Bill. However, the Committee is again open to the pursuit of civil monetary penalties at the national level in 2013 if these amendments do not prove effective.

The Committee also considered the potential cost impact of the Bill on the state and franchising participants. The departments charged with administering and enforcing compliance with the proposed Bill tentatively estimated that a minimum of $4.2 million would be required to discharge these duties over the next four years. Of greater significance, the Committee remains unconvinced of the arguments from supporters of the Bill that its passage will attract franchise investment to Western Australia and not increase compliance costs for reputable franchising participants.

The report ends with a brief discussion on how the planned Western Australian Small Business Commissioner might offer a more effective vehicle than the proposed Bill for improving the outcomes of franchising disputes while further lifting the standards of conduct in the industry.

The findings and recommendations of this Report are not unanimous. The Committee's Deputy Chair, Mr Bill Johnston, MLA has expressed a dissenting view which has been appended.

FINDINGS

Page 11

Finding 1

Franchising is most appropriately and usefully regulated at the commonwealth level, as most franchise systems operate across multiple state jurisdictions.

Page 14

Finding 2

Supporters of the Franchising Bill 2010 argue that states should act due to inadequate reform at the commonwealth level.

Page 21

Finding 3

Evidence and conclusions drawn from previous inquiries indicates that incidences of misconduct in the franchising industry are serious; but not widespread.

Page 21

Finding 4

Given Finding One, it is the Committee's view that there must be compelling reasons to introduce state-based legislation.

Page 24

Finding 5

The additional disclosure provisions that followed the Matthews Report and were implemented in 2008 significantly enhanced the quality of due diligence that was available for those considering entry into a franchise business.

Page 31

Finding 6

Amendments to the *Competition and Consumer Act 2010* (including the introduction of the Australian Consumer Law) that have come into effect in 2010 and 2011 should significantly improve the investigative and enforcement capabilities of the Australian Competition and Consumer Commission (ACCC). Under these changes, the ACCC can now:

- Issue Public Warning Notices for suspected breaches of the Franchising Code of Conduct.
- Apply to the Courts for redress orders for franchisees not party to the ACCC's legal proceeding, but who suffered from the same breach of the Code (group redress orders).
- Issue notices asking franchisors to substantiate claims or representations made about their business.
- Conduct random audits compelling franchisors to produce disclosure documents, franchise agreements and marketing fund accounts.
- Apply to the Courts for pecuniary penalties of up to $1.1 million for charges of unconscionable conduct under section 22 of the Australian Consumer Law.

Page 34

Finding 7

The post-Ripoll Report amendments to the Franchising Code of Conduct that have been implemented in 2010 and 2011 mark a significant shift in franchising regulation.

Page 34

Finding 8

The full suite of amendments to the Franchising Code of Conduct and the *Competition and Consumer Act 2010* that have been implemented over the last three years address many of the problems cited in earlier inquiries and are intended to lift the standards of conduct in the franchising industry.

Page 34

Finding 9

Given the significance of recent amendments under the national legislative framework, which are due for further review in 2013, the Committee is not convinced that the Franchising Bill 2010 is an appropriate measure at this time.

Page 39

Finding 10

If enacted as drafted, it is the Committee's view that the Franchising Bill 2010 would not be directly inconsistent with the *Competition and Consumer Act 2010* or the Franchising Code of Conduct.

Page 40

Finding 11

The Committee is of the view that the Bill is not drafted to operate retrospectively.

Page 47

Finding 12

The 2010 amendment to the Franchising Code of Conduct that inserted clause 23A preserves existing case law on the concept of good faith, and recognises developments in that law.

Page 58

Finding 13

Given its doubts about the ability to effectively define good faith in statute, the federal government decided at that time (2010) not to introduce such a provision in the Franchising Code of Conduct.

Instead, after extensive consultation, it has introduced a substantial number of amendments to the Code in 2010 aimed at commonly cited problem areas in franchise relationships.

Page 58

Finding 14

If a general statutory obligation to act in good faith is to be imposed into franchising legislation, it should be pursued at the commonwealth level during the next review of the effectiveness of recent amendments in 2013.

Page 62

Finding 15

The major impediment to justice is the cost of accessing the courts, particularly for small franchisees.

Good faith provisions, such as that included in clause 11, rely on accessing courts and therefore, do not significantly improve access to justice.

A statutory definition of good faith should reduce court debate over whether good faith applies to a franchising agreement, notwithstanding the current common law duty to act in good faith.

The Committee was unconvinced that the narrow definition of good faith as articulated in clause 11 would further reduce overall court time or otherwise improve access to justice. Indeed, it could lead to greater debate regarding the parameters articulated in the Bill.

Page 62

Finding 16

The Committee is of the view that the Bill will have little deterrent effect, especially in the short term, and is unlikely to improve access to justice for participants in franchising. Given this, and having regard to the substantial cost to the state estimated by the Department of Commerce to enforce the Bill, the Committee has deep concerns that the Bill will not provide a net benefit to the Western Australian franchising industry.

Page 67

Finding 17

Recent changes to the penalty regime for breaches of the Franchising Code of Conduct, in particular group redress orders, are designed to provide a more restorative and direct remedy to aggrieved parties than civil monetary penalties.

However, the Committee is open to the consideration of civil monetary penalties for breaches of the Code at the commonwealth level if these recent amendments do not have the anticipated deterrent effect.

Page 69

Finding 18

If the Bill is enacted, a party may be exposed to a multiplicity of actions under section 12 and administrative arrangements would need to be made between the ACCC and the Commissioner for Consumer Protection to avoid this outcome.

Page 71

Finding 19

A court should retain its discretion in regards to undertakings as to damages, with the exception of the Commissioner for Consumer Protection.

Page 85

Finding 20

According to departmental estimates, there will be a minimum requirement of $4.2 million over the next four years to discharge the expanded responsibilities foreseen under the Bill.

The Committee is confident that any revenues obtained via the collection of civil monetary penalties will not substantially offset this cost.

Page 88

Finding 21

This Bill may increase costs for many compliant franchising participants (particularly franchisors) who will consider it prudent to obtain legal advice regarding the potential impact on their business.

It is plausible that under such circumstances, franchisors would look to pass these costs on by way of higher establishment fees on new contracts or royalty increases under existing agreements.

RECOMMENDATIONS

Page 35

Recommendation 1

The Committee recommends that the Franchising Bill 2010 be opposed.

Page 43

Recommendation 2

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 4(1) should be amended to explicitly remove any ambiguity as to whether, and to what extent, the Bill is intended to have extra-territorial application.

Page 44

Recommendation 3

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 4 should be amended to stipulate that the Bill does not apply to agreements that are excluded under sections 5(3)(a) and (b) of the Franchising Code of Conduct.

Page 58

Recommendation 4

The Committee recommends that, if the Franchising Bill 2010 is to proceed, any statutory obligation to act in good faith should be left undefined.

Page 67

Recommendation 5

The Minister for Small Business ensure that the effectiveness of the amendments to the *Competition and Consumer Act 2010* and the Franchising Code of Conduct is reviewed in 2013 by the federal government, with particular emphasis given to considering the need to introduce:

- civil monetary penalties for breaches of the Franchising Code of Conduct; and,
- a general statutory obligation to act in good faith into the Code.

Page 70

Recommendation 6

If the Bill is to be enacted, the Minister for Commerce make sure that administrative arrangements are made between the ACCC and the Commissioner for Consumer Protection to ensure that the risk of a multiplicity of actions under clause 12 is negated.

Page 72

Recommendation 7

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 13(2) should be amended to apply only to the Commissioner for Consumer Protection.

Page 76

Recommendation 8

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 14(1)(b) "a renewal order" should be removed.

Page 78

Recommendation 9

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 15(1) should be deleted and clause 15(2) should be amended to read:

A person who suffers loss or damage by an act or omission of another person that contravenes this Act has a cause of action against that person for damages for the loss or damage.

MINISTERIAL RESPONSE

In accordance with Standing Order 277(1) of the Standing Orders of the Legislative Assembly, the Economics and Industry Standing Committee directs that the Parliamentary Secretary to the Minister for Small Business and the Minister for Transport and Housing representing the Minister for Commerce report to the Assembly as to the action, if any, proposed to be taken by the Government with respect to recommendations No. 5 and No. 6 of the Committee.

CHAPTER 1 INTRODUCTION

1.1 What is franchising

1. Under a franchise system, one party (the franchisor) grants another (the franchisee) 'the right to operate a replicated franchise business under the same trade name and use established management, marketing and operating procedures'.[2] The grant is conditional upon the franchisee 'paying the franchisor a capital investment and ongoing fees and complying with franchise procedures'.[3] Franchisors are then expected to provide a uniform marketing strategy as well as an appropriate level of training, guidance and equipment.

2. Under this system franchisors retain significant control over their business model while franchisees use their own capital and labour to grow the brand. For the franchisee, there is an opportunity to establish themselves in a proven and recognisable business without incurring the risks inherent in a start-up enterprise. Indeed the success rate of franchisees is considered much higher than those who venture independently into small business.[4]

3. It has been reported that 'Australia is the most franchised nation in the world on a per capita basis'.[5]

4. A 2010 industry survey estimates that there were 1,025 franchise systems under which 69,900 individual outlets were currently operating nationally. The sector employs 690,000 people and generates approximately $128 billion per annum. Although the number of systems operating in Western Australia can not be confirmed, it is estimated that that state has approximately 9,000 franchise outlets.[6]

5. A 2009 survey of franchisees found that the median purchase price for a franchised unit was $110,000 (prices ranged from zero to $2 million), while most had annual turnovers in the range of $0.2 to $1.99 million.[7]

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2 Australian Competition and Consumer Commission, *The Franchisee Manual*, 2010, p. 2. Available at: www.accc.gov.au/content/index.phtml/itemId/795322. Accessed on 30 May 2011.

3 ibid.

4 Mr Jack Cowin, Chairman, Competitive Foods Australia Pty Ltd, *Transcript of Evidence*, 4 April 2011, p. 6; Mr Steve Wright, Executive Director, Franchise Council of Australia, *Transcript of Evidence*, 4 April 2011, p. 2.

5 Australian Competition and Consumer Commission, *ACCC Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising Code of Conduct*, September 2008, para. 2.1. Available at: www.aph.gov.au/senate/committee/corporations_ctte/franchising/submissions/sub60a.pdf. Accessed on 20 May 2011.

6 Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, pp. 5-6.

7 Asia-Pacific Centre for Franchising Excellence, *Towards Conflict Resolution Australian Survey 2009*, pp. 81-82. Available at: www.franchise.edu.au/franchise-conflict-research.html. Accessed on 13 May 2011.

6. Franchising differs from other commercial relationships in that beyond the period of tenure, which is usually fixed, many of the contractual obligations are loosely defined.[8] The Committee was advised that a franchise contract is 'a living, changing document', in which the power is skewed very much towards the franchisor.[9] The variable nature of the contract, and the imbalance of power it perpetuates, is considered a necessary component to franchising.[10] It allows the franchisor to retain the flexibility to adapt to changing market conditions and to protect the brand (and other franchisees) from non-performing or "free-riding" franchisees.[11]

7. However, this imbalance leaves franchisees dependent upon the integrity of the franchisor. A recent federal inquiry noted that:

> *…abuse of this power can lead to opportunistic practices including encroachment, kickbacks, churning,*[12] *non-renewal, transfer, termination at will, and unreasonable unilateral variations to the agreement.*[13]

8. Other inquiries have cited bullying, refusal to enter or adhere to mediation and colluding with suppliers to mark-up the prices of supplies as other examples of alleged abuse.[14]

9. With ambiguity surrounding contractual obligations, and potential for franchisors to abuse the power imbalance, the possibility of conflict is another intrinsic element of franchising. Franchising generally is a mutually successful and rewarding business system. Even so, legislation has evolved to regulate the conduct of franchise participants in order to minimise the incidence of abusive practices.

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8 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 2.9.

9 Mr Jack Cowin, Chairman, Competitive Foods Australia Pty Ltd, *Transcript of Evidence*, 4 April 2011, p. 4.

10 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 2.6-2.7, 8.3; Professor Andrew Terry, as cited in Economic and Finance Committee, *Franchises*, House of Assembly, South Australia, 6 May 2008, p. 84.

11 "Free-riding" refers to franchisees reducing costs, particularly those related to maintaining the integrity of the brand, in order to maximise profits. Economic and Finance Committee, *Franchises*, House of Assembly, South Australia, 6 May 2008, pp. 14-15.

12 "Churning" is most commonly recognised as the practice of a franchisor deliberately setting-up or allowing a franchisee to fail for the purpose of repeatedly on-selling the franchise to profit from establishment fees. Churning has also been used to describe the practice of a franchisor taking over a profitable franchise business at the end of an agreement for the purpose of increasing company profits.

13 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 8.3.

14 *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008, p. 13.

1.2 Regulation of franchising

(a) Franchising Code of Conduct

10. Since 1998, franchising participants have been bound by a mandatory industry code enforceable under the *Competition and Consumer Act 2010* (CCA), formerly the *Trade Practices Act 1974* (TPA).

11. The mandatory industry code is popularly known as the Franchising Code of Conduct (hereafter "the Code"). It is included as a schedule to the *Trade Practices (Industry Codes - Franchising) Regulations 1998*.

12. The stated purpose of the Code is 'to regulate the conduct of participants in franchising towards other participants in franchising'.[15] The original explanatory statement added that the Code is particularly intended 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 risk and generate growth in the sector by increasing the level of certainty for all participants,

with a further aim 'to provide protection for all franchisees through the establishment of - minimum standards of disclosure and conduct'.[16]

13. Part 1 of the Code defines a franchise agreement, confirming that such arrangements include oral, written or implied agreements where one person grants to another:

> *…the right to carry on a business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor*.[17]

14. This definition is also applicable to transfers, renewals, extensions 'or extensions of the scope' of a franchise agreement.[18]

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15 Part 1, section 2, *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

16 Trade Practices (Industry Codes - Franchising) Regulations 1998 No. 162 - Explanatory Statement, 1998. Available at: www.austlii.edu.au/au/legis/cth/num_reg_es/tpcr19981998n162545.html. Accessed on 10 May 2011.

17 Part 1, section 4(1)(b) *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

18 ibid., Part 1, section 4(2)(a).

15. Under the Code, franchisors must create and maintain a disclosure document in one of two standard prescribed formats. A "long-form" document is required for businesses with an anticipated annual turnover exceeding $50,000 during the agreement, while the "short-form" document can be issued for franchises operating below this threshold.[19]

16. The purpose of the disclosure document is to help prospective franchisees 'to make a reasonably informed decision about the franchise'.[20] This document must be provided, along with a copy of the Code, 14 days prior to the franchisee entering an agreement.[21] The ongoing maintenance of the document is designed to ensure that incumbent franchisees continue to receive updated information that is materially relevant to the operation of the business.[22]

17. Franchisors must not enter into a new agreement, or extend a current agreement unless they receive signed confirmation that the franchisee or prospective franchisee has had the opportunity to read and understand the Code and the disclosure documents. The confirmation from prospective franchisees must also include a signed statement that they have obtained independent advice about the proposed agreement, or that they have chosen not to seek this advice despite it being recommended.[23]

18. The Code confirms that franchisees are entitled to a seven-day "cooling off" period and should receive documents detailing any lease arrangements applicable to the franchised business.[24] Franchisees should also be provided with an audited statement outlining how marketing fees, or any other cooperative fees levied, have been used by the franchisor.[25]

19. Franchisors are further obliged to provide details of any 'materially relevant facts' regarding the ownership status of the franchisor and whether they, or an associate, are subject to a listed selection of criminal or civil proceedings.[26]

20. Sections 21-23 describe the rights of respective parties when a franchisor seeks to terminate an agreement, both where a breach is evident and when a franchisee claims there has been no breach. A dispute resolution process is available in Part 4 of the Code that can, under certain conditions, be available to a franchisee who claims the termination process represents a

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19 Part 2, section 6(1)-(2) *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

20 ibid., Part 2, section 6A(a).

21 ibid., Part 2, section 10.

22 ibid., Part 2, section 6A.

23 ibid., Part 2, section 11(2).

24 ibid., Part 3, sections 13-14.

25 ibid., Part 3, section 17.

26 ibid., Part 3, section 18.

breach. Either party may also exercise this process should a dispute arise over any other aspect to the agreement.[27]

21. If parties to a franchise agreement can not resolve their dispute independently, either party may call for a mandatory mediation session. The Code makes provision for the Office of the Franchising Mediation Adviser (OFMA) to appoint an independent mediator within 14 days. OFMA was established under the Code to provide a low-cost option for resolving disputes without the need to go to Court. Once a mediator has been appointed, parties have 30 days to reach an agreeable outcome. The mediation process is terminated if agreement is not reached in this time or, if no resolution is imminent, either party requests a termination of the process.[28]

(b) Disclosure Document

22. Annexure 1 (long-form) and Annexure 2 (short-form) of the Code show the template required for the disclosure document. The long-form document is extensive with 28 separate clauses indicating the information franchisors are expected to provide. Among the most prominent are:

- A statement of advice confirming the cooling off provisions and the importance of conducting appropriate, independent due diligence before entering the agreement;[29]
- Details of the business experience of the franchisor and its office bearers, including a record of convictions or current proceedings against the franchisor or a franchise director for a range of matters including breaches of a franchise agreement or contraventions of trade practices laws;[30]
- The contact details of current franchisees within the business system and a record of the number of franchised business that were transferred; terminated; not renewed or acquired back by the franchisor over the last three years;[31]
- Any restrictions around the exclusivity of the site being operated by the intended franchisee;[32]
- Any restrictions around the use of intellectual property and the supply of goods and services by the franchisor and franchisee;[33]

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27 Part 3, sections 21(5) and 22(4), Part 4, section 27 *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

28 ibid., Part 4, sections 27-30A.

29 ibid., Annexure 1, section 1.1(e).

30 ibid., Annexure 1, sections 3-4.

31 ibid., Annexure 1, section 6.

32 ibid., Annexure 1, section 8.

- Details on the purpose and recipients of any pre-payments, establishment costs or other recurring and isolated costs that the franchisee will, or might be, called on to pay;[34]
- A list of references to the sections in the franchise agreement that address the obligations of both parties;[35] and
- A similar list of references to other conditions of the agreement including those pertaining to variations of the contract; the operations manual[36]; franchisee rights on selling the business and any goodwill entitlements on expiry, transfer or termination.[37]

23. The short-form document is an abridged version containing information from 13 of the 28 clauses. However, if a franchisee receiving a short-form document requests the additional information contained in the longer document, the franchisor must make this available.[38]

(c) Enforcement and compliance

24. From 1 July 1998, the Code became a mandatory industry code enforceable under s51AD (Part IVB) of the TPA. Remedies provided for a breach of this section included; injunctions (s80); damages (s82); corrective advertising (s86C); enforceable undertakings (s87B); and other orders such as setting aside or varying the contract (s87).

25. Franchising participants also had recourse to similar remedies from unconscionable conduct and misleading and deceptive provisions applicable to small business transactions.

26. Breaches of the Code and the subsequent remedies are now enforceable under the same sections of the *Competition and Consumer Act 2010* (CCA), which superseded the TPA on 1 January 2011. Alternatively, the unconscionable (s22) and misleading and deceptive conduct (s18) provisions are now contained in the Australian Consumer Law (ACL), which is a schedule to the CCA.[39]

27. The remedies available for these contraventions have been broadened under amendments to the legislative regime that have come into effect throughout 2010 and 2011. These amendments will be examined further in Chapter Three.

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33 Annexure 1, sections 7, 9 and 10 *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

34 ibid., Annexure 1, section 13.

35 ibid., Annexure 1, sections 15-16.

36 An operations manual operates in conjunction with the franchise agreement. It is designed to advise franchisees on how to operate a business under a franchise system. 'It covers all aspects of the business, and may be separated into different manuals addressing such subjects as accounting, personnel, advertising, promotion and maintenance'. whichfranchise Australia, 'Australian Franchise Glossary - What is Franchising'. Available at: www.whichfranchise.net.au/index.cfm?event=getArticle&articleID=22. Accessed on 16 June 2011.

37 Annexure 1, section 17 *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

38 ibid., Part 2, section 6C.

39 Volume 3, Schedule 2 (The Australian Consumer Law), *Competition and Consumer Act 2010* (Cth).

28. The agency responsible for ensuring compliance with the Code is the Australian Competition and Consumer Commission (ACCC). The ACCC's compliance role involves liaising with franchising participants and providing education services to inform parties of their obligations under the Code. In addition, the ACCC has enforcement powers which enable it to pursue breaches of the Code or the CCA. Importantly, the ACCC can only involve itself in a franchising dispute where a breach of the Code or the CCA is evident or suspected.[40]

1.3 Inquiries around franchising

29. Franchising has been subject to regular parliamentary scrutiny at the federal and state level since the mid-1970s.

30. In 1976, a review of the effectiveness of the TPA (the Swanson Committee) recommended that franchisees should receive the right to fair and equitable compensation upon termination or non-renewal of an agreement.[41]

31. Three years later a similar federal review (the Blunt Committee) called for the introduction of franchisee protection laws. In particular, the Blunt Committee sought: greater franchisee rights around disclosure and transfer entitlements; a list of conditions under which an agreement can be terminated; and the apportionment of goodwill[42] upon termination or non-renewal.[43]

32. The Beddall Committee conducted a broader inquiry into small business regulation in 1990. Again, it called for the introduction of franchising legislation and recommended the introduction of a pre-agreement disclosure process and a cooling off period for prospective franchisees. The Beddall Committee report led to the introduction of the voluntary Franchising Code of Practice in 1993.[44]

33. In 1997 the House of Representatives Standing Committee on Industry, Science and Technology (the Reid Committee) tabled a report into fair trading practices. The Reid Committee echoed the calls of earlier inquiries for franchise-specific legislation and recommended that legislation should provide for 'compulsory registration of franchisors and

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40 Australian Competition and Consumer Commission, 'Franchising Code of Conduct amendments', 24 June 2010. Available at: www.accc.gov.au/content/index.phtml/itemId/815467. Accessed on 3 May 2011.

41 From summary in, Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 3.57.

42 Goodwill is the value placed on a business over and above its tangible assets.

43 Trade Practices Consultative Committee, *Small business and the Trade Practices Act*, AGPS, Canberra, December 1979 (vol. 1), pp.7, 14-15.

44 From summary in, Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 3.59.

compliance with codes of practice'.[45] A year after this report was tabled the mandatory Franchising Code of Conduct was introduced.

34. The then federal Small Business Minister, Hon. Fran Bailey, called for a review of the Code in 2006. Named after its Chairman, KPMG National Managing Partner, Mr Graeme Matthews, the Matthews Review made 34 recommendations, many relating to amendments to the Code. These included:

- Reducing the period for which materially relevant facts must be disclosed from 60 to 14 days;
- Requiring franchisors to provide prospective franchisees with a copy of the franchise agreement in the form it is to be executed;
- Disclosing the business experience of the franchisor's officers and the contact details of any former franchisee from the last three years; and
- Inserting a statement in the Code obligating franchise participants to 'act towards each other fairly and in good faith'.[46]

35. The federal government supported 31 of the Matthews Review recommendations. Many of these were included in a major round of amendments to the Code on 1 March 2008.[47] Notable, however, was the government's decision not to insert a good faith obligation, arguing that good faith was a factor that can be taken into account when judging unconscionable conduct under the TPA.[48]

36. Within two years another federal committee, the Parliamentary Joint Committee on Corporations and Financial Services, inquired into the adequacy of the Code. Tabling in December 2008, the "Ripoll Report" made 11 recommendations. The government was urged to amend the Code to include a clear statement of risk in the disclosure document, including the liabilities and consequences facing a franchisee in the event of a franchisor's business

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45 House of Representatives Standing Committee on Industry, Science and Technology, *Finding a Balance: Towards Fair Trading in Australia*, Canberra, May 1997, para 3.112.

46 Franchising Code Review Committee, *Review of Disclosure Provisions in the Franchising Code of Conduct*, Office of Small Business, Canberra, October 2006, pp. 32-47. Available at http://www.innovation.gov.au/SmallBusiness/CodesOfConduct/Documents/FranchisingCodeReviewReport2006.pdf. Accessed on 24 May 2011.

47 *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008, p. 17.

48 *Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct*, February 2007, p. 9. Available at: http://www.innovation.gov.au/SmallBusiness/CodesOfConduct/Documents/GovtResponsetoRecommendationsFranchisingCoC.pdf. Accessed on 24 May 2011.

failing. The Ripoll Report also called for greater pre-entry disclosure regarding the process applicable to end-of-term arrangements.[49]

37. In a similar vein to the Matthews Review, a recommendation was made to insert a "Standard of Conduct" clause into the Code stating that all parties (including prospective parties) 'shall act in good faith in relation to all aspects of a franchise arrangement'.[50] Moreover, a call was made to amend the then *Trade Practices Act 1974* to include pecuniary penalties for breaches of the Code and to consider adopting similar penalties for cases of unconscionable and misleading and deceptive conduct.[51] Of the 11 recommendations, only those calling for a good faith clause and pecuniary penalties for breaches of the Code were rejected outright.

38. Two state-based franchising-related inquiries have been completed in recent years. In Western Australia, the former Labor government ordered a review of the adequacy of state and federal franchising legislation and the existing remedies available to franchisees. This 2008 report has become known as the Bothams Report, named after its Chair, two-time WA Franchisee of the Year award winner, Mr Chris Bothams. Part of the report's stated purpose was to 'make recommendations to enhance the franchising business in Western Australia'.[52]

39. The Bothams Report made 20 recommendations, many of which suggested actions that the federal government should consider in the areas of pre-franchise education; disclosure and due diligence; end-of-term arrangements; dispute resolution; and enforcement. Twelve of these recommendations suggested amendments to the Code or the TPA and often echoed the sentiment expressed in some of the federal reports. These included support for a detailed statement of risks highlighting franchisee rights and responsibilities when a franchise fails.[53] Again it was urged that franchisors be compelled to explicitly state end-of-term arrangements, including any goodwill or compensation entitlements franchisees may have in the event of non-renewal or termination.[54] Bothams argued that the Code should also make franchisors provide a 'reasonable period of notification' to franchisees if there is no intention to renew.[55] Finally, Bothams called for the TPA to be amended to prescribe explicit penalties for breaches of the Code—including penal terms for criminal offences.[56]

40. Of the 12 recommendations calling for amendments to franchising regulation, seven have been wholly or partly reflected in a round of amendments to the Code in 2010. Significantly,

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49 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 4.80 and 6.91.

50 ibid., para. 8.60.

51 ibid., para. 9.35-9.37.

52 *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008, p. 1.

53 ibid., pp. v, 14.

54 ibid., p. iv.

55 ibid.

56 ibid., pp. vi, 31.

as Chapter Three will show, the federal government has yet to adopt such explicit penalties for breaches of the Code.

41. The South Australian Economic and Finance Committee completed an inquiry into the efficacy of franchising laws (hereafter "SA Report") in May 2008: one month after the Bothams Report was tabled. The SA Report included a set of recommendations similar to the Bothams Report including support for the introduction of specific penalties for breaches of the disclosure requirements under the Code.[57] Like the Matthews and Ripoll reports, the SA Report also supported the introduction in the Code of a stated duty to 'act in accordance with good faith and fair dealing': in this instance during the franchise relationship and specifically during renewal negotiations.[58]

1.4 Significance of uniform national franchising regulation

42. A common theme emanating from these inquiries was that franchising was best suited to regulation and enforcement under a uniform national legislative regime. The Ripoll Report was unequivocal:

> *Taking into consideration the fact that many franchise systems operate across multiple state jurisdictions, the committee believes that franchising is most appropriately and usefully regulated at the Commonwealth level*.[59]

43. While the Bothams inquiry acknowledged that franchising reform was necessary in Western Australia, the report did not support 'separate stand alone state regulation'.[60] It added that recommendations for reform originating from states should be pursued via the commonwealth:

> *Regulatory changes to the franchising sector should be undertaken by the Commonwealth Government given that franchising often involves national brands operating across Australia*.[61]

44. Calls supporting the maintenance of a single regulatory regime have since been supported by several prominent franchise academics and a member of the "Expert Panel" commissioned

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57 Economic and Finance Committee, *Franchises*, House of Assembly, South Australia, 6 May 2008, p. 42.

58 ibid, pp, 60,69.

59 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 3.55.

60 See Chairman's Letter to Minister in *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008.

61 *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008, p. i.

in 2010 by the federal government to consider provisions for strengthening statutory unconscionable conduct and the Code.[62]

45. Uniform franchising legislation is consistent with the current Council of Australian Government (COAG) initiative to 'create a seamless national economy, and reduce costs incurred by business complying with unnecessary and inconsistent regulation across jurisdictions'.[63] The Australian Consumer Law is an example of this reform agenda whereby 20 existing state and territory consumer protection laws have been merged, 'provid[ing] consumers with a law that is easy to understand [and]…making compliance easier for businesses that trade in more than one jurisdiction'.[64]

Finding 1

Franchising is most appropriately and usefully regulated at the commonwealth level, as most franchise systems operate across multiple state jurisdictions.

46. There are a number of parties who support the principle of uniform legislation, but argue that states should now act independently because the extent or rate of reform at the federal level has been inadequate.[65] This line of argument has also been advanced by a franchisee association and a franchise consultancy group.[66] This counter-view has been reflected in recent legislative proposals in South Australia and Western Australia.

47. It is interesting to note what has occurred in the South Australian Parliament since the Economics and Finance Committee tabled its report into franchising in 2008. The SA Report concluded that reform was required:

> *…but it would be best achieved through the implementation of a range of nationally consistent measures...administered from a central authority*.[67]

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62 Submission No. 2 from Dr Jenny Buchan, 5 January 2011, p. 1; Submission No. 55 from Professor Andrew Terry and Mr Cary Di Lernia, 24 January 2011, p. 1; Submission No. 104 from Mr David Lieberman, 25 January 2011, p. 1.

63 COAG Reform Council, '*National Partnership Agreement to Deliver a Seamless National Economy: Performance Report for 2009-10*', 23 December 2010, p. 12. Available at: www.coagreformcouncil.gov.au/reports/competition.cfm. Accessed on 10 May 2011.

64 Commonwealth of Australia, 'The Australian Consumer Law', 2010. Available at: www.consumerlaw.gov.au/content/Content.aspx?doc=fact_sheets/FAQ.htm. Accessed on 10 May 2011.

65 Associate Professor Frank Zumbo, *Transcript of Evidence*, 11 April 2011, pp. 9-10; Submission No. 86 from Competitive Foods Australia Limited, 25 January 2011, p. 38.

66 Submission No. 65 from Franchisee Association of Australia Incorporated, 24 January 2011, pp. 1-2; Submission No. 21 from Franchise Central (Australia) Pty Ltd, 20 January 2011, p. 1.

67 Economic and Finance Committee, *Franchises*, House of Assembly, South Australia, 6 May 2008, p. 62.

48. However, the Committee added that it would:

> *…in the absence of any positive action elsewhere, consider making appropriate recommendations to the relevant State Minister to provide what level of redress it can with the legislative resources available*.[68]

49. On 3 December 2009, Mr Tony Piccolo, Member for Light and also a member of the Economics and Finance Committee, introduced a private member's bill—the Franchising Bill (South Australia) 2009—to the South Australian Parliament. Mr Piccolo said if the federal government had responded to the recommendations of the SA Report in a 'fair and timely' manner, he would not have introduced the Bill. The objective of the Bill was 'to fill in the gaps that exist in the current Franchising Code of Conduct and other trade practices and consumer law at the national level'.[69]

50. The Bill sought to adopt the Franchising Code of Conduct as a law of South Australia (to be known as the "SA Franchise Law") with several amendments including a statutory obligation to act in "good faith", which was given the definition of acting 'fairly, honestly, reasonably and in a cooperative manner'.[70] The Bill provided for the establishment and empowerment of a Commissioner of Franchises who could facilitate alternative dispute resolution processes if mediation under the Code failed. The Commissioner could also conduct investigations for possible breaches of the Code. Finally, the Bill looked to impose pecuniary penalties for contraventions the SA Franchise Law.[71]

51. The Franchising Bill (South Australia) 2009 lapsed when the 51st Parliament dissolved soon after in preparation for the March 2010 state election. Mr Piccolo has since suggested that the Small Business Minister in South Australia is currently consulting on two other bills, including one to establish a Small Business Commissioner, which may pursue similar reforms.[72] As it stands, a draft bill for a Small Business Commissioner has been released and a steering committee has been established to determine how to enhance franchising laws in South Australia.[73] In the interim, the Economics and Finance Committee (comprising a new

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68 Economic and Finance Committee, *Franchises*, House of Assembly, South Australia, 6 May 2008, p. 62.

69 Mr Tony Piccolo, South Australia, House of Assembly, *Parliamentary Debates* (Hansard), 3 December 2009, pp. 5009-5010.

70 Clause 4(2) Franchising Bill (South Australia) *2009* (South Australia).

71 ibid., Clauses 7 and 14. Under clause 14, pecuniary penalties could also be applied for attempting to contravene the SA Franchising Law; aiding or abetting a person contravening the law; inducing or attempting to induce others to contravene the law; conspiring with others to contravene the law; or being in any way involved in a contravention.

72 Mr Tony Piccolo, South Australia, House of Assembly, *Parliamentary Debates* (Hansard), 24 March 2011, pp. 3009-3110.

73 Hon Tom Koutsantonis, (Minister for Small Business), *Small Business to Get its Own Commissioner in South Australia*, Media Statement, Government of South Australia, Adelaide, 24 November 2011; Government of South Australia, 'Small Business Commissioner', 10 February 2011. Available at: www.southaustralia.biz/sbc. Accessed on 31 May 2011.

membership) is conducting another inquiry to determine how recent amendments to the Franchising Code of Conduct have addressed the SA Report's earlier recommendations.[74]

1.5 Franchising Bill 2010 (Western Australia)

52. The Franchising Bill 2010 (hereafter same or "the Bill") was introduced in the Western Australian Parliament on 13 October 2010. Like the Piccolo Bill, The Franchising Bill 2010 is a private member's bill seeking to apply the Code as a law of Western Australia and provide a statutory duty to act in good faith. Introduced by the member for Southern River, Mr Peter Abetz, MLA, the Bill is for '[a]n Act to regulate the conduct of people who are parties to franchise agreements and for related matters'.[75]

53. Mr Abetz advised that the Bill intends to address recommendations of the Ripoll Report that have thus far been rejected by the federal government: namely the imposition of financial penalties for breaches of the Code and the inclusion of a statutory obligation requiring parties to act in good faith in all aspects of a franchise agreement.[76] The Bill adopts an almost identical definition of good faith to that incorporated in the Bill introduced by Mr Piccolo in South Australia (see 50 above).[77] Both Bills were drafted with the assistance of Associate Professor Frank Zumbo from the Australian School of Business at the University of New South Wales. Unlike the Piccolo Bill, which sought to establish a dedicated franchising commissioner, Mr Abetz's Bill seeks to vest the enforcement oversight role with the Western Australian Commissioner for Consumer Protection.[78]

54. Mr Abetz explained that the Bill 'is concerned to ensure that the parties adhere to generally acceptable standards of conduct'[79] and abide by the Code. The Bill targets:

> *…a small but significant number of rogue franchisors in the market who are undermining confidence in the franchising sector by their unethical and predatory conduct.*[80]

55. Mr Abetz added that the Bill 'will not impose any additional costs on good franchisors'.[81]

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74 Economics and Finance Committee, 'Current Inquiries - Franchises (Supplementary Inquiry).' Available at: www.parliament.sa.gov.au/Committees/Pages/Committees.aspx?CTId=5&CId=173. Accessed on 1 June 2011.

75 Franchising Bill 2010 (Western Australia).

76 Mr Peter Abetz, MLA, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 13 October 2010, p. 7652.

77 Clause 11(1) Franchising Bill 2010 (Western Australia).

78 ibid., Clauses 3(2),12(1),13(1) and 14(2)).

79 Mr Peter Abetz, MLA, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 13 October 2010, p. 7653.

80 ibid., pp. 7652-7653.

81 ibid., p. 7653.

56. While not opposed to the power imbalance inherent in franchising contracts, Mr Abetz argued that his Bill would establish 'an appropriate legal framework to protect the interests and rights of parties to a contract'.[82] Ultimately, this should have the effect of making Western Australia an attractive investment destination for prospective franchisees.[83]

Finding 2

Supporters of the Franchising Bill 2010 argue that states should act due to inadequate reform at the commonwealth level.

57. On 18 November 2010, the Western Australian Parliament referred the Franchising Bill 2010 to the Economics and Industry Standing Committee for consideration and report. Six days later, Mr Abetz was co-opted to the Committee for the duration of the inquiry into the Bill.

58. To assist in its deliberations, the Committee called for submissions during December 2010 through January 2011, inviting comment on whether the passage of the Bill, in its current form, would be directly inconsistent with the TPA, now the *Competition and Consumer Act 2010* and the Franchising Code of Conduct. Comment was also sought on whether the Bill would enhance the purpose of the Code and whether it would result in a cost impact on the state or participants in franchising.

59. A total of 116 submissions were received and the Committee conducted 11 public hearings. The list of those who provided a submission and who appeared before the Committee is included in Appendices One and Two to this report.

60. It soon became evident to the Committee as it collected its evidence that the status of the franchising sector is a highly emotive issue. This is not surprising given that the structure of franchising contracts leaves the sector prone to disputation (see paragraph 9 above) and that the financial and emotional impact on franchisees can be traumatic when a franchise relationship breaks down.

61. It is common knowledge that a dispute between two large and successful franchising participants in Western Australia over the status of their contractual arrangements has been ongoing since 2003. Indeed, the Franchise Council of Australia (FCA) has publicly implied

82 Mr Peter Abetz, MLA, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 13 October 2010, p. 7654.

83 ibid., p. 7653.

that the motivation behind the Franchising Bill 2010 is linked to the commercial interests of one of these parties.[84]

62. The Committee is not looking to enter into a debate about the motives, commercial or other wise, of the proponents of the Bill. It is of the view that the commercial dispute that was referred to throughout the inquiry remains the exclusive concern of the parties involved.

63. Similarly, the Committee did not seek comment on the extent of the problems in franchising as these have been addressed in several other recent inquiries, including the Bothams Report.[85] The Committee's primary consideration is on the legal and logistical implications of the Bill before it, particularly given the overarching national regulatory framework applicable to franchising.

64. The Committee would like to express its gratitude to all who contributed to the Inquiry.

84 Franchise Council of Australia, '30 Reasons Why Abetz's Bill is Bad', n.d. Available at: www.franchise.org.au/articles/30-reasons-why-abetz-s-bill-is-bad.html. Accessed on 26 May 2011.

85 However, the Committee did become directly aware of particular examples of proven and alleged misconduct throughout the submission and hearing process.

CHAPTER 2 MAGNITUDE OF THE PROBLEM?

65. The proposed Bill marks a departure from the current uniform national regulatory regime, which is generally considered to be most appropriate for franchising (see section 1.4 above). Given the potential significance of this proposal it is prudent, before analysing the Bill, to ascertain the magnitude of the problem facing the franchising sector.

66. Perceptions of the severity of problems in franchising cover a broad spectrum. The Committee received evidence stating that, 'thousands of inexperienced investors continue to fall [to] unfair franchises'.[86] Writing in support of the Bill, the Federal Member for Canning, Mr Don Randall added that rogue and opportunistic franchisors were an 'epidemic problem' and that there were 'hundreds of thousands of franchisees in Australia who have been burned financially and emotionally' by such types.[87]

67. Alternatively, Mr Peter Abetz has offered a more tempered assessment, stating that the rogue franchisor element was a small but significant number (see paragraph 54 above). This view was shared by one of the state's leading franchise industry participants, Mr Jack Cowin, another supporter of the Bill.[88]

68. The Ripoll Report confirmed that it remains difficult to obtain accurate statistical data pertaining to the franchising sector.[89] Much of the current data available is based on surveys of franchisors, which have obvious limitations, particularly when trying to determine the extent of unconscionable behaviour and disputation. Notwithstanding this point, the Committee feels that there is material available that provides a reasonable insight.

69. The ACCC now publishes biannual reports on the trends in franchising and data on small business enquiries and complaints. For the period July through December 2010, franchising complaints represented 0.6% of all complaints received by the ACCC. This equated to 308 calls nationally, 36 of which were from Western Australia.[90] In its submission to the Ripoll Report, the ACCC advised that franchising-related complaints had 'generally declined'

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86 Submission No. 65 (Appendix 1) from Franchisee Association of Australia Incorporated, 24 January 2011, p. 8.

87 Submission No. 111 from Mr Don Randall, MP, 24 January 2011, p. 3.

88 Mr Jack Cowin, Chairman, Competitive Foods Australia Pty Ltd, *Transcript of Evidence*, 4 April 2011, p. 9.

89 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, p. xv.

90 Australian Competition and Consumer Commission, 'Comparison of franchising and small business complaints and enquiries 1 July - 31 December 2010', n.d, p. 1. Available at: http://www.accc.gov.au/content/item.phtml?itemId=973579&nodeId=b3835ff4cf17bd13b34e63680dde14bd&fn=ACCC%20franchising%20&%20small%20business%20complaints%20&%20enquiries%20data.pdf. Accessed on 10 May 2011.

between June 2004 and July 2008.[91] The ACCC advised the Committee that there has not been a significant change in the monthly spread of complaints in the period that has followed.[92]

70. The Western Australian Small Business Development Corporation (SBDC) provides preliminary assistance in regards to franchising disputes in this state. SBDC advised that less than 2 per cent of its annual enquiries are regarding franchise matters that could be dispute related.[93] There were 38 such enquiries from 1 July 2009 to 31 March 2011. Six of these were identified 'as involving alleged unconscionable conduct'.[94] The full break down showing the various matters underpinning these disputes is included in Table 1 below.

Table 1 Number and nature of franchising disputes 1 July 2009-31 March 2011 (SBDC)[95]

Nature of dispute	**No. of disputes**
Contractual issues	12 (32%)
Misleading conduct / false or misleading representations	9 (24%)
Disclosure	2 (5%)
Unconscionable Conduct	6 (16%)
Termination of franchise agreement	4 (11%)
Exclusive dealing	4 (11%)
Transfer for a franchise agreement	1 (3%)

71. The ACCC argued in its submission to the Ripoll Report that while it was worth re-examining the Code to improve stakeholder concerns, from the analysis of the complaints it

91 Australian Competition and Consumer Commission, *ACCC Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising Code of Conduct* , September 2008, 2.11. Refer to footnote five for this document's web address.

92 Mr Brian Cassidy, Australian Competition and Consumer Commission, Letter, 3 May 2011.

93 Ms Jacqueline Finlayson, A/Managing Director, Small Business Development Corporation, *Transcript of Evidence*, 11 April 2011, pp. 1-5.

94 Submission No. 102(A) from Small Business Development Corporation, 6 May 2011, p. 1.

95 ibid.

received, 'there does not appear to be endemic misconduct regarding the Code or the [then *Trade Practices*] Act by most franchisors'.[96]

72. Similarly, the Bothams Report—for which the SBDC provided the secretariat support—did not detect 'patterns of unconscionable conduct', but concluded that improvements to the regulatory regime were warranted (and should be undertaken by the federal government).[97]

73. The SBDC's Martin Hasselbacher was part of the secretariat to the Bothams Inquiry. His comment to the Committee was insightful:

> *I think there are elements that are undesirable, but certainly the evidence that was presented to the inquiry alluded to misconduct by just a small handful of franchisors. I certainly do not consider it as epidemic.*[98]

74. When asked to elaborate on the nature of the problems for which the Bothams' secretariat received accounts, Mr Hasselbacher added that:

> *The vast majority I could put down to probably a lack of understanding on the part of the franchisee that they either did not do their due diligence appropriately when they first entered into the agreement or that they did not fully understand their rights and obligations under a franchise agreement and under the federal legislation, so they got themselves into a situation, when really if they were fully informed to begin with, they might not have ended up in such a situation.*[99]

75. Mr Hasselbacher's conclusions are supported by a random sample survey of 345 franchisees in 2009 conducted by the Asia-Pacific Centre for Franchising Excellence under a research grant from the ACCC and the Australian Research Council. The survey found that just over one-third of franchisees felt that they were sufficiently diligent in 'gathering more information prior to entering the franchise agreement'.[100] In addition, a plurality (48.4 per cent) indicated that they relied heavily on 'gut feeling' when deciding to go into franchising (28.7 per cent disagreed with that statement).[101]

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96 The investigative qualities of the ACCC have come under criticism from a variety of parties. This will be examined in Chapter Three. Australian Competition and Consumer Commission, *ACCC Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising Code of Conduct*, September 2008, p. 4. Refer to footnote five for this document's web address.

97 *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008, p. i.

98 Mr Martin Hasselbacher, Assistant Director, Policy, Small Business Development Corporation, *Transcript of Evidence*, 11 April 2011, p. 6.

99 ibid.

100 Asia-Pacific Centre for Franchising Excellence, *Towards Conflict Resolution Australian Survey 2009*, p. 10. Available at: www.franchise.edu.au/franchise-conflict-research.html. Accessed on 13 May 2011.

101 ibid., p. 12.

76. This franchisee survey produced a series of other responses which, given the inherent imbalance of power in franchise agreements, would suggest that problems in the sector are evident but not systemic. While more than a quarter of respondents were mistrustful of their franchisor, 74 per cent confirmed that there was not a lot of conflict in the relationship (15 per cent indicated there was).[102] Sixty-two per cent indicated that the franchise system requirements placed on them were reasonable (17 per cent disagreed); 56 per cent felt that the agreement balanced the interests of both parties (27 per cent felt there was an imbalance); and 54 per cent felt their relationship was fair (24 per cent disagreed).[103]

77. Evidence presented to the Committee and to earlier inquiries confirms that the emotional and material consequences for franchisees whose businesses fail can be profound.[104] The Committee acknowledges that there appears to be a small element of franchisors whose opportunistic behaviours can lead to such outcomes.

78. However, the more pervasive problem appears to be in the level of prior investigation being undertaken by parties contemplating entry into a franchise system. This is particularly concerning given that—as the Ripoll Report noted—the period in which prospective franchisees can exercise the greatest influence over the franchise relationship is in the pre-contractual stage.[105] Certainly, an appropriate deterrence regime should be in place to target what appears to be a minority of unscrupulous operators. However, the focus of policy makers should be on ensuring that the quality and availability of information provided to those conducting due diligence is sufficient to inform them both of the probity of the franchisor and their rights and obligations under the franchise agreement.

79. The challenge facing the Committee as it considers this Bill is in determining the weight and appropriateness of any state-based legislative response in light of these difficulties facing the franchising sector. The Committee is generally supportive of the principle put forward by the Law Council of Australia, that:

> *…in view of the strong justification for the harmonisation of* [franchising] *laws, there must be compelling reasons to seek to introduce additional regulation in a sector with uniform regulation nationwide*[106]

80. In this respect, the Committee was interested in examining recent changes to the national regulatory framework before contemplating the merits of the Bill.

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102 Asia-Pacific Centre for Franchising Excellence, *Towards Conflict Resolution Australian Survey 2009*, pp. 6, 52. Available at: www.franchise.edu.au/franchise-conflict-research.html. Accessed on 13 May 2011.

103 ibid., pp. 37-38, 49.

104 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 7.5-7.8.

105 ibid., para, 4.95.

106 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 4.

Finding 3

Evidence and conclusions drawn from previous inquiries indicates that incidences of misconduct in the franchising industry are serious; but not widespread.

Finding 4

Given Finding One, it is the Committee's view that there must be compelling reasons to introduce state-based legislation.

CHAPTER 3 RECENT AMENDMENTS TO REGULATORY FRAMEWORK

3.1 Franchising Code of Conduct

81. There have been two separate rounds of amendments to the Code following the Matthews Report and the Ripoll Report. These changes came into effect on 1 March 2008 (Matthews) and 1 July 2010 (Ripoll). Neither set of amendments have been applied retrospectively.

(a) Post-Matthews Report amendments (2008)

82. The 2008 amendments were designed to 'increase the transparency, quality and timeliness of disclosure of information by the franchisor to existing and prospective franchisees'.[107] A summary of the major changes is consistent with this assessment. From March 2008, franchisors have had to:

- provide prospective franchisees with a copy of the franchise agreement, 'in the form in which it is to be executed', at least 14 days before a contract is signed. This is in addition to a pre-existing obligation to supply a copy of the Code and a disclosure document;[108]
- provide copies of any 'related agreements' the franchisee is required to sign at least 14 days prior to contract. This applies to leases; subleases; hire purchase agreements; intellectual property agreements; security (finance) arrangements; confidentiality and restraint of trade arrangements*;[109]
- include in the disclosure document the name and contact details of any franchisee who has left the system in the last three financial years (unless the former franchisee has requested in writing that their details not be provided)*;[110]
- provide a separate document outlining the history of the franchise site, including details of any franchise business that previously operated there and the circumstances under which these arrangements ceased*;[111]

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107 Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 2.

108 Part 2, section 10(c) *Trade Practices (Industry Codes - Franchising) Regulations 1998*, 1 March 2008.

* Denotes that this information is only compulsory in long-form disclosure documents. However, it must also be made available on request to short form document recipients (franchises with annual turnover below $50,000). See paragraph 23 above.

109 Annexure 1, Section 18.2 *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth), 1 March 2008.

110 ibid., Annexure 1, Section 6.5. Under this 2008 amendment, franchisors were 'taken to comply' with the Code by producing these details. Further amendments in 2010 following the Ripoll Report again reworded section 6.5 of the long-form disclosure document to say that the franchisor 'must supply' these details (unless the former franchisee requested in writing that their details not be provided).

- provide details of any parties that give rebates to the franchisor for goods supplied to the franchisee under the agreement*;[112]
- supply a copy of an annual audited financial statement (and the audit report) detailing income and expenditure of any marketing fund to which the franchisee pays fees;[113] and
- disclose any materially relevant facts regarding changes in franchisor ownership or any proceedings and convictions against the franchisor for a stated list of offences within 14 days (formerly a 60 day limit).[114]

83. Finally, mandatory rights of association for franchisees now extend to prospective franchisees.[115]

84. The Ripoll Report expressed the view that the 2008 changes were likely to address some of the concerns relating to the pre-contractual period that it had noted in its submissions. In particular, the provisions to provide greater detail of former franchisees were intended to assist prospective franchisees in determining whether churning was taking place. A recommendation was made that the efficacy of these amendments be reviewed in 2010.[116]

85. This Committee is of the view that the additional disclosure provisions that followed the Matthews Report greatly enhanced the quality of due diligence that was available for those considering entry into a franchise business.

Finding 5

The additional disclosure provisions that followed the Matthews Report and were implemented in 2008 significantly enhanced the quality of due diligence that was available for those considering entry into a franchise business.

(b) Post-Ripoll Report amendments (2010)

86. The 2010 amendments to the Code that followed the Ripoll Report were intended to achieve a policy balance. Further improvements to disclosure requirements were designed to give prospective franchisees an even greater understanding of the risks and obligations of a

111 Annexure 1, Section 11.3 *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth), 1 March 2008.

112 ibid., Annexure 1, Section 9.1(j).

113 ibid., Part 3, Section 17(1).

114 ibid., Part 3, Section 18(1).

115 ibid., Part 3, Section 15.

116 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 4.100, 5.19.

franchise agreement without representing an excessive compliance burden for businesses.[117] The major changes are summarised in the following paragraphs.

87. After recommendations from the Matthews and Ripoll reports called for a detailed statement of risk on the front page of long and short-form disclosure documents, the government agreed to the inclusion of a more general statement. Franchisors are now obliged to declare that:

> *Franchising is a business and, like any other business, the franchise (or the franchisor) could fail during the franchise term. This could have consequences for the franchisee.*[118]

88. The federal government also requested the ACCC to develop additional educational material to inform franchisees of the potential liabilities they might face if their franchisor fails.[119]

89. Under the earlier version of the Code it was compulsory to provide the details of any 'recurring or isolated' payments that would be payable by the franchisee to the franchisor or a third-party. This clause was broadened in 2010 to include any such payments that were considered 'reasonably foreseeable by the franchisor'.[120]

90. As noted in paragraph 37 above, the Ripoll recommendation to insert a good faith clause into the Code was not adopted. While the government was not opposed to the principle of parties acting in good faith, it was not convinced the term could be appropriately defined to be effective in a mandatory code of conduct. Instead the government chose to pursue further amendments that would directly target commonly cited problem behaviours and improve the power imbalance in franchise agreements towards the franchisee.[121]

91. A key area addressed in this respect was end-of-term arrangements. A new clause was inserted requiring franchisors to advise at least six months before the expiry of the agreement (or one month prior for contracts shorter than six months in duration), whether they intend to renew or offer a new franchise agreement to the incumbent.[122] In addition, disclosure documents must now contain details outlining the arrangements to apply at the

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117 Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 3.

118 Annexure 1, section 1(e) and Annexure 2, section 1(e) *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

119 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, pp. 6 and 21. Available at: http://www.innovation.gov.au/SmallBusiness/CodesOfConduct/Documents/GovernmentresponseFranchising.pdf Accessed on 24 May 2011.

120 Annexure 1, section 13.6A and Annexure 2, section 7.6A *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

121 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, pp. 4-5. Refer to footnote 119 for this document's web address.

122 Part 3, section 20A *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

end of the agreement. This includes information regarding the treatment of residual inventory; any rights the franchisee has to sell the business; whether exit payments are available and their method of calculation; and how significant capital expenditure undertaken by the franchisee will be considered at the end of the franchise agreement.[123]

92. A second strategy adopted *in lieu* of a good faith clause was the inclusion of a list of five "desirable" behaviours, any of which each party would have to demonstrate to be seen as attempting to resolve their dispute under the Code's mediation process.[124]

93. The government also asked an "Expert Panel" to provide counsel on 'Strengthening Statutory Unconscionable Conduct and the Franchising Code of Conduct'. Advice was sought on amendments to the Code that could effectively address five areas where parties may engage in opportunistic behaviour. These were:

- Unilateral variation of franchise agreements;
- Unforeseen capital expenditure;
- Attribution of legal costs;
- Confidentiality obligations; and
- Franchisor-initiated changes to franchise agreements when the franchisee is trying to sell the business.[125]

94. The Expert Panel found that '[l]egitimate commercial reasons exist for the unilateral variation of franchise agreements, particularly (but not solely) through amendments to the operations manual'.[126] Even so, scope existed for this privilege to be abused. Rather than prohibit unilateral variations, as some contributors to the Ripoll (and Matthews) reports had requested, the Expert Panel suggested that a record of any unilateral variations for the previous three financial years be included in the disclosure documents.[127] The federal government accepted this suggestion and included it in the 2010 amendments.[128]

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123 Annexure 1, section 17C and Annexure 2, section 9C *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

124 ibid., Part 4, section 29.

125 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, p. 6. Refer to footnote 119 for this document's web address.

126 Horrigan, B., Lieberman, D., & Steinwall, R. *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct, Report to the Hon Dr Craig Emerson MP*, February 2010, pp. xi, 50. Available at: http://www.treasury.gov.au/documents/1744/PDF/unconscionable_conduct_report.pdf. Accessed on 24 May 2011.

127 ibid., pp. 50, 52.

128 Annexure 1, section 17A and Annexure 2, section 9A *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

95. The Expert Panel made similar findings around the commercial legitimacy of the other four practices. Again it was argued that while prohibition was inappropriate, prospective franchisees would greatly benefit from further disclosure (and education) about key issues that may affect their decision to enter the business.[129] In response to this review, the federal government inserted a series of additional new clauses requiring the franchisor to state:

- Whether the franchisee will be required, through the franchise agreement or the operations manual, to undertake 'unforeseen significant capital expenditure' that is not disclosed before the agreement is signed.[130]
- Whether the franchisor's legal costs incurred during dispute resolution will be attributed to the franchisee;[131]
- Whether confidentiality obligations will be imposed and the areas they are likely to cover;[132] and
- Whether a requirement to amend the franchise agreement will be imposed while the franchisee is in the process of trying to sell the business.[133]

96. The government complemented these changes by amending the Code to confirm that nothing would limit the implied common law obligation to act in good faith in a franchise agreement to which the Code applies.[134] The debate about incorporating a statutory obligation to act in good faith remains highly contentious and is explored in detail in Chapter 4.

3.2 Compliance and enforcement regime

97. As discussed in section 1.2(c) above, the responsibility for compliance and enforcement under the Code rests with the ACCC under the *Competition and Consumer Act 2010* (CCA) and the Australian Consumer Law (ACL). Following the Ripoll Report the federal government looked to support its targeted enforcement measures by providing broader powers to the ACCC.

98. It is highly likely that these amendments were made in light of the ongoing criticism directed towards the ACCC in the various inquiries into franchising. In its submission to the Ripoll

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129 Horrigan, B., Lieberman, D., & Steinwall, R. *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct, Report to the Hon Dr Craig Emerson MP*, February 2010, pp. 53, 61, 66, 71. Refer to footnote 126 for this document's web address.

130 Annexure 1, section 13A and Annexure 2, section 7A *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth).

131 ibid., Annexure 1, section 13B and Annexure 2, section 7B.

132 ibid. Annexure 1, section 17B and Annexure 2, section 9B.

133 ibid., Annexure 1, section 17D and Annexure 2, section 9D.

134 ibid., Part 4, section 23A.

report, the ACCC said that it considers all complaints regarding breaches of the Code and 'does not hesitate to take enforcement action against anyone who fails to comply with the Code or the Act'.[135] Currently, the ACCC website displays the results of 23 matters it has successfully pursued since 1998 for such breaches.[136] The regulator added, in comments to the South Australian inquiry, that there was an expectation gap in the franchise sector regarding what ACCC involvement in a matter could actually achieve. Sometimes investigations it has undertaken have not substantiated a breach while many complaints it received pertained to contractual disputes that were not within the regulator's remit and were more suited to mediation.[137]

99. Notwithstanding these comments, the ACCC's enforcement and compliance promotion activities have been criticised in most of the major franchising inquiries. The SA Inquiry found that the ACCC was not highly regarded in some sections of the franchising community.[138] The Ripoll Report acknowledged limitations the ACCC then faced in not being able to independently initiate investigations. However, it argued that the regulator was capable of 'taking a more active role in dealing with franchising-related complaints'.[139] The report also recommended greater development and distribution of educative material explaining the scope and limitations of the ACCC's role. Meanwhile the Bothams Report said better resources, and a dedicated franchising enforcement unit, would allow the ACCC to respond to matters in a timely manner.[140]

100. The Committee notes that submissions to this Inquiry have continued the criticism directed towards the ACCC in earlier reports.[141] However, a series of very recent amendments to the CCA and ACL should significantly improve the regulator's investigative and enforcement capabilities.

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135 Australian Competition and Consumer Commission, *ACCC Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising Code of Conduct*, September 2008, para. 1.3. Refer to footnote five for this document's web address.

136 Australian Competition and Consumer Commission, 'Franchising Code complaints, investigations and outcomes', 2011. Available at: www.accc.gov.au/content/index.phtml/itemId/816437#h3_164. Accessed on 2 June 2011.

137 Economic and Finance Committee, *Franchises*, House of Assembly, South Australia, 6 May 2008, pp. 90-91.

138 ibid., p. 94.

139 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 9.32-9.33.

140 *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008, pp. v, 30.

141 Submission No. 30(A) from Retail Traders' Association of Western Australia, 27 April 2011, p.1; Submission No. 87 from Ms Narelle Walter, 23 January 2011, p. 5; Submission No. 111 from Mr Don Randall, MP, 24 January 2011, p. 1.

(a) Direct remedies for breaches of the Code

101. Under amendments to the CCA that came into effect on 1 January 2011, the ACCC can issue a Public Warning Notice if it has 'reasonable grounds to suspect' that the Code has been breached.[142] The federal government has validly argued that '[t]his warning—or naming and shaming—power will alert the public to rogue or unscrupulous franchisors'.[143]

102. As of 1 January 2011, group redress orders are now available for breaches of the Code. Under this provision, the Commission can apply to a court to remedy losses of franchisees who were not part of the legal proceeding, but suffered harm from the same act or omission.[144] The ACCC's Deputy Chair, Dr Michael Schaper has said that as a result of this amendment, 'The court will be more readily able to remedy those losses'.[145]

(b) Remedies via breaches of the *Competition and Consumer Act 2010*

103. The misleading and deceptive conduct (s18) and unconscionable conduct (s22) provisions formerly under the *TPA* have been carried over to the ACL and are still applicable to mandatory industry codes (see paragraph 26 above).

104. Criticisms have been made that unconscionable conduct cases in particular have been difficult to prove for franchising participants.[146] In recognition of this issue the federal government has now amended the CCA to 'increase the understanding and clarity of the unconscionable conduct provisions'.[147] Previously, courts had eleven guiding factors when determining unconscionable conduct. This included the extent to which small business participants acted in good faith. Now, courts may also have regard to whether a contract

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142 Part IVB, Section 51ADA *Competition and Consumer Act 2010* (Cth); Dr Michael Schaper, 'Enforcement and Audits - the ACCC's Plans and Intentions'. Presentation to National Franchising Conference, 10 October 2010, p. 7. Available at: www.accc.gov.au/content/index.phtml/itemId/951182. Accessed on 10 May 2011.

143 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, p. 3. Refer to footnote 119 for this document's web address.

144 Part IVB, Section 51ADB *Competition and Consumer Act 2010* (Cth).

145 Part IVB, Section 51ADA *Competition and Consumer Act 2010* (Cth); Dr Michael Schaper, 'Enforcement and Audits - the ACCC's Plans and Intentions'. Presentation to National Franchising Conference, 10 October 2010, p. 8. Refer to footnote 142 for this document's web address.

146 Associate Professor Frank Zumbo, *Transcript of Evidence*, 11 April 2011, p. 14; Mr Leo Tsaknis, Barrister, appearing on behalf of Retail Traders' Association of Western Australia, *Transcript of Evidence*, 13 April 2011, p. 9.

147 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, p. 12. Refer to footnote 119 for this document's web address.

exists between the parties as well as the respective level of compliance to the terms and conditions and the general conduct throughout the agreement.[148]

105. From 2011, substantial pecuniary penalties are in place for breaches of s22 of the ACL (unconscionable conduct). These amount to a maximum fine of $220,000 for a person and up to $1.1 million for a body corporate.[149] Significantly, state regulators can now also apply for pecuniary penalties in relation to s22.[150] Other new remedies available under s22 include: undertakings (s218); public warning notices (s223) (also available for breaches of s18 misleading and deceptive conduct); and collective compensation orders on behalf of injured parties (s237).[151]

(c) Broader investigative powers (ACCC)

106. Under s220 of the Australian Consumer Law, the ACCC can now issue substantiation notices requiring parties to provide documentation substantiating claims or representations made regarding their business. Failure to respond to a substantiation notice within 21 days can result in the issuance of an infringement notice which can carry a penalty of $6,600 for a corporation or $1,320 for individuals. If information provided in a substantiation notice is proven to be false or misleading pecuniary penalties are again available: $27,500 for a corporation or $5,500 for an individual (s219-222; s224). The ACCC's Dr Schaper has advised that substantiation notices could be issued under a franchise agreement where a false representation is made, but the franchisee 'suffers little harm as result of the representation'.[152] Substantiation notices now avail the ACCC with a preliminary investigative tool[153] that obviates the need to commence court proceedings.

107. An important amendment that came into effect in 2011 is the random audit powers now vested with the ACCC.[154] Under these powers, the regulator can request franchisors to produce a range of materials including disclosure documents; franchise agreements; professional advice statements; and marketing fund accounts.[155] Recipients must respond within 21 days to the request. If the documentation confirms that further investigation may

148 Section no. 22(j)(iii)-(iv) *Competition and Consumer Act 2010* (Cth) Volume 3, Schedule 2 - The Australian Consumer Law.

149 ibid., section no. 224(3).

150 Confirmed by the Department of Commerce: Submission No. 99(B) from Department of Commerce, 21 April 2011, pp. 3-4.

151 Submission No. 99 ('Attachment A') from Department of Commerce, 2 February 2011, p. 3; Submission No. 99(B) from Department of Commerce, 21 April 2011, p. 8.

152 Dr Michael Schaper, 'Enforcement and Audits - the ACCC's Plans and Intentions'. Presentation to National Franchising Conference, 10 October 2010, p. 7. Refer to footnote 142 for this document's web address.

153 ibid., p. 5.

154 Part IVB, Section 51ADD *Competition and Consumer Act 2010* (Cth).

155 Dr Michael Schaper, 'Enforcement and Audits - the ACCC's Plans and Intentions'. Presentation to National Franchising Conference, 10 October 2010, pp. 8-9. Refer to footnote 142 for this document's web address.

be warranted, the ACCC can pursue the matter and, if necessary commence enforcement proceedings.[156]

108. Random audit powers were sought by the ACCC in its submission to the Ripoll Report and offer a range of benefits.[157] The regulator will be able to monitor compliance more promptly and without relying on complaints by franchisees before taking action. However, franchisees can also report alleged contraventions anonymously without fear of reprisal. The ACCC has since validly argued that these investigation powers mitigate the imbalance in bargaining power between franchise participants and will strengthen compliance with the Code.[158]

Finding 6

Amendments to the *Competition and Consumer Act 2010* (including the introduction of the Australian Consumer Law) that have come into effect in 2010 and 2011 should significantly improve the investigative and enforcement capabilities of the Australian Competition and Consumer Commission (ACCC). Under these changes, the ACCC can now:

- Issue Public Warning Notices for suspected breaches of the Franchising Code of Conduct.
- Apply to the Courts for redress orders for franchisees not party to the ACCC's legal proceeding, but who suffered from the same breach of the Code (group redress orders).
- Issue notices asking franchisors to substantiate claims or representations made about their business.
- Conduct random audits compelling franchisors to produce disclosure documents, franchise agreements and marketing fund accounts.
- Apply to the Courts for pecuniary penalties of up to $1.1 million for charges of unconscionable conduct under section 22 of the Australian Consumer Law.

156 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, p. 10. Refer to footnote 119 for this document's web address.

157 Australian Competition and Consumer Commission, 'ACCC Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising Code of Conduct ', September 2008, p. 4. Refer to footnote five for this document's web address.

158 Dr Michael Schaper, 'Enforcement and Audits - the ACCC's Plans and Intentions'. Presentation to National Franchising Conference, 10 October 2010, pp. 8-9. Refer to footnote 142 for this document's web address.

(d) Franchise sector education

109. Recognising the need to better educate prospective franchisees about the regulator's role (see 99 above), the ACCC has collaborated with Griffith University to develop an online pre-entry franchise education program. The federal government argues that this course, offered free of charge, may 'reduce the risk of unrealistic expectations and surprises after a franchisee buys into a franchise'.[159]

110. This course should complement the wealth of valuable educative material already available to prospective franchisees on the ACCC's web site.[160] This site provides fact sheets describing the recent amendments to the Code and includes *The Franchisee Manual*, a helpful booklet that articulates several opportunistic behaviours as 'warning signs' of which prospective franchisees should be wary.[161] This material would be of great benefit to individuals conducting due diligence, but does not appear to be widely utilised. In 2009, only seven per cent of franchisees indicated that they had obtained information from the ACCC before entering a franchise.[162] It is arguable that an awareness and understanding of the ACCC's franchising information would significantly empower prospective franchisees and reduce the level of disputation in the sector.

3.3 Committee's view on recent amendments

111. Several proponents of the Franchising Bill 2010 argue that the federal government reforms are inadequate.[163] Another contributor to this inquiry, who is open to state-based franchising legislation, says that there is insufficient protection for franchisees who can not afford expensive litigation.[164] Some proponents of the Bill acknowledge the value of the ACCC's new random audit powers, but argue that without an explicit good faith obligation and civil penalties for breaches of the Code, rogue operators will be undeterred.[165] A further criticism

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159 Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 8.

160 Australian Competition and Consumer Commission, 'Franchising Code', 2011. Available at: www.accc.gov.au/content/index.phtml/itemId/6118. Accessed on 30 May 2011.

161 Australian Competition and Consumer Commission, *The Franchisee Manual*, 2010, p. 8. Available at: www.accc.gov.au/content/index.phtml/itemId/795322. Accessed on 30 May 2011.

162 Asia-Pacific Centre for Franchising Excellence, *Towards Conflict Resolution Australian Survey 2009*, p. 72. Available at: www.franchise.edu.au/franchise-conflict-research.html. Accessed on 13 May 2011.

163 Submission No. 65 from Franchisee Association of Australia Incorporated, 24 January 2011, p. 2; Submission No. 87 from Ms Narelle Walter, 23 January 2011, p. 2.

164 Submission No. 13 from Mr Scott Cooper, 19 January 2011, p. 1.

165 Associate Professor Frank Zumbo, *Transcript of Evidence*, 11 April 2011, pp. 2, 4; Submission No. 86 from Competitive Foods Australia Limited, 25 January 2011, pp. 7, 40.

is that the reforms undertaken have focused too much on upfront disclosure and do not adequately address conduct throughout the agreement.[166]

112. The Committee is of the view that such criticisms, particularly the latter, fail to acknowledge the weight of the recent amendments and how they serve to enhance the Code. As stated in paragraph 12 above, the Code aims address the imbalance of power and lift the standards of conduct between franchising participants without endangering the vitality of the sector.

113. The increase in up-front disclosure requirements—coupled with improved educational materials—is a sound strategy. The pre-entry period is the time when the franchisee has the greatest bargaining power, including the ability to walk away from an agreement if the information provided is inadequate or raises concerns. The Small Business Development Corporation confirmed that the 2010 amendments 'addressed many of the concerns raised in the various inquiries by enhancing the upfront disclosure of end of agreement arrangements'.[167]

114. The expanded interpretive provisions under s22 and the introduction of pecuniary penalties for breaches of this section have been introduced after extensive consultation, undertaken in large part to improve the quality of legislation pertaining to franchising.[168]

115. Public warning and substantiation notices, along with non-party redress for breaches of the Code and the CCA, provide timely enforcement options previously unavailable to the regulator. Importantly, all of these reforms have been implemented under a national framework, thereby alleviating compliance issues for the many businesses working across multiple jurisdictions.

116. The federal government has agreed to 'review the efficacy' of the post-Matthews and post-Ripoll amendments in 2013, arguing that the franchising sector, 'deserves some certainty and stability'[169] after what has been an extended period of multiple inquiries and reforms. While the introduction of the private members' bills in the South Australian and Western Australian parliaments—and suggestions that similar reforms may be pursued in Queensland[170]—indicates an element of dissatisfaction with the extent of reform, the Committee remains cautious of departures from the national framework.

117. Noteworthy in this respect is the conclusion of the Expert Panel's 2010 report. The panel did not suggest that the reform process was complete. However, it argued that the introduction

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166 Submission No. 86 from Competitive Foods Australia Limited, 25 January 2011, p. 11; Submission No. 30 from Retail Traders' Association of Western Australia, 21 January 2011, p. 6.

167 Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 8.

168 This issue is explored in greater detail in section 4.5(a)(ii) below.

169 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, p. 23. Refer to footnote 119 for this document's web address.

170 Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 14.

of the ACL and amended unconscionable conduct provisions will dramatically alter the trade practices landscape. It added that enhancements to the Code 'will mark a significant shift in franchising regulation'.[171] The panel supported a review in three to five years, urging 'a need for measured reform, consolidation in practice and continuous improvement and review based on evidence'.[172]

118. The Committee's general view is consistent with the sentiments expressed by the Expert Panel: both in respect of the significance of recent amendments and the prudence behind the timing of the 2013 review. Consequently, for the Committee to support the Bill there needs to be an unequivocal demonstration that the proposed legislation would not detract from the current regulatory regime nor cause undue disruption to the franchise sector. In the following chapters, the Committee considers the legislative and cost impact of the Bill and discusses why it is not persuaded of its need at this time. However, should Parliament wish to pass this Bill, Chapter 4 includes some suggested amendments designed to improve the clarity of the Bill in order to ensure it operates in accordance with its intended purpose.

Finding 7

The post-Ripoll Report amendments to the Franchising Code of Conduct that have been implemented in 2010 and 2011 mark a significant shift in franchising regulation.

Finding 8

The full suite of amendments to the Franchising Code of Conduct and the *Competition and Consumer Act 2010* that have been implemented over the last three years address many of the problems cited in earlier inquiries and are intended to lift the standards of conduct in the franchising industry.

Finding 9

Given the significance of recent amendments under the national legislative framework, which are due for further review in 2013, the Committee is not convinced that the Franchising Bill 2010 is an appropriate measure at this time.

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171 Horrigan, B., Lieberman, D., & Steinwall, R. *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct, Report to the Hon Dr Craig Emerson MP*, February 2010, p. 90. Refer to footnote 126 for this document's web address.

172 ibid.

Recommendation 1

The Committee recommends that the Franchising Bill 2010 be opposed.

CHAPTER 4 CONSIDERATION OF THE BILL

4.1 Introduction

119. It is not the Committee's role to adjudicate upon the legality of the Bill, or the interpretation of any clause of the Bill. If and when the Bill becomes an Act it is the sole province of the Courts to determine its legality and interpret its sections.

120. However, in order to inform Parliament, the Committee has considered it appropriate to receive submissions on the legality of the Bill and interpretation of its clauses, and to express its view (not a determination) based on these submissions.

4.2 Validity and Consistency of the Bill

121. The Committee has examined whether the Bill, if enacted as drafted, would be inconsistent with the *Competition and Consumer Act 2010* and the Franchising Code of Conduct and if it would be a valid law of Western Australia.

(a) Validity

122. Section 2(1) of the *Constitution Act 1889* (WA) provides that:

> *There shall be … a Legislative Council and a Legislative Assembly: and it shall be lawful for Her Majesty, by and with the advice and consent of the said Council and Assembly, to make laws for the peace, order, and good Government of the Colony of Western Australia…*

123. Case law in this area[173] has established a test for validity; that there must be some relevant connection to the state. In the Bill, this relevant connection is sought to be made by clause 4(1) which reads:

> *A franchise agreement (as defined in the Franchising Code of Conduct (WA)) is a **WA franchise agreement** for the purposes of this Act if the agreement relates to the conduct of a business in, or partly in, Western Australia.*

124. For these reasons, it is the opinion of Mr Malcolm McCusker AO QC and Messrs Daryl Williams SC and Leo Tsaknis, that the Bill, if enacted, would be a valid law of Western Australia. The Committee has had no legal opinion to the contrary.

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[173] Particularly *Pearce v Florenca* (1976) 135 CLR 507 at 518, *Union Steamship Company of Australia Pty Ltd v King* (1988) 166 CLR 1 at 14, *Mobil Oil Australia Pty Limited v Victoria* [2002] HCA 27.

(b) Consistency

125. Concerns were raised regarding the Bill's consistency with the CCA and the Code.[174]

126. Section 109 of the Commonwealth Constitution provides that:

> *When a law of a State is inconsistent with a law of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid.*

127. The test of direct inconsistency is whether the clause will alter, impair or detract from the operation of a Commonwealth law.[175] The Committee did not receive any submissions or any other evidence which explicitly applied this test in respect of the Bill. However, the Committee believes it has received sufficient evidence on this issue to form a view.

128. Mr Daryl Williams SC and Mr Leo Tsaknis discerned 'no basis for any inconsistency between the Bill, the Trade Practices Act 1974 and the Code, whether by reason of s109 of the Commonwealth Constitution, or otherwise'.[176]

129. The Law Council of Australia advised the Committee that it 'has not identified any direct inconsistency between the Bill in its current form and the *Trade Practices Act 1974 (Cth)/Competition and Consumer Act 2010 (Cth) … or the Franchising Code of Conduct…*'.[177]

130. In relation to clause 11 of the Bill, the Law Society of Western Australia advised that as there is no good faith obligation in the CCA or the Code, the duty to act in good faith contained in the Bill is not inconsistent with the CCA or the Code.

131. Further, Mr Malcom McCusker AO QC gave his opinion that:

> *Although there is no such provision in the Commonwealth Code, there is no "inconsistent" provision in it either. Furthermore, section 51AC of the Trade Practices Act prohibits a corporation from engaging in" unconscionable conduct in connection with the supply or acquisition of goods or services", and that provision is not "inconsistent" with a positive duty to act in good faith (as defined) although it is not synonymous.*[178]

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174 Submission No. 69 from Icon Law, 24 January 2011, pp. 2-7; Submission No. 95 from Yum! Restaurants International, 24 January 2011, pp. 2-8; Submission No. 98 from Queensland Law Society, 2 February 2011, pp. 2-4.

175 *Victoria v The Commonwealth* (1937) 58 CLR 618, Dixon J at 630.

176 Submission No. 86 from Competitive Foods Australia Limited, 27 January 2011, 'Annexure 1', p. 7.

177 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 2.

178 Submission No. 30 from Retail Traders Association of Western Australia, 21 January 2011, 'Appendix A', p. 3.

132. In respect of inconsistency with the enforcement and remedy provisions (clauses 12-15) of the Bill, Mr McCusker AO QC refers to the similar remedies for breach provided by the *Trade Practices Act 1974* and states that:

> *Although the Bill contains a number of similar provisions, none is "inconsistent" with the Trade Practices Act. That Act does not purport to "cover the field" so as to provide exclusive duties or remedies in relation to franchises.*[179]

133. Mr McCusker AO QC is referring to Section 51AEA of the *Trade Practices Act 1974* which states:

> *It is the Parliament's intention that a law of a State or Territory should be able to operate concurrently with this part unless the law is directly inconsistent with this Part.*

134. Mr Alan Robertson SC addressed the argument that there is inconsistency because the commonwealth Parliament intended that corporations not be liable for penalties for contravening the Code and gave his opinion that:

> *… authority shows that mere differences of penalty give rise to s. 109 inconsistency only in covering the field cases and not, as here, where the Commonwealth Parliament has stated its intention that the laws are to operate concurrently...*[180]

135. The Committee agrees with the opinions of Mr McCusker AO QC, Mr Robertson SC, the Law Council of Australia and the Law Society of WA and is of the view that the Bill, in its current form, will not alter, impair or detract from the operation of the CCA or the Code and is therefore not directly inconsistent with those laws.

136. The Committee notes however that if a duty to act in good faith or civil monetary penalties for breaches of the Code is introduced in the CCA or Code in the future, these parts of the Bill may become directly inconsistent with these amended commonwealth laws and will be rendered inoperable to the extent of the inconsistency.

Finding 10

If enacted as drafted, it is the Committee's view that the Franchising Bill 2010 would not be directly inconsistent with the *Competition and Consumer Act 2010* or the Franchising Code of Conduct.

179 Submission No. 30 from Retail Traders' Association of Western Australia, 21 January 2011, 'Appendix A', p. 3.

180 Submission No. 86 from Competitive Foods Australia Ltd, 27 January 2011, 'Annexure 1', p. 3.

4.3 Retrospectivity

137. The Committee heard concerns from contributors to the Inquiry that clauses 4(2)(a), 11(2) and 14(4) may be retrospective in application to existing franchise agreements.

138. The Committee is guided in its assessment by the opinions of Mr Malcom McCusker AO QC, Mr Alan Robertson SC, and Messrs Daryl Williams QC and Leo Tsaknis, all of whom have stated that the Bill is not retrospective.[181]

139. Mr McCusker AO QC provides:

> *The only arguably* "retrospective" *aspect is in Clause 11(2) which imposes a duty to act* "in good faith"*(as defined) on persons who are already parties to a WA Franchise Agreement. The pre-existing rights and duties of the parties, as they stood, will be thereby altered. What they could have done, as the law and franchise agreement previously allowed, will be altered to some extent.*
>
> *However, the duty to act in good faith is to apply only to future dealings or negotiations, after the enactment of the Bill. And the monetary penalties and other remedies are to apply only to* "a breach of this Act". *Nothing in the Bill purports to impose penalties for acts done prior to commencement of the Act.*[182]

140. Their view is echoed in the other opinions, and also by the Bill's drafter, Associate Professor Frank Zumbo.[183]

141. In the absence of expert opinion to the contrary, the Committee is of the view the Bill is not drafted to operate retrospectively.

Finding 11

The Committee is of the view that the Bill is not drafted to operate retrospectively.

[181] Submission No. 30 from Retail Traders' Association of Western Australia, 21 January 2011, 'Appendix A', p. 4; Submission No. 86 from Competitive Foods Australia Limited, 27 January 2011, 'Annexure 2', pp 3-4; Submission No. 86 from Competitive Foods Australia Limited, 27 January 2011, Att 1, p. 11.

[182] Submission No. 30 from Retail Traders Association of Western Australia, 21 January 2011, 'Appendix A', p. 4.

[183] Submission No. 101(A) from Associate Professor Frank Zumbo, 24 May 2011, pp. 16-17.

4.4 Clause 4 - WA FRANCHISE AGREEMENT

142. Concerns were raised around the extra-territorial application of the Bill and the definition of ***WA franchise agreement***.

(a) Extra-territorial application

143. The Bill states that 'a franchise agreement (as defined in the Franchising Code of Conduct (WA)) is a ***WA franchise agreement*** for the purposes of this Act if the agreement relates to the conduct of a business in, or partly in, Western Australia'.[184] According to several submissions, this definition has the potential to include interstate franchisees of WA-based franchisors and franchisees with a tenuous link to Western Australia.[185]

144. The breadth of the extraterritorial application needs to be clarified. Dr Michael Underdown of the Law Society of Western Australia advised the Committee that it will be very hard to apply the Act if it does not apply extraterritorially.[186] Without extraterritorial application, franchisors outside of Western Australia would not be required to abide by the Act in relation to their Western Australian based franchisees or present themselves to a Western Australian court in answer to a claim that they have breached the Act.

145. Given that most large franchisors are registered outside of Western Australia, it is arguable that the legislation would be largely ineffectual if it were restricted to exclude those franchisors. For example, without extraterritorial application, franchisors such as Wendys, Midas and Bakers Delight, whose franchisee/franchisor relationship problems are well-publicised, would not be subject to the legislation.

146. Problems may arise when determining which jurisdiction and court will hear a case involving an interstate party.[187] Arrangements exist between the states for decisions made in one state to be implemented in another, but the process may be lengthier, thereby increasing the costs to litigating parties.

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184 Clause 4(1) Franchising Bill 2010.

185 Submission No. 31 from Bedshed Franchising Pty Ltd, 18 January 2011, p. 1; Submission No. 40 from Franchising Solutions Pty Ltd, 21 January 2011, p. 2; Submission No. 59 from Quick Service Restaurant Holdings Pty Ltd, 24 January 2011, pp. 1-2; Submission No. 98 from Queensland Law Society, 2 February 2011, pp. 5-6; Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 5; Dr Michael Underdown, Law Society of Western Australia, *Transcript of Evidence*, 5 May 2011, p. 2.

186 Dr Michael Underdown, Law Society of Western Australia, *Transcript of Evidence*, 5 May 2011, p. 3.

187 Submission No. 98 from Queensland Law Society, 2 February 2011, Att. 1, p. 5; Dr Michael Underdown, Law Society of Western Australia, *Transcript of Evidence*, 5 May 2011, p. 3.

(b) Definition of WA franchise agreement

147. A major cause of concern with clause 4 of the Bill centres on the test of whether a business is being conducted in, or partly in, Western Australia. The Explanatory Memorandum indicates that this section was intended to provide a requirement that there be a connection to Western Australia, which would be in accordance with the state parliament's right to make laws. At a hearing, Associate Professor Zumbo was asked about the potential regulatory reach of the definition. He replied:

> *We made very clear that there has to be a relevant connection with Western Australia. … [W]e do* [make it clear], *because in the bill it talks about a Western Australian agreement; that is the relevant connection. It does not talk about just any franchise agreement; it talks about a Western Australian franchise agreement that is carrying out business, partly or wholly, in Western Australia.*[188]

148. However, neither the Explanatory Memorandum nor Associate Professor Zumbo provide any guidance as to what kind of business might be described as being conducted 'partly in' Western Australia. While the Committee cannot know how the courts might interpret the term 'partly in', it is of the opinion that the definition of ***WA franchise agreement*** should be amended to remove this ambiguity.

149. Mr Abetz advised that it was his understanding that as clause 3 provided:

> *If a term is given a meaning in the Franchising Code of Conduct (WA), it has the same meaning in this Act, unless the contrary intention appears*
>
> and that in the Code, the term 'business' is used exclusively for franchisees, no further clarification was needed.[189]

150. Mr Peter Quinlan SC was briefed by Quick Service Restaurant Holdings Pty Ltd to provide an opinion on the extra-territorial application of the Bill. In respect of the term "business" Mr Quinlan SC advises that in the context of franchising there are two quite distinct ways in which the word "business" is employed:

> *First, the "business" may refer to the overarching commercial activity associated with the "system or marketing plan" controlled by the franchisor….or alternatively, the "business" may refer to the particular commercial operation conducted by each individual franchisee.*[190]

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188 Associate Professor Frank Zumbo, *Transcript of Evidence*, 11 April 2011, p. 10.

189 Mr Peter Abetz, MLA, Co-opted Member, Economics and Industry Standing Committee, *Transcript of Evidence* (Law Society of Western Australia), 5 May 2011, p. 2.

190 Quinlan, P. 'Franchising Bill 2010 (WA) - Opinion', 31 March 2011, p. 10. The Quinlan opinion is contained in Supplementary Information provided by Quick Service Restaurant Holdings Pty Ltd at a hearing on 11 April 2011. A copy can be found on the Committee's website at www.parliament.wa.gov.au/eisc.

151. Mr Quinlan SC notes that in the context of standard form franchise agreements, "business" is used in both senses, although generally in the latter of the two described above.[191] He believes that a Court would be more likely to construe the word "business" in the narrower sense, that is, by the second meaning, which is consistent with the use of the word "business" in the Code.[192] As such, in respect of Quick Service Restaurant Holdings Pty Ltd, the Bill, if enacted, would only apply to 'those agreements where the commercial operation of the franchisee is conducted wholly, or partly, in Western Australia'.[193] Mr Quinlan SC stresses however that much would depend on the terms of the individual agreements and on the precise nature of the franchisee's business. He advises that if the intention of the Bill is as he has concluded:

> *…it would be possible to make it clearer in the Bill that "business" within the meaning of clause 4 refers to the commercial operation of the franchisee and not to the system or marketing plan operated by the franchisor.*[194]

152. Giving consideration to the intent of the Bill, the Committee is of the view that the extraterritorial application needs to extend to non-Western Australian based franchisors of Western Australian based franchisees, but should not include the non-Western Australian based franchisees of Western Australian based franchisors.

Recommendation 2

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 4(1) should be amended to explicitly remove any ambiguity as to whether, and to what extent, the Bill is intended to have extra-territorial application.

153. The Committee also received submissions which stated that the Bill may inadvertently apply to fractional franchise agreements and franchise agreements regulated by other industry codes (such as the Oil Code), which are excluded under sections 5(3)(a) and (b) of the Code.[195] The Queensland Law Society is concerned that although the Bill adopts the Code,

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191 Quinlan, P. 'Franchising Bill 2010 (WA) - Opinion', 31 March 2011, p. 10. Refer to footnote 190 for details on accessing this opinion.

192 ibid., p. 11.

193 ibid.

194 ibid., pp. 11-12.

195 Submission No. 69 from Icon Law, 24 January 2011, p. 8; Submission No. 98 from Queensland Law Society, 2 February 2011, p. 7.

there is no express exclusion of types of agreements which the Commonwealth intended not to be covered by the Code.[196]

154. The Committee is of the view that if Parliament wishes to pass this Bill, all reasonable efforts should be made to remove ambiguity from it. Therefore, clause 4 of the Bill should be amended to stipulate that the Bill does not apply to agreements excluded under sections 5(3)(a) and (b) of the Code.

Recommendation 3

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 4 should be amended to stipulate that the Bill does not apply to agreements that are excluded under sections 5(3)(a) and (b) of the Franchising Code of Conduct.

4.5 Clause 11 - Good faith

155. The inclusion of an express duty of good faith in franchising regulation has been a key issue in franchising reform in recent years, particularly in the Matthews, Ripoll and the SA inquiries.

156. In order to 'provide positive reinforcement to the development of improved relationships and dealings between franchisors, franchisees and prospective franchisees' the Matthews Review (conducted in 2006) recommended:

> *A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part 1 of the Code.*[197]

157. In response, the federal government rejected the recommendation by stating that it:

> *…agrees with the intention that franchisors franchisees and prospective franchisees act towards each other fairly and in good faith. Section 51AC of the Trade Practices Act 1974 includes 'good faith' as a factor that can be taken into account when determining unconscionable conduct.*[198]

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196 Submission No. 98 from Queensland Law Society, 2 February 2011, p. 7.

197 Franchising Code Review Committee, *Review of the Disclosure Provisions in the Franchising Code of Conduct*, Office of Small Business, Canberra, October 2006, pp. 46-47. Refer to footnote 46 for this document's web address.

198 *Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct*, February 2007, p. 9. Refer to footnote 48 for this document's web address.

158. In May 2008, the South Australian House of Assembly's Economic and Finance Committee tabled its report into franchises and recommended:

> *…amending the Franchising Code of Conduct by inserting a provision imposing a duty to act in accordance with good faith and fair dealing by each party of the franchise relationship.*[199]

159. The SA Inquiry Committee was concerned about the limited redress options available to franchisees in cases where franchisors abused their contractual discretions and powers and saw no reason why an express obligation of good faith could not be implemented.[200] This recommendation, and the SA Inquiry report as a whole, was considered in the Ripoll Report, which was tabled later that year in December.

160. The Ripoll Report noted that there 'remains concern in the sector at the continuing absence of an explicit overarching standard of conduct for parties entering a franchise agreement' and recommended that the following new clause be inserted into the Code:

> *6 Standard of Conduct*
>
> *Franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.*[201]

161. While the federal government agreed in principle that franchisors and franchisees should undertake their business in good faith, it noted that proposals from franchisee representatives for the inclusion of a good faith obligation were generally motivated by specific issues, and so chose instead to target these problems, including by way of disclosure and end-of-term arrangements (see paragraph 91 above).[202] The government had concerns with the inclusion of a general, undefined good faith obligation in the Code because the law on good faith is still evolving and it would create uncertainty, leading to adverse commercial consequences for franchisees.[203]

162. Undoubtedly, the government's decision not to accept the Ripoll Report's recommendation on the duty of good faith was one of the major reasons behind the introduction of the Franchising Bill 2010. The express duty of good faith in clause 11 of the Bill has been included to address this gap in the Code. In contrast to the concerns of the commonwealth government, the Explanatory Memorandum states that its inclusion will provide 'certainty

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199 Economic and Finance Committee, *Franchises*, House of Assembly, South Australia, 6 May 2008, pp. 14-15.

200 ibid., p. 59.

201 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 8.60.

202 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, pp. 4-5. Refer to footnote 119 for this document's web address.

203 ibid., p. 13.

for all participants in the franchising industry in [Western Australia] regarding the nature and scope of that duty'.[204]

163. It is essential to note that duty of good faith in the Bill is defined; it is not a general undefined duty as recommended in the Ripoll Report. Good faith in the Bill will be discussed in two parts: firstly in terms of the inclusion of a statutory duty of good faith in general and secondly in terms of the specific words used in the definition.

(a) Inclusion of good faith generally

164. The Committee received a significant response to clause 11 of the Bill. Most proponents of the section chose to refute opponents' arguments rather than provide a case for support, with the notable exceptions of the Bill's drafter, Associate Professor Zumbo, and Competitive Foods Australia Limited (CFAL). Consequently, the Committee's deliberations on the inclusion of a statutory duty of good faith focussed primarily on the validity of arguments surrounding the adequacy of provisions in the CCA and ACL and the implied duty of good faith in the Code and at common law.

(i) Good faith as part of the Code and the common law

165. The principle of good faith is recognised in the Code under section 23A, which reads:

> *Nothing in this code limits any obligation imposed by the common law, applicable in a State or Territory, on the parties to a franchise agreement to act in good faith.*

166. This provision was part of the amendments made to the Code, which took effect from 1 July 2010. It preserves existing case law on the concept of good faith, and recognises future developments in that law.[205] Many contributors to the Inquiry were of the opinion that good faith as a concept was part of the common law and this was adequate.[206] On this subject, the Law Council of Australia advised the Committee that Australian courts have been prepared to recognise that a franchise agreement includes an implied term requiring parties to act in good faith, citing several cases by way of example.[207] There are also many

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204 Franchising Bill 2010 - Explanatory Memorandum (EM 162) (Western Australia).

205 Australian Competition and Consumer Commission, 'Frequently asked questions about the Franchising Code amendments', nd. Available at: http://www.accc.gov.au/content/index.phtml/itemId/935262. Accessed on 23 May 2011.

206 Including: Submission No. 2 from Dr Jenny Buchan, 5 January 2011, p. 2; Submission No. 58 from McDonalds Australia Limited, 24 January 2011, p. 1; Submission No. 80 from Law Council of Australia, 25 January 2011, p. 5; Submission No. 84 from Franchise Council of Australia, 25 January 2011, pp. 3-4.

207 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 5.

academic papers discussing the rise in the recognition of an implied duty of good faith in cases involving commercial contracts generally.[208]

Finding 12

The 2010 amendment to the Franchising Code of Conduct that inserted clause 23A preserves existing case law on the concept of good faith, and recognises developments in that law.

167. Mr Peter Abetz points out however, that as the duty of good faith is not a statute law, in each case the courts must first decide whether it is relevant to the matter at hand. This takes time, which will increase the costs, making it less accessible to franchisees.[209] The argument that can be inferred here is that the inclusion of a statutory duty of good faith would eliminate the uncertainty faced under the common law.

168. Further advocating a statutory duty of good faith, Associate Professor Zumbo states that it is consistent with the implied duty under the common law and the defining terms in the Bill reflect what the courts have held to be the underlying duties of parties to a commercial contract.[210]

169. A number of contributors to the Inquiry noted that a statutory obligation of good faith had been introduced in franchising legislation in a number of international jurisdictions, including the United States and Canada.[211] CFAL cited section 3 of the *Arthur Wishart Act (Franchise Disclosure) 2000* (Ontario Franchises Act) as including a statutory obligation of good faith. This section reads:

> (1) *Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement.*
>
> (3) *For the purpose of this section, the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.*[212]

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208 Brown, L., 'The Impact of Section 51AC of the Trade Practices Act 1974 (Cth) on Commercial Certainty', *Melbourne University Law Review*, vol. 28, no. 3, December 2004; Gordon, M., 'Discreet Digression: The Recent Evolution of the Implied Duty of Good Faith', *Bond Law Review*, vol. 19, no. 2, 12 November 2007; Hon. Marilyn Warren, AC, 'Good faith, where are we at?', Speech presented to the Judicial College of Victoria, 'Developments in Contract' Series, Melbourne, 15 October 2009.

209 Mr Peter Abetz MLA, Co-opted Member, Economics and Industry Standing Committee, *Transcript of Evidence* (Quick Service Restaurant Holdings Pty Ltd), 11 April 2011, p. 15.

210 Submission No. 101 from Associate Professor Frank Zumbo, 31 January 2011, p. 28.

211 See for example: Submission No. 101 from Associate Professor Frank Zumbo, 31 January 2011, p. 30; Mr Wayne Spencer, Executive Director, Retail Traders' Association of Western Australia, *Transcript of Evidence*, 13 April 2011, p. 4.

212 Section 3 *Arthur Wishart Act (Franchise Disclosure) 2000 (*Ontario, Canada).

170. In contrast with the Bill, the Ontario Franchises Act does not define good faith.

171. Unlike Australia, Canada does not have a national legislative framework for franchising. Furthermore, only four out of its ten provinces have franchising legislation (Ontario, Alberta, New Brunswick and Prince Edward Island). A similar situation exists in the United States, which has a national Franchise Rule which covers disclosure requirements, but does not have a national legislative framework governing franchise relationships. Not all states have franchise relationship laws, and not all of these laws contain an obligation to act in good faith. The Committee could identify only one state (Iowa) which had defined good faith:

> *A franchise imposes on the parties a duty of good faith in performance and enforcement of the franchise agreement. "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.*[213]

172. Beyond the possible difficulties in interpreting the definition, it must be noted that this duty applies only to the performance and enforcement of the agreement, whereas the proposed duty in the Bill applies to all dealings and negotiations in connection with the agreement.

173. The Committee acknowledges the introduction of a statutory obligation to act in good faith in various international jurisdictions. However, it is of the view that these examples are of little practical use to the discussion due to the lack of uniform franchise relationship laws in these jurisdictions and the circumstances in which the concept of good faith is applied.

(ii) The applicability of unconscionable conduct to franchising

174. As previously indicated at paragraph 103 above, the ACL prohibits unconscionable conduct (sections 20-22, formerly part IVA of the TPA). Some opponents of the Bill argue that unconscionable conduct is adequate and more appropriate for the regulation of conduct than a statutory duty of good faith.[214] CFAL disputes this on the basis of the provision's broad application to all business arrangements (not franchising specifically), its lack of definition and the high standard of proof set by the courts.[215] The Retail Traders' Association of Western Australia (RTA) also point out that unconscionable conduct and good faith are not synonymous concepts and unconscionable conduct imposes different standards to good faith conduct.[216]

175. The unconscionable conduct provisions have been amended substantially since their first introduction in 1986, with consideration as to the performance of the provisions as well as

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213 Chapter 532H.10, *Iowa Code, 2011,* (Iowa, United States of America).

214 Submission No. 47 from Snap Franchising Ltd, 21 January 2011, p. 3; Submission No. 58 from McDonald's Australia Pty Ltd, 24 January 2011, p. 1; Submission No. 80 from Law Council of Australia, 25 January 2011, p. 5; Submission No. 84 from Franchise Council of Australia, 25 January 2011, pp. 3-4.

215 Submission No. 86 from Competitive Foods Australia Limited, 27 January 2011, p. 26.

216 Mr Leo Tsaknis, Barrister, appearing on behalf of the Retail Traders' Association of Western Australia, *Transcript of Evidence*, 13 April 2011, p. 9.

the needs of the industries governed by the TPA.[217] In 1997, the House of Representatives Standing Committee on Industry, Science and Technology (Reid Committee) conducted the Inquiry, *Finding a Balance: Towards Fair Trading in Australia*. This Inquiry led to the introduction of section 51AC of the TPA and made mandatory the Franchising Code of Conduct.

176. The Reid Committee found that small businesses were vulnerable to exploitation and abuse of power, particularly in the areas of franchising, retail tenancy, misuse of market power by larger competitors and small business finance.[218] The Reid Committee recommended, among other measures, a provision replacing the provisions of Part IVA of the TPA which prohibited unfair conduct. While the then government did not endorse this recommendation, it committed to the inclusion of section 51AC, which would give small business, including franchisees, genuine access to protection against unconscionable conduct.[219]

177. The Reid Committee also discussed how to appropriately legislate a mandatory Franchising Code of Conduct, referring to definitional issues in respect of what is and is not a franchise. The Reid Committee concluded that its proposed general unfair conduct provision (what would become the unconscionable conduct provision) would catch any franchisor who sought to get around that definition.[220]

178. The intention of the Reid Committee Report and the federal government's response was clear: section 51AC of the TPA was intended to apply to and be utilised by the franchising industry.

179. From the time of its enactment, sections 51AC(3) and 51AC(4) have provided a list of matters that the Court may have regard to in determining a contravention. Of particular relevance to the franchising industry are:

(a) the relative strengths of the bargaining positions of the supplier/acquirer and the business consumer/small business supplier

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217 Horrigan, B., Lieberman, D., & Steinwall, R. *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct, Report to the Hon Dr Craig Emerson MP*, February 2010, Appendix D, pp. D-1 - D-3). Refer to footnote 126 for this document's web address.

218 House of Representatives Standing Committee on Industry, Science and Resources, *Finding a balance: Towards Fair Trading in Australia - Recommendations*, 26 May 1997, p. 1. Available at: http://www.aph.gov.au/house/committee/isr/Fairtrad/report/RECOMM.PDF. Accessed on 24 May 2011.

219 Horrigan, B., Lieberman, D., & Steinwall, R. *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct, Report to the Hon Dr Craig Emerson MP*, February 2010, Appendix D, p. D-2). Refer to footnote 126 for this document's web address.

220 House of Representatives Standing Committee on Industry, Science and Resources, *Finding a balance: Towards Fair Trading in Australia - Franchising*, 26 May 1997, p. 119. Available at: http://www.aph.gov.au/house/committee/isr/Fairtrad/report/CHAP3.PDF. Accessed on 24 May 2011

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(f) the extent to which the supplier's/acquirer's conduct towards the business consumer/small business supplier was consistent with the supplier's/acquirer's conduct in similar transactions between the supplier and other like business consumers/small business suppliers

(g) the requirements of any applicable industry code

(i) the extent to which the supplier/acquirer unreasonably failed to disclose to the business consumer/small business supplier:

(i) any intended conduct of the supplier/acquirer that might affect the interests of the business consumer/small business supplier; and

(ii) any risks to the business consumer/small business supplier arising from the supplier's/acquirer's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer/small business supplier);

(j) the extent to which the supplier/acquirer was willing to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer/small business supplier

(k) the extent to which the supplier/acquirer and the business consumer/small business supplier acted in good faith.

180. Subsequently, the following matter of particular relevance to the franchising industry was added to that list:

(ja) whether the supplier/acquirer has a contractual right to vary unilaterally a term or condition of a contract between the acquirer and the business consumer/small business supplier for the supply/acquisition of the goods or services.

181. The Committee has heard the concerns of contributors to the Inquiry regarding problems with the unconscionable conduct provisions, particularly in respect of the ACCC's prosecution performance. Parties who have concerns with the effectiveness of the unconscionable conduct provisions often quote that the ACCC has had only two or three successful prosecutions under these provisions. The Expert Panel Report points out that:

… an effective testing and exploration of new provisions can result in some losses, as the ambit of the law is settled. Further, the figure of 'only two' successful judgements represents only a fraction of the ACCC's unconscionable conduct actions and understates the ACCC's broad enforcement activities, which often results in successful resolution of matters before a final judgement.[221]

[221] Horrigan, B., Lieberman, D., & Steinwall, R. *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct, Report to the Hon Dr Craig Emerson MP*, February 2010, p. 9. Refer to footnote 126 for this document's web address.

182. Still, the deficiency in case law after a decade was becoming a problem, and led to the Senate Economics Committee Inquiry into the need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the TPA. While the Inquiry examined the issues surrounding unconscionable conduct generally, the core of the report focuses on section 51AC. The Senate Economics Committee believed that the courts were narrowly interpreting this section and that the present legal position was skewed to favour big business interests, sometimes at the direct expense of smaller businesses and consumers.[222] The Senate Economics Committee specifically referred to submissions received from franchisees alleging serious misconduct which should be pursued under section 51AC. It also noted the many similar submissions received by the Ripoll Inquiry.[223]

183. The Senate Economics Committee acknowledged that 'the courts' current interpretation of section 51AC sets the bar too high for small business' and examined how to reform the provisions without limiting legitimate business interests or the efficient operation of the market.[224] It did not recommend inserting a definition of unconscionable conduct into the TPA because of the difficulties in defining the concept and the creation of obligations and uncertainties for legislatures, regulatory bodies and the courts.[225]

184. In October 2008, COAG agreed to the establishment of a national consumer law. The Australian Consumer Law, which came into effect on 1 January 2011, drew on the recommendations of the Ripoll Report, the Senate Economics Committee's Report and the subsequent Expert Panel Report and the commitments of the federal government in response to these recommendations.

185. The unconscionable conduct provisions in the ACL have undergone a general refinement in language but otherwise reflect much the same intent as under the TPA. A notable amendment, however, is the clarification that the terms and progress of a contract and the conduct of the contracted parties may be relevant to a finding of unconscionable conduct.[226]

186. Two other important changes have been made in the ACL that affect the unconscionable conduct provisions. The first is the introduction of pecuniary penalties. A pecuniary penalty of $1.1 million if the person is a body corporate or $220,000 if the person is not a body corporate may now be imposed for a breach of the unconscionable conduct provisions. The second is the empowerment of state regulators to enforce the ACL. In Western Australia, this is the Commissioner for Consumer Protection.

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222 Senate Committee on Economics, *The need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the Trade Practices Act 1974*, Senate Printing Unit, Canberra, December 2008, pp. 31-32.

223 ibid., p. 31.

224 ibid., p. 32.

225 ibid., pp. 33, 43.

226 Section no. 22(j)(iii)-(iv) *Competition and Consumer Act 2010* (Cth) Volume 3, Schedule 2 - The Australian Consumer Law.

187. The Committee is of the view that the unconscionable conduct provisions at section 22 of the CCA (formerly section 51AC of the TPA) were developed and have been amended with the needs of the franchising industry in mind. The continued monitoring of these provisions and the recent changes to the consumer law in Australia demonstrate that successive federal governments and the commonwealth parliament as a whole have been committed to providing an effective law.

188. It is the Committee's view that the issues it has identified with clause 11 of the Bill will result in a similar situation as has occurred with the unconscionable conduct provisions; that is, a long process of amendment and improvement. While this is not a reason not to enact legislation, the Committee believes that any provision that proposes a move away from a national legislative framework for franchising must have a real and immediate effect. Anything less than that would duplicate the same problems that have been experienced under the current legislative framework.

(b) Definition of Good Faith in the Bill

(i) Use of the term "means"

189. Clause 11 (1) reads:

> In this section —
>
> ***act in good faith*** means to act fairly, honestly, reasonably and cooperatively.

190. Concerns were raised regarding the use of the term "means", which lends to an exhaustive interpretation. On this issue, the Department of Commerce refers to *Statutory Interpretation in Australia*, quoting:

> *The orthodox and, it is submitted, the correct approach to the understanding of the effect of these expressions is that 'means' is used if the definition is intended to be exhaustive while 'includes' is used if it is intended to enlarge the ordinary meaning of the word.*[227]

191. The use of the word "means" in the definition has two effects. Firstly, it limits the consideration of whether a party acted in good faith to those four elements and secondly, it implies that only one element needs to be missing in a party's conduct for that party to be taken not to have acted in good faith.[228] Given the penalties proposed for a breach of this section, this second effect is particularly serious.

192. Associate Professor Zumbo, in reference to his decision to use the word "means", stated:

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227 Submission No. 99 from Department of Commerce, 27 January 2011, p. 2.

228 Submission No. 90 from Borello Legal Pty Ltd, 24 January 2011, p. 2.

> *I was pretty specific on the word "means" for a number of reasons, but particularly because we wanted there to be a statutory definition that was self-contained and that reflected the common law.*[229]

193. As the Inquiry progressed and the effect of the word "means" become apparent to the Committee, it sought advice from various witnesses on whether the word "includes" would be more appropriate.

194. Dr Michael Underdown, though appearing on behalf of the Law Society of Western Australia, expressed in his personal capacity his view that:

> *… if you are going to define it, it would be better to use the word "including" so that you are not limiting the definition. … There are various rules of statutory interpretation. Normally a judge will look at the intention of Parliament. … if Parliament says that good faith means A, B, C and D and does not use the word "including", the courts will generally interpret that as meaning that that is all Parliament wanted to include in the definition.*[230]

195. Mr Derek Sutherland, appearing with the Queensland Law Society, pointed out that the term "includes" may be just as inappropriate as "means". It sets the bar higher to say that acting in good faith includes fairly, honestly, reasonably and co-operatively as well as any number of undefined elements.[231]

196. Conversely, Mr Leo Tsaknis, representing the RTA, stated:

> *Having regard to this particular legislation, in my view, a "means" definition provides greater certainty and is to be preferred.*

197. Mr Tsaknis explains that as clause 10 of the Bill allows additional rights or obligations, the common law is not excluded and parties can choose to pursue conduct breaches through the common law or through the definition at section 11 of the Act. Therefore, as flexibility is provided by section 10, the definition should use the term "means" to provide certainty.[232] The Committee also notes that the application of section 23A of the Code would prevent the exclusion of the common law (unless specifically excluded in a franchise agreement).

(ii) Choice of the four defining terms

198. The discussion on the use of the terms "fairly, reasonably, honestly and co-operatively" focuses on the interpretation of each term and the potential for specific terms to prevent the pursuit of legitimate business interests.

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229 Associate Professor Frank Zumbo, *Transcript of Evidence*, 11 April 2011, p. 11.

230 Dr Michael Underdown, Special Counsel, *Transcript of Evidence*, 5 May 2011, pp. 6-7.

231 Mr Derek Sutherland, Chair, Franchising Law Committee, Law Society of Queensland, *Transcript of Evidence*, 11 April 2011, p. 8.

232 Mr Leo Tsaknis, Barrister, appearing on behalf of the Retail Traders' Association of Western Australia, *Transcript of Evidence*, 13 April 2011, p. 8.

199. In their opinion provided to CFAL, Mr Daryl Williams QC and Mr Leo Tsaknis state that the words used in the definition are:

> *… well known to the common law and lawyers, and, broadly speaking, they are non-technical terms which will be interpreted in accordance with their ordinary meaning. It is to the meaning of the quoted words that the courts will turn to determine what the duty to act in good faith requires in the circumstances of the particular case.*[233]

200. The RTA also has this understanding and cites the matter of *JF Keir v Priority Management Systems* in which Rein J accepted submissions made by a franchisee that when the franchisor exercised his powers under the franchise agreement, the implied duty of good faith required the franchisor to act, among others, reasonably and honestly.[234]

201. It is from the ruling of Rein J in this matter that Mr Abetz derived the four terms used in the definition of good faith in the Bill. At a hearing, Mr Abetz stated:

> *Justice Rein, in New South Wales I think it was, has ruled in two cases now and I quote from his ruling. It states —*
>
> *… I summarised the submissions made on behalf of the franchisee in that matter, which I accepted as to the content of the duty of good faith. In short, and relevantly, the franchisor is required to act reasonably and honestly —*
>
> *These are the two terms that we put in our definition in the bill. The ruling continues —*
>
> *(to an objective standard), not to act for ulterior motive, —*
>
> *Which I guess we could say means fairly. The quote continues —*
>
> *to recognise and have regard to the legitimate interest of both parties in the enjoyment of the fruits of the contract, and to avoid rendering the franchisee's interest under the agreement nugatory or worthless or seriously undermining it …*
>
> *Which in common language means cooperatively. So, the four adjectives that we use in the bill would seem to summarise what Justice Rein says is the common-law obligation.*[235]

202. The Law Council of Australia advised the Committee that:

> *While the law is capable of determining honesty with some precision, the same cannot be said in relation to "fair", "reasonable" or "cooperative" as they are employed in this context. The concepts have been drawn from common law doctrine and applied in the Bill bluntly, potentially disconnecting them from the nuance of their origin.*[236]

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233 Submission No. 86 from Competitive Foods Australia Limited, 27 January 2011, Attachment 1, p. 10.

234 Submission No. 30 from Retail Traders' Association of Western Australia, 21 January 2011, p. 6; *Inquiry into the Operation of Franchise Businesses in Western Australia: Report to the Western Australian Minister for Small Business*, Small Business Development Corporation, Perth, April 2008, p. 10.

235 Mr Peter Abetz, MLA, Co-opted Member, Economics and Industry Standing Committee, *Transcript of Evidence* (Law Council of Australia), 4 April 2011, p. 2.

236 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 5.

203. Similarly, the Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre[237] stated that:

> *…the requirement to act "fairly, honestly, reasonably and cooperatively" depend in the main on the eye of the beholder for potentially widely varying interpretations. "Honest" and "honestly" are the least likely to be misinterpreted as one is either honest or dishonest… However the other concepts which form the definition of Good Faith relating to fairness, reasonableness and cooperation hinge on subjective viewpoints that are unlikely to align at all times, and in particular, during franchise disputes.*[238]

204. Professor Andrew Terry and Mr Cary di Lernia agree that honesty is 'the most uncontroversial proposition' in the good faith debate. However, honesty is 'not such a ground-breaking or instructive requirement for, as Einstein J states in *Aiton Australia Pty Ltd v Transfield Pty Ltd*, 'parties are subject to a *universal* duty to act honestly' in any case'.[239]

205. As to fairness, Professor Terry and Mr di Lernia state that:

> *While an intuitively attractive idea, fairness is too abstract an ideal to which to subject contractual parties in the real world. …. While the idea of fairness may go beyond a general duty of honesty in requiring the fair exercise of contractual terms, no guidance on what constitutes 'fair' has been given in the case law beyond not acting for ulterior motives or extraneous purposes.*[240]

206. On good faith as reasonableness, Professor Terry and Mr di Lernia state that:

> *… to require parties to a commercial contract to temper their conduct by reference to 'reasonable' standards of conduct has implications for the fundamental need for certainty in franchise contracting, despite its relational nature*.[241]

207. At paragraph 201 it was noted that Mr Abetz drew the term "cooperation" from the common law concept which recognises the legitimate interest of both parties to a contract. The Law Council of Australia submitted how attempting to codify this concept can fundamentally alter its application:

> *The common law concept of cooperation in good faith allows for a court to balance an obligation to do all that is necessary to "secure the success of the contract" against the*

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237 The Committee acknowledges there is a 'strong relationship' between the Centre for Franchising Excellence at Griffith University and the Franchise Council of Australia (FCA), who are strong opponents of this Bill. This information is declared on the Centre's website (www.franchise.edu.au/industry-partnerships.html), and the Centre acknowledges the funding it receives from the FCA for its franchisor survey series.

238 Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, p. 2.

239 Terry, A. & Di Lernia, C., 'Franchising and the Quest for the Holy Grail: Good Faith or Good Intentions?', *Melbourne University Law Review*, vol. 33, no. 2, 2009, p. 558.

240 ibid., p. 559.

241 ibid., p. 568.

economic self-interest that each party necessarily and legitimately pursues. By contrast, a legislative requirement to act cooperatively, without reference to any limitation, qualification or balancing process, is a recipe for misapplication and dispute. On a broad application, this concept may prevent a party from pursuing its legitimate business interests.[242]

208. The Committee heard concerns from several other contributors that the effect of one or more of these words would prevent a party from acting in its legitimate business interests.[243]

209. Borrello Legal, a Perth-based commercial law firm with experience in representing both franchisors and franchisees voiced their concern that:

Notwithstanding that a person may be acting fairly, honestly and reasonably, to act "co-operatively" means to act with the interests of the other person in mind and with a view to reaching a mutually acceptable position. This may not always be possible. For example, in our experience, many franchise systems have met with reluctance and reticence on the part of many franchisees to the introduction of new services and products within the franchise system. Whilst the franchisor might be acting in the best interests of the franchise network as a whole, can it be said that the franchisor is acting co-operatively where it acts for the greater good in imposing the obligation upon all franchisees to provide a consistent offering across the franchise network?[244]

210. Quick Service Restaurant Holdings Pty Ltd (QSRH) provided another example:

… if a party is in default of its agreement and owes considerable monies to another, how is it possible for the non defaulting party to act in a "cooperative" manner - yet by not doing so would constitute a breach of the provisions of the Bill.[245]

211. Mr Leo Tsaknis, representing the RTA, raised a very important point with the Committee that there is a difference between procedures and outcome in construing what is acting in good faith:

…the qualification is that the obligation to act in good faith applies only in respect of any dealing or negotiation in connection with a franchise agreement, whether that is the entering or renewing. So, the good faith is that dealing or negotiating in good faith; that is, it is concerned with procedures, it is not concerned with outcomes.… What reasonableness does do, or does not prevent, is self-interested behaviour. So long as you act honestly in negotiations; that is, you put forth proposals and you are prepared to listen to proposals, you can act as self interested, it seems to me under this bill, as you wish to act. Merely

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242 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 6.

243 Submission No. 59 from Quick Service Restaurant Holdings Pty Ltd, 24 January 2011, p. 3; Submission No. 62 from Thomsons Lawyers, 24 January 2011, p. 2; Submission No. 90 from Borrello Legal, 27 January 2011, p. 2; Submission No. 97 from Asia-Pacific Franchising Centre of Excellence and Franchise Advisory Centre, 1 February 2011, pp. 5-6.

244 Submission No. 90 from Borrello Legal, 27 January 2011, p. 2.

245 Submission No. 59 from Quick Service Restaurant Holdings Pty Ltd, 24 January 2011, p. 3.

putting a proposal, which the other party considers unreasonable, is not acting unreasonably in negotiations or in connection with negotiations.[246]

(iii) Effect of clause 11

212. The Committee is of the view that codifying the common law concept of good faith with an exhaustive definition using four imprecise terms will cause uncertainty. Additionally, litigation will not be decreased and may even be increased.

213. The level of response the Committee received in connection with this section of the Bill, and the varied opinions and interpretations that are presented in this report, is testament to the ambiguity of clause 11. If the Bill is enacted, these opinions and interpretations would be argued in a court and at some indeterminable point in the future, a body of case law would emerge. The Committee must have regard to the intent of clause 11, which is to provide a minimum standard of conduct that is lacking from the Commonwealth legislative framework and to ensure that standard is enforced.

214. With this in mind, the Committee refers to the comments of Ms Jacky Finlayson, Acting Managing Director of the Small Business Development Corporation:

Our concern is that although, if proclaimed, the bill will lead to a testing of the good faith provisions in court and the establishment of a body of case law with regard to the matter, ultimately even if courts find it easy to decide what constitutes good faith, this may not be the case for small business, who must make decisions involving their capital and their investment based on what they understand of the here and now …[247]

215. The definition will still need to be tested and determined in court proceedings that could prove lengthy. As a result, it may not provide clarity to franchising participants on their rights and obligations in the immediate term.

216. It is acknowledged that three recent inquiries have recommended a general good faith obligation be included in the Code. The federal government, in response to the Ripoll Report, noted concerns that a general notion of acting in good faith would increase risk, while an obligation expressed in high-level terms may provide little practical protection to parties.[248] Instead, the federal government, after extensive consultation, introduced a substantial number of amendments to the Code aimed at commonly cited problem areas in franchise relationships (see 91 through 96 above). These amendments have been in place for less than 12 months; introducing an uncertain definition of good faith before the

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246 Mr Leo Tsaknis, Barrister, appearing on behalf of the Retail Traders' Association of Western Australia, *Transcript of Evidence*, 13 April 2011, p. 7.

247 Ms Jacqueline Finlayson, Acting Managing Director, Small Business Development Corporation, *Transcript of Evidence*, 11 April 2011, pp. 2-3.

248 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, pp. 4-5. Refer to footnote 119 for this document's web address.

amendments have had time to have effect would be imprudent. The federal government has indicated its intention to review the effectiveness of the amendments in 2013. The Minister for Small Business should, through the Small Business Ministerial Council, ensure that a review is conducted within this timeframe.

217. The Committee feels that these amendments will address many of the problems cited in earlier inquiries and lift the standards of conduct in the franchising industry. However, should recent amendments prove inadequate, the Committee is not opposed to the development of a general duty of good faith for franchising—at the commonwealth level.

Finding 13

Given its doubts about the ability to effectively define good faith in statute, the federal government decided at that time (2010) not to introduce such a provision in the Franchising Code of Conduct.

Instead, after extensive consultation, it has introduced a substantial number of amendments to the Code in 2010 aimed at commonly cited problem areas in franchise relationships.

Finding 14

If a general statutory obligation to act in good faith is to be imposed into franchising legislation, it should be pursued at the commonwealth level during the next review of the effectiveness of recent amendments in 2013.

Recommendation 4

The Committee recommends that, if the Franchising Bill 2010 is to proceed, any statutory obligation to act in good faith should be left undefined.

4.6 Part 4 - Enforcement and Remedies

218. The enforcement and remedies provisions in clause 4 of the Bill are intended to offer avenues of recourse for breaches of the Code and failing to act in good faith while providing a deterrent against those breaches.

219. Arguably, deterrence will only occur if parties believe that there are consequences for breaching the Code and for failing to act in good faith. For that to occur, there must be

willingness on the part of the regulator to prosecute such cases and a body of case law established. The lack of case law and prosecutorial activity on the part of the ACCC was well-covered in the Ripoll Inquiry. The Ripoll Report made three recommendations aimed at improving deterrence and prosecution, only one of which (civil monetary penalties for breaches of the Code) was not accepted by the federal government.[249]

220. Mr Graeme Samuel, Chairman of the ACCC, expressed concern to the Ripoll Committee about the 'expectation gap' in what franchisees believed the ACCC should be able to do to assist them, and the Committee noted that some of the criticism may stem from a lack of understanding of the ACCC's enforcement role.[250] The Committee is concerned that this same expectation gap may occur in relation to this Bill.

221. The Commissioner for Consumer Protection, Ms Anne Driscoll, advised the Committee that she had concerns about the potential number of cases that could be referred to the Commission. She stated that:

> *… consumer protection locally has a reputation that generally we will try to conciliate and educate, and deal with every single matter that is presented to us as a formal complaint. Obviously from time to time, and to some extent, against a public interest test, … we will then take the matter as a legal proceeding. It will be very difficult to manage this.*[251]

222. The Commissioner, like the ACCC, would not be able to prosecute each complaint that is brought before him/her. Filtering would need to be done with regard to a public interest test, resourcing, and the potential outcome of the case.[252] Ms Driscoll pointed out that even if they thought they might lose, a matter might still be prosecuted in order to test the law to demonstrate there is a gap.[253]

223. Mr Samuel discussed this issue with the Ripoll Committee and highlighted the role that complainants themselves play in getting a matter to prosecution. He indicated that:

> *… franchising-related complaints within* [the ACCC's] *Code compliance and enforcement role fall broadly into three categories:*
>
> - *a relevant complaint is lodged but the complainant does not want to be involved in taking the complaint further;*

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249 The two recommendations that were accepted were the introduction of pecuniary penalties for unconscionable and misleading and deceptive conduct as well as expanded investigatory powers for the ACCC.

250 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 9.19

251 Ms Anne Driscoll, Commissioner for Consumer Protection, Department of Commerce, *Transcript of Evidence*, 6 April 2011, p. 9.

252 ibid.

253 ibid.

- *a relevant complaint is lodged and the complainant assists the ACCC investigation, but insufficient evidence is uncovered to substantiate the complaint; or*

- *a relevant complaint is lodged, the complainant is able to provide evidence that substantiates the complaint, and the matter is suitable for taking forward.*[254]

224. Mr Samuel explained that only cases in the third category can be taken forward and that the majority of relevant franchising-related complaints they received actually fell into the first two categories.[255]

225. Ms Jacky Finlayson, Acting Managing Director of the Small Business Development Corporation, summarised these issues very clearly when she said:

> *We are also concerned that the bill may create expectations of remedy for small business that cannot be fulfilled because of the selective nature of that approach. I understand you have already heard from the Commissioner for Consumer Protection, speaking about the difficulties she foresees in filtering the volume of complaints she expects might be a consequence of this bill, and selecting the handful that her office may take forward to the court system. While this selective approach may lead to ultimately a change in behaviour across the industry, unless you are one of the few businesses that is selected for this kind of attention from the consumer protection commissioner, there is little comfort in that in the immediate term, and I would argue that perhaps the expectations might be higher than that. This is actually one of the main reasons why the ACCC is criticised by businesses, because it takes on so few cases, and it is arguable that the Franchising Bill could end up creating a similar situation in Western Australia.*[256]

226. The Department of Commerce advised the Committee that if the Bill were enacted, it expected to have 22 franchising cases per year requiring litigation.[257] The level of complexity for these cases would vary, with a likely breakdown of two very high, two high, four medium and fourteen low complexity. Ms Catherine Scott, Legal Policy Officer for the Department of Commerce, explained that matters involving complex evidence and a high standard of proof would be considered to be in the high to very high complexity category. Ms Scott stated:

> *…the department would expect investigations and litigation related to establishing a breach of the good faith provisions to fall within the high or very high categories.*[258]

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254 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008. para. 9.4.

255 ibid., para. 9.5.

256 Ms Jacqueline Finlayson, Acting Managing Director, Small Business Development Corporation, *Transcript of Evidence*, 11 April 2011, p. 3.

257 These cases could include breaches of the Code, unconscionable conduct and misleading and deceptive conduct.

258 Ms Catherine Scott, Legal Policy Officer, Department of Commerce , Electronic Mail, 3 June 2011.

227. The evidence of the Department of Commerce and the Small Business Development Corporation indicate to the Committee that better prosecutorial outcomes should not be expected from the Commissioner for Consumer Protection than are achieved by the ACCC. The small number of higher complexity matters that are expected to be prosecuted each year means that case law will be slow to develop, and this in turn will diminish the Act's deterrent effect.

228. Of course, industry participants may also initiate private proceedings under the Act, which could contribute to the development of case law. The Committee is concerned however that the Bill does not increase participants' access to justice. The Ripoll Report noted that a recurring theme in submissions it received was that 'the expense of litigation, including time, severely limits the ability of many franchisees to take independent legal action even when they are confident of demonstrating clear breaches of the Code'.[259]

229. Mr Abetz argues that court costs will be reduced in litigating for a breach of good faith under the Bill as opposed to under the common law as time would not have to be taken up determining whether a duty to act in good faith applies in each particular situation.[260] He believes this will make litigation more affordable and therefore more accessible to franchisees.[261] The Committee's view is that while the applicability may be more easily established, with the issues identified in section 4.5(b) above regarding the duty to act in good faith, it is not possible to say that overall court time would be reduced as a direct result of this provision.

230. Ms Finlayson of the SBDC does not believe that further legislation will result in better access to justice for franchisees. She provided a list of complaints discussed with the SBDC's advisors in the previous 22 months and stated:

> *It could be argued that the Franchising Bill could potentially provide grounds for these franchisees to bring action against the franchisors. However, likewise, it could be argued that these issues appear prime facie to relate to misrepresentation, misleading and deceptive conduct, and/or unconscionable conduct, which are already prohibited under the commonwealth Competition and Consumer Act 2010. The real issue for franchisees experiencing conduct-related issues with their franchisors appears to be the cost of pursuing matters through the court system rather than a lack of legislative protections.*[262]

231. In summary, the Committee is of the view that the Bill will have little deterrent effect, especially in the short term, and is unlikely to improve access to justice for participants in franchising. Given this, and having regard to the substantial cost to the state estimated by the

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259 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 9.24.

260 Mr Peter Abetz, Co-opted member, Economics and Industry Standing Committee, *Transcript of Evidence* (Quick Service Restaurant Holdings Pty Ltd), 11 April 2011, p. 15.

261 ibid.

262 Ms Jacqueline Finlayson, Acting Managing Director, Small Business Development Corporation, *Transcript of Evidence*, 11 April 2011, p. 3.

Department of Commerce to enforce the Bill, the Committee has deep concerns that the Bill will not provide a net benefit to the Western Australian franchising industry.

Finding 15

The major impediment to justice is the cost of accessing the courts, particularly for small franchisees.

Good faith provisions, such as that included in clause 11, rely on accessing courts and therefore, do not significantly improve access to justice.

A statutory definition of good faith should reduce court debate over whether good faith applies to a franchising agreement, notwithstanding the current common law duty to act in good faith.

The Committee was unconvinced that the narrow definition of good faith as articulated in clause 11 would further reduce overall court time or otherwise improve access to justice. Indeed, it could lead to greater debate regarding the parameters articulated in the Bill.

Finding 16

The Committee is of the view that the Bill will have little deterrent effect, especially in the short term, and is unlikely to improve access to justice for participants in franchising. Given this, and having regard to the substantial cost to the state estimated by the Department of Commerce to enforce the Bill, the Committee has deep concerns that the Bill will not provide a net benefit to the Western Australian franchising industry.

4.7 Clause 12 - Civil monetary penalties

232. Clause 12 of the Bill provides for civil monetary penalties of up to $100,000 if the person is a body corporate and up to $10,000 if the person is not a body corporate, to be imposed for contraventions of the Act.

(a) The application of civil monetary penalties for breach of clause 11

233. In advocating for the inclusion of civil monetary penalties for failing to act in good faith, Associate Professor Zumbo argues that:

> *The availability of civil monetary penalties under the Franchising Bill 2010 for failing to act in good faith is directly consistent with the Federal regulatory framework for franchising.*[263]

234. Associate Professor Zumbo cites the fact that a failure to act in good faith can potentially trigger the imposition of civil monetary penalties under the ACL where that failure gives rise to unconscionable conduct prohibited under the CCA.[264]

235. The Law Council of Australia advised the Committee that the broad and uncertain definition of good faith in the Bill is unsuitable for the application of pecuniary penalties, and stated that:

> *Introducing pecuniary penalties for conduct is a substantial step that should only be taken when there is a clear case for applying a penalty for any conduct that could constitute a breach of the provision.*[265]

236. While the Committee acknowledges that the inclusion of civil monetary penalties for breaches of conduct in the Bill appears consistent with the recent changes made to the ACL, it does not believe that this is consistent with the federal regulatory framework for franchising. The federal regulatory framework for franchising is based on national, not state-based, legislation, regulation and enforcement.

237. Additionally, the Committee notes that the decision to include civil monetary penalties for unconscionable conduct was made to improve the effectiveness of provisions that have been in force for well over a decade and the case for application was well made through repeated reviews. Clause 11 contains the first defined statutory duty of good faith in Australian legislation; it is untested in the courts and will, in the Committee's view, cause confusion. Associate Professor Frank Zumbo, the Bill's drafter, and CFAL were the only contributors to the Inquiry to explicitly state a case for the inclusion of civil monetary penalties for a breach of the duty to act in good faith. However, there were other contributors who offered their general support for the inclusion of civil monetary penalties in the Bill.

(b) The application of civil monetary penalties for breaches of the Code

238. The Ripoll Report recommended pecuniary (civil monetary) penalties be included in the former TPA for breaches of the Code. The Department of Innovation, Industry, Science and Research explains the government's decision not to implement the recommendation:

> *… industry codes seek to include mutual obligations by way of information exchange and disclosure on businesses within a sector, such as franchising. Therefore, the Government*

263 Submission No. 101 from Associate Professor Frank Zumbo, 31 January 2011, p. 33.

264 ibid.

265 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 9.

> *did not consider it appropriate to impose punitive measures in the Franchise Code … given that industry codes are in the nature of light-touch regulation.*[266]

239. Instead, the federal government chose to implement a range of new protections and enforcement powers under the Code and the CCA, including civil monetary penalties for unconscionable conduct. Several contributors to the Inquiry argued that this negated the need for civil monetary penalties in the Bill.[267] One of these contributors was Mr Brett Dingli, Legal Counsel for QSRH, who argues that these remedies allow the franchisee, the aggrieved party, to get a result, which a monetary penalty does not.[268]

240. In relation to civil monetary penalties for breaches of the Code, the Law Council of Australia states:

> *Pecuniary penalties for all Code breaches would not be a proportionate response to what appears to be an overstated problem of non-compliance with the Code. … the majority of complaints in relation to franchise businesses appear to have arisen from conduct that may contravene the consumer protection and unconscionable conduct provisions of the CCA. Pecuniary penalties are already available for conduct that merits the application of such a remedy. Against that background, the case for introducing penalties for the more procedural or disclosure based provisions of the Code has not been made out.*[269]

241. In respect of the availability of civil monetary penalties for breaches of the Code, Associate Professor Zumbo makes a similar argument as with breaches of good faith, stating:

> *The availability of civil monetary penalties for non-compliance with the Franchising Code of Conduct is directly consistent with the Federal regulatory framework for franchising.*[270]

242. Associate Professor Zumbo cites the fact that non-compliance with the Code may give rise to a breach of section 22 of the ACL which in turn may result in the imposition of a civil monetary penalty. Given this, he argues that the availability of civil monetary penalties under the Bill is an appropriate policy position, especially to promote full compliance with the Code.

243. The Committee does not believe that the proposed availability of civil monetary penalties for non-compliance with the Code is directly consistent with the federal regulatory framework for franchising, as no such remedy is available for the same contravention under the national legislation.

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266 Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 5.

267 Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 5; Submission No. 99 from Department of Commerce, 2 February 2011, p. 20.

268 Mr Brett Dingli, National Inhouse Legal Counsel, Quick Service Restaurant Holdings Pty Ltd, *Transcript of Evidence*, 11 April 2011, p. 11.

269 Submission No. 80 (Att A) from Law Council of Australia, 28 April 2011, p. 3.

270 Submission No. 101 from Associate Professor Frank Zumbo, 31 January 2011, p. 16.

244. In support of his argument, Associate Professor Zumbo refers to the matter of *Master Education Services Pty Ltd v Ketchell* [2008] HCA 38 (the Ketchell case). In dispute was whether the franchise agreement between the two parties could be considered illegal because, in contravention of clause 11(1) of the Code, the franchisor had failed to obtain from the franchisee the required written statement that the franchisee had received, read and had a reasonable opportunity to understand the Code. The New South Wales Court of Appeal determined that section 51AD of the TPA, read together with clause 11(1) of the Code, prohibited the franchise agreement. This decision was overturned by the High Court of Australia.

245. Associate Professor Zumbo's concern with the High Court of Australia's decision is the 'obvious connotation that there are minor breaches that we should not be worried about'.[271] He emphasises that a failure to comply with a requirement of the Code is a breach of the Code and each breach undermines the effectiveness of the Code.[272]

246. The High Court of Australia ruled that

> *The detailed provision by the* [TPA] *for the consequences of non-compliance with an industry code, such as the Franchising Code of Conduct, does not support a conclusion that it was intended that the harsh consequences provided by the common law were to follow upon contravention of s51AD.*[273]
>
> Further,
>
> *One of the purposes of the Code is the protection of the position of the franchisee. It is not expressed to prohibit the franchisee from entering into an agreement where a franchisor had not complied with cl 11. … It is not to be assumed in every case that a franchisee wished to be relieved of their bargain. To render void every franchise agreement entered into where a franchisor has not complied with the Code would be to give the franchisor, the wrong-doer, an opportunity to avoid its obligations… A preferable result, and one for which the* [TPA] *provides, is to permit a franchisee to seek such relief as appropriate to the circumstances of the case.*[274]

247. Associate Professor Zumbo argues that the Ketchell case is an example of a breach of the Code for which the current remedies (injunctions, damages and other orders) are not effective. The Committee does not agree with Associate Professor Zumbo on this issue. The original matter which gave rise to this series of decisions was Mrs Ketchell being sued by Master Education Services Pty Ltd (MES) for her failure to pay fees owed under the franchise agreement. Mrs Ketchell made the counter-claim that MES's failure to comply

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271 Submission No. 101 from Associate Professor Frank Zumbo, 31 January 2011, p. 20.

272 ibid.

273 Master Education Services Pty Limited v Ketchell [2008] HCA 38.

274 ibid.

with clause 11 of the Code made it unlawful for MES to receive any of the monies claimed.[275]

248. The Committee fails to see how a civil monetary penalty would be an effective remedy for the franchisee in this situation, particularly as the penalty itself would be paid to the state, not to the franchisee. Arguably, there are more appropriate remedies available under existing legislation for breaches of this kind (for example section 87 of the CCA - enforceable undertakings). With reference to the Law Council of Australia's advice at paragraph 240, the Committee is concerned that some of the provisions of the Code may be ill-suited to the application of civil monetary penalties and therefore indiscriminate application should be avoided.

249. The Committee acknowledges that there have been repeated calls from earlier inquiries for the inclusion of civil monetary penalties for breaches of the Code. In response to the Ripoll Report, the federal government advised that:

> *At this stage, the Government does not propose to introduce civil pecuniary penalties for breaches of industry codes. However, the Government will keep this matter under review and allow time for the extensive improvements which will be made to the Franchising Code to take effect.*[276]

250. Recent amendments have added group redress orders and Public Warning Notices (see 101 and 102 above) to the list of remedies available for breaches of the Code under the CCA, which already includes injunctions, damages, and other orders. Group redress orders in particular are arguably designed to offer restorative justice and to provide a direct and proportionate remedy to aggrieved parties.

251. The Committee respects the federal government's recent efforts and its intent to review the requirement to introduce civil monetary penalties for breaches of the Code. However, the Committee is open to the consideration of civil monetary penalties at the commonwealth level if the recent amendments do not have the anticipated deterrent effect. The Committee urges the Minister for Small Business to continually monitor this issue and provide leadership through the Small Business Ministerial Council to ensure this matter remains a priority.

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275 Master Education Services Pty Limited v Ketchell [2008] HCA 38.

276 *Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services - Opportunity not opportunism: improving conduct in Australian franchising*, 16 November 2009, p. 11. Refer to footnote 119 for this document's web address.

Finding 17

Recent changes to the penalty regime for breaches of the Franchising Code of Conduct, in particular group redress orders, are designed to provide a more restorative and direct remedy to aggrieved parties than civil monetary penalties.

However, the Committee is open to the consideration of civil monetary penalties for breaches of the Code at the commonwealth level if these recent amendments do not have the anticipated deterrent effect.

Recommendation 5

The Minister for Small Business ensure that the effectiveness of the amendments to the *Competition and Consumer Act 2010* and the Franchising Code of Conduct is reviewed in 2013 by the federal government, with particular emphasis given to considering the need to introduce:

- civil monetary penalties for breaches of the Franchising Code of Conduct; and,
- a general statutory obligation to act in good faith into the Code.

(c) The potential for "double jeopardy"

252. Concerns were raised that the wording of clause 12(2) may expose a person to "double jeopardy". The clause reads:

> *The court must not order the person to pay a monetary penalty for an act or omission if, under the Trade Practices Act 1974 (Commonwealth) or the Fair Trading Act 1987, the person has been ordered to pay a pecuniary penalty for the act or omission.*

253. Mr Daryl Williams QC was briefed to provide an opinion to CFAL in respect of certain aspects of the Bill. In relation to "double jeopardy" Mr Williams QC advised that:

> *The rule against double jeopardy refers to the principle of criminal law that once a person has been tried and convicted, he or she cannot subsequently be tried for the same offence. Section 17 of the Criminal Code (WA) extends this principle to any alternative charge which might have been brought against an accused. Any proceedings under clause 12 of the Bill are civil proceedings for the imposition of a monetary penalty, not criminal proceedings, and thus no question of "double jeopardy" would arise.*[277]

[277] Submission No. 86 from Competitive Foods Australia Limited, 27 January 2011, 'Annexure 1', p. 12.

254. Mr Williams QC advised:

> *Neither the Fair Trading Act nor the Trade Practices Act presently impose pecuniary penalties for a breach of the Franchising Code. Thus, clause 12(2) of the Bill has no present application.*[278]

255. The Committee notes that while Mr Williams QC is technically correct on the first point, the Committee believes clause 12(2) is intended to prevent the kind of scenario where a franchisor could have a pecuniary penalty imposed under the ACL for unconscionable conduct and under the Act for failing to act in good faith, where the conduct or behaviour being addressed in both cases was the same. This is the type of concern that was raised with the Committee and is what contributors mean when they have used the term "double jeopardy".

256. Opponents to this clause are concerned that there is no requirement for individual litigants or the Commissioner for Consumer Protection to await the outcome of an ACCC investigation into or litigation of a party before commencing their own investigation or litigation. This could expose the party to the imposition of civil monetary penalties under the Bill or the CCA where the same act or omission is litigated against under the respective provisions.[279] The Law Council of Australia puts it most succinctly:

> *If the Bill is passed:*
>
> - *franchisees could commence private proceedings alleging unconscionable conduct, misleading or deceptive conduct and failure to act in good faith;*
> - *the ACCC could commence proceedings seeking (among other orders) pecuniary penalties for unconscionable conduct; and*
> - *the Commissioner for Consumer Protection could commence proceedings seeking (among other orders) pecuniary penalties for failure to act in good faith.*[280]

257. If the proceedings commenced privately or by the Commissioner for Consumer Protection were to conclude before the ACCC's proceedings and a civil monetary penalty imposed, there is nothing to prevent the ACCC from imposing a civil monetary penalty at the conclusion of its proceedings. Several contributors to the Inquiry also raised concerns that

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278 Submission No. 86 from Competitive Foods Australia Limited, 27 January 2011, 'Annexure 1', p. 12.

279 Submission No. 47 from Snap Franchising Ltd, 21 January 2011, p. 2; Submission No. 62 from Thomsons Lawyers, 24 January 2011, pp. 2-3; Submission No. 69 from Icon Law, 24 January 2011, p. 10; Submission No. 80 from Law Council of Australia, 25 January 2011, p. 4; Submission No. 98 from Queensland Law Society, 2 February 2011, p. 2; Submission No. 99 from Department of Commerce, 2 February 2011, p. 20.

280 Submission No. 80(A) from Law Council of Australia, 28 April 2011, p. 2.

the Bill does not take into account the non-monetary penalties and other remedies available to the ACCC.[281]

258. Associate Professor Zumbo advised the Committee that clauses 12(1), 12(2) and 12(3) are actually safeguards against double jeopardy because the imposition of a civil monetary penalty is entirely at the discretion of the court, which must, along with the prohibition described in 12(2):

> *…have regard to whether the person has previously been found by a court, in proceedings relating to a contravention of this Act, the Fair Trading Act or the Code to have done any similar act or made any similar omission.*

259. Associate Professor Zumbo also advised that section 224 of the ACL provides a safeguard against double jeopardy as it provides:

> *(2) In determining the appropriate pecuniary penalty, the court must have regard to all the relevant matters including:*
>
> *(a) the nature and extent of the act or omission and of any loss or damage suffered as a result of the act or omission; and*
>
> *(b) the circumstances in which the act or omission took place; and*
>
> *(c) whether the person has previously been found by a court in proceedings under Chapter 4 or this part to have engaged in any similar conduct.*

260. The Committee believes that a party may be exposed to a multiplicity of actions if the Bill is enacted, including private proceedings, proceedings commenced by the ACCC and proceedings commenced by the Commissioner. While the Committee considers that the intent of clause 12(2) is clear, it may not be sufficient to prevent this multiplicity of actions, and administrative arrangements would need to be agreed between the ACCC and the Commissioner to prevent overlap of actions from the two regulators.

Finding 18

If the Bill is enacted, a party may be exposed to a multiplicity of actions under section 12 and administrative arrangements would need to be made between the ACCC and the Commissioner for Consumer Protection to avoid this outcome.

[281] Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, p. 3; Submission No. 98 from Queensland Law Society, 2 February 2011, p. 3; Submission No. 99(B) from Department of Commerce, 21 April 2011, p. 14.

Recommendation 6

If the Bill is to be enacted, the Minister for Commerce make sure that administrative arrangements are made between the ACCC and the Commissioner for Consumer Protection to ensure that the risk of a multiplicity of actions under clause 12 is negated.

4.8 Clause 13 - Injunctions

261. Clause 13 provides that that Commissioner or any other person may apply to the Supreme Court or the District Court for an injunction against a person who has, by any act or omission, contravened the Act, attempted to do so or to have been an accessory to the contravention.

262. Injunctions are available under section 80 of the CCA for breaches of the Code.[282] Section 80 of the CCA makes the same provisions as clause 13 of the Bill, the only exception being that clause 13 also provides for an injunction as a remedy to a breach of the duty to act in good faith, which is specific to the Bill.

263. The main issue for dispute with section 13 is subsection 13(2)[283] which reads:

> *If a franchisee under a WA franchise agreement or the Commissioner makes an application under subsection (1), the court cannot require the applicant to give an undertaking as to damages.*

264. The Bill proposes to expressly prohibit the Court from requiring a franchisee to give an undertaking as to damages. The intent of the clause is clearly for the Court not to take into account the failure of a franchisee to offer an undertaking as to damages as a material factor in deciding whether or not to grant an interim injunction.

265. Associate Professor Zumbo explains the reasoning behind clause 13(2):

> *Under the Bill franchisees are not required to give undertakings as to damages as such undertakings are typically sought by the franchisor to prevent a franchisee from having its*

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282 See paragraphs 24-26.

283 Submission No. 47 from Snap Franchising Ltd, 21 January 2011, p. 2; Submission No. 62 from Thomsons Lawyers, 24 January 2011, p. 3; Submission No. 80 from Law Council of Australia, 25 January 2011, p. 9; Submission No. 95 from Yum! Restaurants International, 24 January 2011, p. 8; Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, p. 3; Submission No. 98 from Queensland Law Society, 2 February 2011, p. 4; Submission No. 99 from Department of Commerce, 2 February 2011, p. 21.

allegations effectively assessed by the Court. It is unfair that a franchisee is prevented from having the opportunity to have their allegations assessed in Court.[284]

266. The Law Council of Australia presents the opposing view:

If there were no consequences for improperly obtained interim injunctions, there would be no incentive to prevent franchisees from seeking interim injunctions in support of frivolous, vexatious or unmeritorious claims. This would also increase the risk of interim injunctions being abused as a means of exerting undue pressure on franchisors.[285]

267. In commercial litigation, having to proffer an undertaking as to damages is seen as the "price" for applying for an interim injunction.[286] If the plaintiff's claim against the defendant is not upheld at trial, the plaintiff is liable, pursuant to the undertaking as to damages, to compensate the plaintiff for loss and damage suffered as a result of the interim injunction. Absent an undertaking as to damages, the plaintiff is not entitled to compensation.

268. Under the CCA, section 80(6) provides that where the Minister or the Commissioner seeks an interim injunction the court shall not require any undertaking as to damages. The Courts have held that section 80(6) is evidence of "the public character" of section 80 of the CCA, and that legislation such as section 80 substantially departs from the traditional basis for the grant of injunctions.[287]

269. The debate must therefore centre on whether the subject matter of the Bill is sufficiently attenuated by matters of "high public policy" (to capture a phrase used in the Robb case) such that the public interest is served by allowing franchisees, without the deterrent effect of having to proffer an undertaking as to damages, from applying for interim injunctions against franchisors. The Committee's view is that the public interest would not be served by this clause. Unfettered by the risk of being exposed to compensating the franchisor if the franchisee's claim is unsuccessful, franchisees are more likely to press marginal cases against franchisors.

Finding 19

A court should retain its discretion in regards to undertakings as to damages, with the exception of the Commissioner for Consumer Protection.

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284 Submission No. 101(A) from Associate Professor Frank Zumbo, 24 May 2011, p. 15.

285 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 9.

286 See commentary in Robb Evans of Robb Evans & Associates v European Bank Ltd [2009] NSWCA 67.

287 *Australian Competition and Consumer Commission v Dataline.Net.Au Pty Ltd* [2007] FCAFC 146 at [102].

Recommendation 7

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 13(2) should be amended to apply only to the Commissioner for Consumer Protection.

4.9 Clause 14 - Redress Orders

270. Under subsection 14(1)(b), a court may order a renewal order, which is defined as an order that a party to a WA franchise agreement (the ***old agreement***) must renew the old agreement for a period, and on such terms, as the court decides is just having regard to the terms of the old agreement.

271. This provision is intended to ensure that the remedies available to the court for a breach of the Act mirror the remedies available under section 87(2) of the CCA and also grants the court a specific power to make a renewal order if appropriate in particular cases such as where there is an absence of good faith in relation to renewals.

272. It is this power to make a renewal order, at clause 14(1)(b), that is most under dispute in this section. A large number of contributors to the Inquiry claim that it subverts the freedom to contract that underpins Australian commercial law and will result in a perpetual right of renewal for franchisees in Western Australia.[288] There are also concerns that clause 14(4), which provides that an application may be made up to six years after the act or omission occurs, will have extensive economic implications for franchisors.[289]

[288] Submission No. 2 from Dr Jenny Buchan, 5 January 2011, p. 2; Submission No. 25 from National Retail Association, p. 5; Submission No. 59 from Quick Service Restaurant Holdings Pty Ltd, 24 January 2011 p. 4; Submission No. 62 from Thomson's Lawyers, 24 January 2011, p. 3; Submission No. 84 from Franchise Council of Australia, 25 January 2011, p. 3; Submission No. 95 from Yum Restaurants International, 24 January 2011, p. 10; Submission No. 96 from Law Society of Western Australia, 1 February 2011, Attachment 1, p. 1; Submission No. 98 from Queensland Law Society, 2 February 2011, p. 10; Submission No. 99 from Department of Commerce, 2 February 2011, p. 21; Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 6; Submission No. 112 from Park Legal Solutions, 28 January 2011, p. 2.

[289] Submission No. 47 from Snap Franchising Ltd, 21 January 2011, p. 3, Submission No. 62 from Thomsons Lawyers, 24 January 2011, p. 4; Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, p. 4; Submission No. 98 from Queensland Law Society, 2 February 2011, p. 11; Submission No. 99 from Department of Commerce, 2 February 2011, p. 22; Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 6.

(a) Power of the court to issue a renewal order

273. Mr Peter Quinlan SC noted in his opinion that:

> *Such a power, which would involve a court* creating *contractual relationships, would be a very unusual power to confer on a court, given that such a power is foreign to what would ordinarily be regarded as judicial power*.[290]

274. Mr Sean O'Donnell advised the Committee that:

> *The form of order appears to subvert the parties' right to contract and allows an agreement to be forced on a party who doesn't want it. That is not how the law presently works. Only in cases where the court finds there is a concluded agreement but one party refuses to perform it can such an order be made. It is not the role of the legislature or Judges to force agreements on unwilling parties on whatever terms the Court deems appropriate*.[291]

275. The definition of renew appears to indicate that each WA franchise agreement must be capable of renewal.[292] The Code is silent as to the requirement for a franchisor to offer a renewal at the end of the agreement's term, therefore an individual agreement may or may not have a right of renewal, or specifically exclude a right of renewal. Allowing a court to renew a franchise agreement that does not contain (and may specifically exclude) a right to renew potentially undermines the basic principle of contractual certainty and subverts the specific contractual terms and the parties rights of freedom to contract.[293]

276. The Committee notes the view of the Ripoll Committee that:

> *… franchisors should be entitled to decline to renew franchise agreements on expiration if that is their choice. The committee therefore does not support an automatic right to renewal or the requirement for good cause to be shown for not renewing a franchise agreement. It is not the role of the law to force unwilling parties to enter into any commercial arrangement, including new franchise agreements*.[294]

277. From their perspective as a franchisor, Yum! Restaurants International submitted:

> *The right of the parties to allow franchise agreements to expire on their plain terms and conditions is absolutely vital to the ongoing success of the system. Expiry of the agreement*

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290 Quinlan, P. 'Franchising Bill 2010 (WA) - Opinion', 31 March 2011, p. 4. The Quinlan opinion is contained in Supplementary Information provided by Quick Service Restaurant Holdings Pty Ltd at a hearing on 11 April 2011. A copy can be found on the Committee's website at www.parliament.wa.gov.au/eisc.

291 Submission No. 62 from Thomsons Lawyers, 24 January 2011, p. 3.

292 Submission No. 112 from Park Legal Solutions, 28 January 2011, p. 2.

293 Submission No. 99 from Department of Commerce, 2 February 2011, p. 21; Submission No. 112 from Park Legal Solutions, 28 January 2011, p. 2.

294 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Parliament House, Canberra, 1 December 2008, para. 6.85.

is an important, and perhaps the ultimate, security against the progressive diminishment of our brand and system.[295]

278. Dr Jenny Buchan advised that:

The economic aspects of the franchise are structured around an agreement operating for a certain number of years. Renewal orders would potentially give franchisees a right of renewal that they did not negotiate or pay for when they purchased the licence. This potential perpetual right of renewal would damage the value of the franchisor's business, make WA more risky for franchisors to do business and lead to future franchisees having to pay for that risk in increased fees.[296]

279. The RTA are concerned that opponents of this section have looked past the obvious connection between clauses 11 and 14 of the Bill. They point out that section 14 is purely a remedy provision from which no additional rights can be construed or implemented. The RTA submits:

The only right that is created is in section 11(2)(a)(i) of the Bill which requires a franchisor to act in good faith in any dealing or negotiation in connection with a franchise renewal. It does not in any way infer an 'automatic right of renewal'. If the franchisor acts in good faith … and does not grant a renewal, then section 14 of the Bill does not apply to allow the franchisee to claim a renewal.[297]

280. While the RTA is correct, the Committee notes that the remedy is not limited to a contravention of clause 11 of the Bill, but also applies to a contravention of clause 9 of the Bill.

281. During a hearing, Mr Abetz gave an example of how a renewal order might be used:

The renewal is something that the court may, if it believes it is appropriate to impose that—for example, a franchisee is terminated inappropriately [and] *seeks an injunction—issue a renewal order for three months until the matter is heard in court.*[298]

282. The Committee does not object, in principle, to the intent of the provision allowing a franchisee to continue their business while negotiations around termination or non-renewal are being held. However, it is essential to recognise that the period of time for which the court grants the renewal is not the extent of the time that will be required to resolve this situation. In order for the renewal order to be granted, the franchisee must prove that they have suffered, or are likely to suffer, loss or damage as a result of an act or omission described in section 12(1) or 13(1) of the Act. This means they must first prove that the franchisor has contravened section 12(1) or 13(1) of the Act.

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295 Submission No. 95 from Yum! Restaurants International, 24 January 2011, p. 9.

296 Submission No. 2 from Dr Jenny Buchan, 5 January 2011, p. 2.

297 Submission No. 30 from Retail Traders' Association of Western Australia, 21 February 2011, p. 4.

298 Mr Peter Abetz, MLA, Co-opted Member, Economics and Industry Standing Committee, *Transcript of Evidence* (Yum! Restaurants International Pty Ltd), 13 April 2011, p. 4.

283. This could be a lengthy process, particularly if the contravention claimed is a failure to act in good faith under clause 11. An application for a renewal order could be made under many circumstances and at any point during negotiations surrounding the termination or renewal of a franchise agreement. For example, a franchisor might inform a franchisee six months from the expiry of the agreement (as is now required under the Code) that it does not intend to renew the agreement. The parties may enter into negotiations and at some point the franchisee may seek a renewal order because they believe the franchisor is not negotiating in good faith. This matter might be heard and determined before the agreement expires, but it is equally likely that it may not.

284. With the agreement expired and no renewal order in place, the franchisee may not operate the business, which interrupts their income stream and makes the position of their employees uncertain. In this situation, the franchisor would be reluctant to place a new franchisee into the business, were it even likely that they could attract a new franchisee[299], and would be required to run the business as a company-owned franchise or close it until the matter was resolved. This is an untenable position for the franchisee and their employees as well as the franchisor.

(b) Period of limitation - clause 14(4)

285. An application for a redress order can be made up to six years after the act or omission described at clauses 12(1) and 13(1) occur.

286. The Committee is of the view that the applicability of this limitation period to a renewal order only increases the problems discussed at 4.9(a) above. The Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre addressed this issue in detail in their submission:

> *There is a very real concern that the inclusion of* [this provision] *will massively undermine confidence in franchise growth in WA. This is akin to a customer coming back to a restaurant six weeks after they had a bad-tasting meal and demanding a replacement - it is beyond reason… and without precedent… Furthermore, the inclusion of renewal orders for franchise agreement throws uncertainty over existing franchise businesses where a lawful buyer - according to this Bill - could potentially be dispossessed of their business so that it could be reinstated to a former franchisee who had departed the system anywhere up to six years previously. This provision alone creates great danger of undermining the capital value of franchise businesses for sale as any buyer must weigh up the risk that the business could be potentially taken off them in future and returned to a previous franchisee.*[300]

287. The Small Business Development Corporation agrees with this risk assessment, stating that:

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[299] Particularly given that the Code now requires franchisors to advise prospective franchisees of court proceedings they are subject to [Part 3 s18 - Materially Relevant Facts].

[300] Submission No. 97 from Asia-Pacific Centre of Franchising Excellence and Franchise Advisory Centre, 1 February 2011, p. 4.

> *The long-toil nature of this limitation of liability provision would significantly increase the risks and uncertainties associated with the establishment and expansion of a franchise system in Western Australia.*[301]

288. QSRH advised the Committee that if the Bill was to be enacted in its current form, one of the areas it would consider reviewing would be incorporating provisions regulating its position in the event that a court ordered right of renewal was made.[302]

289. The provision of a renewal order does not consider third party agreements that might be essential to the franchisee's business, such as lease agreements. The Queensland Law Society notes that:

> *…there is interestingly no right under the Bill to enable a franchisee or the commissioner to apply to the court for an order to require a landlord to grant a new lease for the same period. If the franchisor holds the head lease and subleases or licences the premises to the franchisee there is no ability of the court to also make an order that the landlord renew the lease of the premises even though that may be essential to the ongoing operation of the franchised business.*[303]

290. Therefore, if a franchisee is unable to obtain a renewal of their lease agreement, any renewal order would be meaningless.

291. The Committee is of the view that allowing a franchisee to apply for a renewal order potentially six years after the franchise agreement has ended has the potential to affect the entire industry by creating uncertainty and risk. For this reason, the Committee does not support the provision of the renewal order as articulated in the Bill.

Recommendation 8

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 14(1)(b) "a renewal order" should be removed.

301 Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 6.

302 Submission No. 59 (A) from Quick Service Restaurant Holdings Pty Ltd, 5 May 2011, p. 2.

303 Submission No. 98 from Queensland Law Society, 2 February 2011, p. 10.

4.10 Clause 15 - Damages

292. Clause 15 provides that:

> *A person who suffers harm as a result of an act or omission of another person that contravenes this Act has a cause of action against that person for damages for the harm.*

293. For the purposes of the clause, ***harm*** means

> *harm of any kind, including but not limited to —*
>
> (a) *personal injury, including impairment of a person's physical or mental condition; and*
>
> (b) *damage to property; and*
>
> (c) *economic loss.*

294. The Committee heard concerns from numerous contributors to the Inquiry regarding the use of the term "harm" and its definition and the right of action for persons not party to a franchise agreement.

(a) Use of the term "harm" and its definition

295. Associate Professor Zumbo advised the Committee that:

> *The drafting of section 15 of the Bill is directly consistent with the drafting of legislative provisions dealing with damages where a person who suffers loss or damage from the conduct of another person involved in a contravention of the particular Act can recover that loss or damage.*[304]

296. The Committee does not agree with this statement. The Committee refers to section 82 of the CCA, section 12GF of the *Australian Securities and Investments Commission Act 2001* and section 500 of the *Environment Protection and Biodiversity Act 1999* as examples of sections that provide a cause of action for damages caused by contravention of the respective Acts. In each instance, the section provides a cause of action for 'a person who suffers loss or damage', whereas the Bill provides a cause of action for 'a person who suffers harm'.

297. Mr Sean O'Donnell, a partner at Thomsons Lawyers and a franchising specialist, argues that this provision 'contemplates a major departure from the type of harm a contracting party can presently be liable to compensate for' and 'the need for such an extension in the area of franchising alone is not justified.[305] The Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Council believe that:

> *The nature of the harm itself is beyond the scope of a business agreement. Economic loss is understandable, but personal injury including impairment of a person's physical or mental*

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304 Submission No. 101(A) from Associate Professor Frank Zumbo, 24 May 2011, p. 15.

305 Submission No. 62 from Thomsons Lawyers, 24 January 2011, p. 4.

> *condition must inevitably require some assessment of these factors not only after the event occurred which supposedly led to the harm, but also long beforehand as well as an exhaustive elimination of other factors unrelated to the franchise that may have caused such conditions.*[306]

298. Mr Darryl Williams QC and Mr Leo Tsaknis note that 'the circumstances in which a person will suffer personal injury as a result of a contravention of the Bill are difficult to envisage'.[307] In their opinion, clause 15(1) of the Bill should be deleted and clause 15(2) be amended to read:

> *A person who suffers loss or damage by an act or omission of another person that contravenes this Act has a cause of action against that person for damages for the loss or damage*[308]*,*

which would make it consistent with section 82 of the CCA.

299. In the absence of any legal opinion arguing to the contrary, the Committee is of the view that a departure from the right to action for "loss or damage" is unusual and not justified and clause 15 should be amended as suggested at paragraph 298.

Recommendation 9

The Committee recommends that, if the Franchising Bill 2010 is to proceed, clause 15(1) should be deleted and clause 15(2) should be amended to read:

A person who suffers loss or damage by an act or omission of another person that contravenes this Act has a cause of action against that person for damages for the loss or damage.

(b) Right of action for persons not party to a franchise agreement

300. Clause 15 of the Bill does not limit the right to action to parties to a franchise agreement, which potentially creates a right for suppliers, landlords, financiers and other people connected with the franchisee or its business to pursue claims for loss they have suffered

306 Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, p. 5.

307 Submission No. 86 from Competitive Foods Australia Pty Ltd, 27 January 2011, 'Annexure 1', p. 13.

308 ibid.

which they do not have under the Code or the CCA.[309] Opponents believe this is unfair and will inevitably create abuse through opportunistic claims.[310]

301. Associate Professor Zumbo argues that:

> *… a franchising relationship may involve a number of interrelated relationships and interrelated agreements. Accordingly, there may be instances where conduct in breach of the Bill may have a knock-on effect on other parties connected to the franchise agreement.*[311]

302. He notes that there must be a direct connection between the harm suffered and a contravention of the Bill, with the onus on proving this on the person seeking damages.[312] Associate Professor Zumbo believes it to be a difficult onus to discharge as there needs to be proof of the harm suffered, a contravention of the Bill, and that the contravention of the Bill resulted in the harm being suffered.[313]

303. The Committee does not believe that it is necessary to restrict the right of action for damages to parties to a franchising agreement. The Acts referred to by way of demonstration at paragraph 296 above do not restrict the right of action to a particular party, each refers "a person" or "another person" without further qualification. The Committee was not presented with any example where an Act has restricted the right of action to a particular party, and in the absence of any legal opinion arguing for this restriction, the Committee is of the view that to do so would be unwarranted.

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309 Submission No. 98 from Queensland Law Society, 2 February 2011, 'Attachment 1', p. 4.

310 Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, p. 4; Submission No. 99 from Department of Commerce, 2 February 2011, pp. 22-23.

311 Submission No. 101(A) from Associate Professor Frank Zumbo, 24 May 2011, p. 16.

312 ibid.

313 ibid.

CHAPTER 5 COST IMPACT OF THE BILL

5.1 Introduction

304. The question of whether the Bill, in its current form, would have a cost impact on the state or franchising participants was the subject of much debate during this Inquiry.

305. Supporters of the Bill believe that it does not require any further public monies and that it simply adds further powers to an existing State Commissioner who is already funded to oversee the Western Australian franchising industry under provisions of the *Fair Trading Act 2010*.[314]

306. Conversely, opponents of the Bill argue that it will have a broad cost impact.[315] Some commonwealth and state government agencies and departments similarly advised that the Bill could have cost implications nationally.[316]

307. The sections below highlight some of the major arguments advanced in this debate.

5.2 Cost impact to the state

(a) Enforcement

308. Under changes the national regulatory framework discussed in paragraph 105 above, the Department of Commerce (DoC) may assume responsibility for enforcing the general conduct provisions (including s18 and s22) of the ACL. The department advised that the Franchising Bill 2010 has potential further cost impacts for the state government, which would have to directly regulate a business-to-business sector (through enforcing the Code) that has hitherto been the responsibility of the federal government.[317] DoC stated that this could 'create a significant cost impost on the state government'.[318] DoC believes that to

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314 Submission No. 86 from Competitive Foods Australia Limited, 25 January 2011, p. 2; Submission No. 30 from Retail Traders' Association of Western Australia, 21 January 2011, p. 7.

315 Submission No. 95 from Yum! Restaurants Australia Pty Limited, 24 January 2011, p. 11; Submission No. 68 from Australian Franchising Systems, 20 January 2011, p.4; Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, pp. 5-7.

316 Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 7; Submission No. 99 from Department of Commerce, 2 February 2011, p. 10; Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 7.

317 The department, through the Commissioner for Consumer Protection, has traditionally regulated the business-to-consumer sector.

318 Submission No. 99 from Department of Commerce, 2 February 2011, p. 14.

perform the role being proposed for it in the Bill, it will need to set up a franchising unit to receive, investigate and potentially litigate complaints.[319]

(i) Cost estimate if the Bill is passed

309. Assuming the Bill is passed unaltered, DoC estimates that it would need to seek an appropriation via the Treasury of $14.717 million over a four-year period to discharge its role under both the Franchising Bill 2010 and the ACL.[320] A breakdown of this estimate is provided in Table 2 below. This estimate is tentative and does not, for example, include any costs that may be awarded against the department in the event of an unsuccessful litigation.

Table 2 Estimated additional appropriation: Franchising Bill and ACL - Dept of Commerce

Additional impact on existing/approved Forward Estimates	**Current Year $'000**	**Forward Est Year 1 $'000**	**Forward Est Year 2 $'000**	**Forward Est Year 3 $'000**	**Forward Est Year 4 $'000**
Salaries (incl on costs and indirect costs)	-	2,058	2,141[+]	2,232[++]	2,326[++]
External Legal Counsel	-	1,490	1,490	1,490	1,490
Total	**-**	**3,548**	**3,631**	**3,722**	**3,816**
Full Time Equivalent Staff	-	10	10	10	10

[+] Represents an adjustment of 4 per cent on the previous year
[++] Represents an adjustment of 4.25 per cent on the previous year

310. The cost estimate in Table 2 comprises two key components. Firstly, salaries for an additional 10 FTE will be required to establish a dedicated Franchising Enforcement Unit. This unit will comprise two Senior Lawyers; three Junior Lawyers; two Senior Investigators; one investigator; one Law Clerk; and one administration Officer. The estimated total salary cost is $8.757 million over four years.

311. External legal counsel costs were estimated at $5.96 million over the four years to secure counsel necessary to litigate an annual case load of 22 franchise-related matters of varying degrees of complexity (two very high complexity; two high complexity: four of medium and 14 of low complexity).[321]

312. The department bases its estimate of 22 cases off a series of assumptions. Using an approximation of 800 franchising complaints or inquiries received by the ACCC in the

319 Submission No. 99(C) from Department of Commerce, 10 May 2011, p. 2.

320 ibid., pp. 1-3.

321 ibid., p. 2.

2009/10 financial year, DoC applied a standard pro-rata 10 per cent to arrive at a figure of 80 for Western Australia. The department posited that a further 40 complaints or inquiries would be dealt with in this state. This spike is attributed to the belief that 'a lack of [legislative] uniformity will result in a disproportionately higher number of cases being brought in WA'.[322]

313. Of these 120 matters, it is assumed that 75 per cent (90) will be resolved via mediation (using success rates attributed to OFMA, the national mediation body established under the Code). Of the remaining cases, it assumed that eight would not proceed beyond initial investigation/conciliation leaving 22 matters for litigation.

(ii) Cost estimate if Bill is not enacted

314. The Department is of the view that it will need to seek an additional appropriation from Treasury of $11.006 million over four years if the Bill does not proceed and it only has to enforce the general conduct provisions of the ACL.[323]

315. The breakdown of this estimate, which again does not account for costs payable in unsuccessful litigation, is provided in Table 3.

Table 3 Estimated additional appropriation: ACL only - Dept of Commerce

Additional impact on existing/approved Forward Estimates	Current Year $'000	Forward Est Year 1 $'000	Forward Est Year 2 $'000	Forward Est Year 3 $'000	Forward Est Year 4 $'000
Salaries (incl on costs and indirect costs)	-	1,661	1,727[+]	1,801[++]	1,877[++]
External Legal Counsel	-	985	985	985	985
Total	**-**	**2,646**	**2,712**	**2,786**	**2,862**
Full Time Equivalent Staff	-	8	8	8	8

[+] Represents an adjustment of 4 per cent on the previous year
Represents an adjustment of 4.25 per cent on the previous year

316. Under this scenario the total salary expense of $7.066 million is for eight extra FTE (with one less Junior Lawyer and the general investigator superfluous). Total external counsel fees are estimated at $3.94 million to litigate for an assumed 16 franchise-related cases (one of very high complexity; two of high complexity; two medium and 11 low complexities). The figure of 16 cases is derived using the same pro-rata methodology and base parameters. This

322 Submission No. 99(C) from Department of Commerce, 10 May 2011, p. 3.

323 A figure provided of $10.332 million was provided by the department in Submission No. 99(C) on page 3. Following a further query from the Committee this figure was corrected to $11.006 million. See Submission No. 99(D) from the Department of Commerce, 21 June 2011, p. 1.

equates to 80 matters a year, one-quarter of which would not be resolved through mediation. Of these 20 residual matters it was estimated that four would not proceed to litigation.

317. Based on the difference between the above scenarios, it is estimated that DoC would require at least an additional $3.711 million over the next four years to discharge its expanded regulatory role if the Bill is enacted.

318. The Small Business Development Corporation (SBDC) had a similar view regarding cost impact, arguing that the Bill 'would result in considerable cost shifting from the Commonwealth Government to the Western Australian Government',[324] as franchisors and franchisees access the unique remedies available in this jurisdiction. The SBDC estimated that the Small Business Commissioner, currently proposed in a separate piece of legislation (see CHAPTER 1), would require an additional up-front allocation of $500,000. This would be followed by a review to determine ongoing costs once the likely demands of the Commissioner under the new legislative regime could be accurately predicted.[325]

(iii) Committee's view

319. The evidence provided by DoC and the SBDC contradicts the argument put forward by some supporters of the Bill that there would be no additional resource allocation requirements for the state.[326] CFAL added that 'it was not possible at this time' to determine whether there would be an overall net cost to the state. CFAL made the point that additional costs incurred by DoC would be offset to the extent that successful civil penalty claims would be payable to the state's consolidated revenue.[327]

320. The Committee is not convinced that monies recouped via civil penalties would substantially offset the combined minimum estimated costs offered by DoC and SBDC. Moreover, the Committee shares the view that the risk of "jurisdiction shopping" inherent in the introduction of state-specific legislation may increase this figure further. As such, the Committee is confident that enforcement of this Bill will generate a net cost to the state, albeit one that is difficult to quantify.

321. Another concern is the likely expectation gap surrounding the capacities of local enforcement agencies to pursue outcomes for more than a select few. This criticism has been directed towards the ACCC previously and will likely confront the local agencies prosecuting what will be an unprecedented body of case law under the good faith definition included in the Bill. These concerns are examined at section 4.6 above.

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324 Submission No. 102 from Small Business Development Corporation, 1 February 2011, p. 13.

325 Ms Jacqueline Finlayson, A/Managing Director, Small Business Development Corporation, *Transcript of Evidence*, 11 April 2011, p. 4.

326 Submission No. 30 from Retail Traders' Association of Western Australia, 21 January 2011, p. 7; Submission No. 86 from Competitive Foods Australia Limited, 25 January 2011, p. 46.

327 Submission No. 86 from Competitive Foods Australia Limited, 25 January 2011, p. 46.

Finding 20

According to departmental estimates, there will be a minimum requirement of $4.2 million over the next four years to discharge the expanded responsibilities foreseen under the Bill.

The Committee is confident that any revenues obtained via the collection of civil monetary penalties will not substantially offset this cost.

(b) Disinvestment and business flight risk

322. The Bill could be detrimental to the broader state economy if it leads to reduced activity in the franchising sector. DoC was concerned that if the Bill was enacted in its current form, 'it may make WA unattractive as a jurisdiction in which to establish franchises'.[328] The passage of the Bill would mark a departure from the national uniform legislative framework and prospective franchisors could be deterred by additional regulatory requirements.[329]

323. The department cited a commentary from the International Franchise Association (IFA).[330] As a result of measures such as the redress orders and statutory good faith obligation contained in the Bill, the IFA 'expect that many franchise companies entering the Australian market will seek to carve Western Australia from a continent wide grant'.[331]

324. The IFA offered an example from the state of Iowa, which enacted some of the most restrictive franchise legislation then evident in the United States in 1992. The IFA claim that more than 130 franchise companies withdrew or significantly reduced their local operations, costing the state more than $226 million in taxation revenue.[332] A later academic study has concluded that 'the passage of the Iowa statute led to a reduction in both the number of franchised units and the total number of chain outlets'.[333]

328 Submission No. 99(B) from Department of Commerce, 21 April 2011, p. 13.

329 See comments and material supplied in Submission No. 99(B) from Department of Commerce, 21 April 2011, pp. 12-13.

330 Submission No. 99(B) from Department of Commerce, 21 April 2011, p. 13.

331 The full IFA commentary was contained in a letter to the Premier dated 9 November 201. A copy of the letter is included in Submission No. 68 from Australian Franchising Systems, 20 January 2011, p. 9.

332 See, Submission No. 68 from Australian Franchising Systems, 20 January 2011, p. 9.

333 Klick, J., Kobayashi, B.H., and Ribstein, L.E. *The Effect of Contract Regulation: The Case of Franchising*, December 2006, p. 6. Available at: www.law.gmu.edu/assets/files/publications/working_papers/07-03.pdf. Accessed on 31 May 2011.

325. Franchisors opposing the Bill argue that comparatively restrictive regulations will have a similarly adverse economic impact in Western Australia,[334] with one particular operator saying that the proposed additional compliance requirements may cause it to relocate its headquarters interstate.[335]

326. Proponents of the Bill argue to the contrary, saying that the provisions of the Bill will attract willing franchisees and that franchisors will always respond to new sources of demand.[336]

(i) Committee's view

327. It is not unreasonable to draw the conclusion that additional regulatory requirements could act as a deterrent to business investment. This is especially so when the current trend in Australia is towards easing the regulatory and compliance burden for business by minimising the level of inconsistent legislation across jurisdictions. As the Department of Innovation, Industry, Science and Research noted, '[t]he prospect of separate state-based franchising legislation creates uncertainty for franchise business in those states and national franchise systems that operate across all states'.[337] This is likely to 'act as a disincentive' for expansion of operations.[338]

328. The Committee feels that the reforms in franchising being undertaken nationally are significant and are likely to address or prevent many of the problems previously afflicting the sector. While further reform may prove necessary, it remains prudent to pursue these via uniform measures rather than potentially introducing uncertainty and risk into franchising in Western Australia.

5.3 Cost impact to franchise participants

(a) Compliance

329. It appears that the most obvious potential cost to franchise participants if this Bill is passed will be around compliance requirements.

330. The Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre has suggested that compliance costs could include seeking legal advice and amending current franchise agreements to reflect new legislation and training staff to understand the new

334 Submission No. 95 from Yum! Restaurants Australia Pty Limited, 24 January 2011, p. 11; Submission No. 59 from Quick Service Restaurant Holdings Pty Ltd, 24 January 2011, p. 19.

335 Submission No. 47 from Snap Franchising Ltd, 21 January 2011, pp. 1-2.

336 Submission No. 86 from Competitive Foods Australia Limited, 25 January 2011, p. 49; Submission No. 91 from Mr Ray Borradale, 28 January 2011, p. 16.

337 Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 7.

338 ibid.

regulatory regime. The Centre estimates that costs could equate to $10,000 per franchisor and $10 million to the sector as a whole.[339]

331. Conversely, the Bill's sponsor, Mr Abetz, argues that, '[t]his bill will not impose any additional costs on good franchisors', as their current behaviour already complies with the Code and the standards the Bill is proposing.[340] This view was supported by two prominent Western Australian franchisors who argued that the Bill would lift standards of conduct in the industry.[341]

332. Other franchisors disagreed with this argument. Mr Mike Stringer is a franchisor overseeing 275 franchisees offering mobile cleaning and car detailing services. Appearing before the Committee with the Franchising Council of Australia, Mr Stringer conceded that there may not be a formal process to follow up with his franchisees if he does not need to change his disclosure document. However, he added that there would be a cost 'in understanding the implications that this [Bill] could have'.[342] For this, he would look to seek legal advice.

333. The Law Council of Australia agreed that the new legislation would increase compliance costs by way of legal advice. Regarding franchisor conduct during the termination of an agreement, Mr Bill Keane, from the Law Council of Australia, said that franchising participants would be interested in the issue of how conduct under common law would differ from the new definition encapsulated in the Bill:

> *….it is more complex and expensive advice, and I imagine that that kind of advice would be required to be given quite regularly if this law was introduced in not only Western Australia, but I imagine that kind of advice would have to be given pretty well nationally because a lot of franchisors would be national.*[343]

334. When asked whether such advice would only be sought at the end of franchise agreements, Mr Keane replied:

> *That is just one example. I imagine there would be many circumstances in which you would be looking at two sources of law—statute law and common law.*[344]

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339 Submission No. 97 from Asia-Pacific Centre for Franchising Excellence and the Franchise Advisory Centre, 1 February 2011, p. 6.

340 Mr Peter Abetz, MLA, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 13 October 2010, p. 7653.

341 Submission No. 1 from Mr Jim Penman, 21 December 2010, p. 1; Mr Tim Castle, Lawyer, Competitive Foods Australia Pty Ltd, *Transcript of Evidence*, 4 April 2011, p. 3.

342 Mr Mike Stringer, Co-director, MPower Franchising Pty Ltd appearing with Franchise Council of Australia, *Transcript of Evidence*, 4 April, 2011, pp. 6-7, 12.

343 Mr Bill Keane, Member, Competition and Consumer Committee of the Business Law Section of the Law Council of Australia, *Transcript of Evidence*, 4 April 2011, p. 8.

344 ibid., p. 9.

335. In its submission to the Inquiry, the Law Council of Australia stated that the increased cost of compliance could affect 'businesses involved in all States'.[345]

(i) Committee's view

336. The Bill proposes a notable departure from the current uniform regulatory framework. While some parties may not take any action if the proposed Bill is passed, the Committee believes that many franchise participants (particularly franchisors) may consider it prudent to seek legal advice to determine what effect the new legislation will have on their operations. The cost this represents will depend on the extent of the advice obtained. These costs will vary according to individual circumstances, but could impact many businesses: the majority of whom are already compliant with the national laws.

337. This could have a flow-on effect to franchisees should, as the Department of Commerce suggest, franchisors look to pass on any higher compliance costs by way of higher start-up fees on new contracts or royalty increases under existing agreements. This is not an implausible scenario and also needs to be considered when determining the merit of the Bill.[346]

Finding 21

This Bill may increase costs for many compliant franchising participants (particularly franchisors) who will consider it prudent to obtain legal advice regarding the potential impact on their business.

It is plausible that under such circumstances, franchisors would look to pass these costs on by way of higher establishment fees on new contracts or royalty increases under existing agreements.

345 Submission No. 80 from Law Council of Australia, 25 January 2011, p. 3.

346 Submission No. 99 from Department of Commerce, 2 February 2011, p. 13.

CHAPTER 6 SMALL BUSINESS COMMISSIONER (WA)

338. The Committee believes that franchising sector participants would derive significant benefit from improved access to justice via non-litigious means. This is important for small businesses that do not have the resources to pursue remedies via costly court proceedings.

339. Another Bill currently before Parliament could provide progress in this respect with less of a cost and compliance burden than the Franchising Bill 2010. The Small Business and Retail Shop Legislation Amendment Bill 2011 (hereafter "Small Business Bill") was introduced on 16 March 2011 by the Parliamentary Secretary representing the Minister for Small Business, Mrs Liza Harvey, MLA. It is intended to amend two pieces of legislation: the *Small Business Development Corporation Act 1983* and the *Commercial Tenancy (Retail Shops) Agreements Act 1985*.

340. The Small Business Bill will create a Western Australian Small Business Commissioner 'who will work to reduce the vulnerability of small business to unfair market practices'.[347] The Commissioner will have a number of functions including the ability to investigate and assist with resolving complaints about unfair market practices affecting small business. The Commissioner will also provide alternative dispute resolution services, which could be in the form of conciliation, mediation or another method that the Commissioner deems appropriate to the circumstances.[348]

341. The Small Business Bill appears to offer several major advantages. Based on a similar model operating successfully in Victoria, the Small Business Commissioner provides a low-cost (around $195 per party per session) non-litigious mediation service. The preliminary investigative powers vested with the Commissioner should encourage the cooperation of a recalcitrant, thereby improving the likelihood of a satisfactory outcome for the aggrieved party (often the franchisee) in the dispute. An added benefit of the Commissioner is the education and guidance services it will offer. These will provide further scope for current and prospective franchise participants to become familiar with the pitfalls that lead to disputes and the information they should obtain before entering a franchise agreement.

342. The Victorian Small Business Commissioner (VSBC) was established in 2003. It provides a cheaper and arguably more effective and expeditious service than what is currently available through the national mediation service (OFMA) under the Code. The VSBC's mediation process, including franchise disputes, has a success rate of around 80 per cent with outcomes usually determined in one session.[349] The cost per party is $195 for the session with the government subsidising the $500 balance paid to the contracted mediator. Interestingly, of

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347 Mrs Liza Harvey, MLA, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 16 March 2011, p. 1445.

348 Clauses 14A(b) and (d),15A Small Business and Retail Shop Legislation Amendment Bill 2011 (Western Australia).

349 It is important to note that a successful mediation may not always produce equal levels of satisfaction between disputants. By its nature, mediation requires parties to compromise and accept sub-optimal outcomes.

the 1,219 matters concluded by the VSBC throughout 2009-10, 34 per cent were settled without requiring mediation. Resolution without meditation is cited as a possible benefit of the VSBC's investigative powers.[350]

343. In contrast, OFMA has a success rate of around 75 per cent for mediation with an average cost of $1,400 shared between the parties.[351]

344. The VSBC model was endorsed by the Expert Panel in its review into unconscionable conduct provisions and the Code:

> *Organisations of this kind are a significant means of fostering improved business conduct in relation to small business, and particularly by way of reducing or mitigating disputes*[352]

345. The Small Business Ministerial Council has also rated the VSBC as one of the 'best practice models for Governments to consider'[353] in the field of small business dispute resolution. Momentum for this concept is growing with a draft bill to introduce a Small Business Commissioner in South Australia currently under review.[354]

346. While the Small Business Bill should improve the standards of conduct and access to justice for aggrieved parties in franchising disputes, the Committee sees scope for providing even greater deterrence against unscrupulous behaviour.

347. Under proposed amendments to the *Commercial Tenancy (Retail Shops) Agreements Act 1985*, the Small Business Commissioner will have to refer disputes not likely to be resolved to the State Administrative Tribunal (SAT) for determination.[355] As part of the referral process the Small Business Commissioner will have to issue a certificate outlining the results of any attempted mediation and, importantly, the conduct of the parties during the mediation process. This information can then be used by the SAT in consideration of its final judgement. During consideration of the Bill, Mrs Harvey advised that:

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350 Office of the Victorian Small Business Commissioner, 'Annual Report 2009-10', September 2010, pp. 9, 19-21. Available at: www.sbc.vic.gov.au. Accessed on 31 May 2011.

351 Office of the Franchising Mediator, 'The Cost of Mediation', n.d. Available at: www.franchisingmediationadviser.com.au/#Cost. Accessed on 31 May 2011; Submission No. 17 from Department of Innovation, Industry, Science and Research, 19 January 2011, p. 3.

352 Horrigan, B., Lieberman, D., & Steinwall, R. *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct, Report to the Hon Dr Craig Emerson MP*, February 2010, p. 86. Refer to footnote 126 for this document's web address.

353 Small Business Ministerial Council, 'Communiqué', 6 August 2010. Available at: www.innovation.gov.au/SmallBusiness/Support/Documents/2010Communique.pdf. Accessed on 31 May 2011.

354 Government of South Australia, 'Small Business Commissioner Bill - Explanatory Paper', 10 February 2011. Available at: www.southaustralia.biz/sbc. Accessed on 31 May 2011.

355 Clause 25C (Part 3) Small Business and Retail Shop Legislation Amendment Bill 2011 (Western Australia).

> *The Commissioner…can specify on the certificate whether the parties to the dispute have been acting in good faith or if one party has been reluctant to participate or has been obstructionist.*[356]

348. Mrs Harvey confirmed that the certificate is only required for referral of commercial tenancy disputes.[357] This is not dissimilar to Victoria, where despite its high mediation success rate, the VSBC is not mandated to refer unresolved small business disputes—with a certification—to the Victorian Civil and Administrative Tribunal (VCAT). However, in its latest Annual Report, the VSBC said it 'still sees merit' in having such authority.[358]

349. The Committee sees value in considering extending the Small Business Commissioner's certification mandate to include small business disputes. This could provide a cheaper avenue to justice for small franchisees via the SAT. While this is a desirable outcome in itself, it is the certification power that could extract greater benefit, given the amount of disputes that are settled during mediation. A formal evaluation of the behaviour of franchising parties during dispute resolution processes is highly likely to improve the level and quality of cooperation.[359] This could arguably lead to higher resolution rates with more balanced outcomes. It may also provide a deterrent that will lift the standards of general behaviour throughout the small business (and franchising) sector.

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356 Mrs Liza Harvey, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 12 April 2011, p. 2820.

357 ibid., p. 2833.

358 Office of the Victorian Small Business Commissioner, 'Annual Report 2009-10', September 2010, p. 15. Available at: www.sbc.vic.gov.au. Accessed on 31 May 2011.

359 This would also address what appears to be a shortcoming in the Code. Despite 2010 amendments to the mediation procedures under s29(8), a party only has to show it is adhering to one of five listed actions to satisfy the criteria of 'trying to resolve a dispute'.

APPENDIX ONE

SUBMISSIONS RECEIVED

List of Submissions received for the inquiry.

Date	Name	Position	Organisation
21 December 2010	Mr Jim Penman	Chief Executive Officer	Jim's Group Pty Ltd
05 January 2011	Dr Jenny Buchan	Senior Lecturer Australian School of Business	University of New South Wales
13 January 2011	Mr Peter Davis		Frontline Recruitment Group
13 January 2011	Mr Michael Stringer	Director	Car Care Australia Pty Ltd
13 January 2011	Mr Stephen Hansen	Franchisee	Hanco Stirling Pty Ltd
18 January 2011	Mr Steven Pynt	Chief Executive Officer	Muzz Buzz Franchising Pty Ltd
12 January 2011	Ms Linda Steele	Proprietor	Goals Plus
18 January 2011	Mr Marcus Delany	Managing Director	Wozzie Trading Pty Ltd
18 January 2011	Mr John Farrell	Federal President	National Federation of Independent Business
18 January 2011	Ms Christine Taylor	Director	Aussie Pooch Mobile
18 January 2011	Mr Tony Maiello	Franchisor	Essential Beauty
18 January 2011	Mr Gerry Gerrard	General Manager	Bakers Delight Holdings Ltd
19 January 2011	Mr Scott Cooper	Former Franchisee	

11 January 2011	Mr John A Brown		
19 January 2011	Mr Derek Black	Managing Director	Cafe2U Pty Ltd (Australia)
19 January 2011	Mr Aji Ponnambolan	Managing Director	Snap-on Tools (Australia) Pty Ltd
19 January 2011	Mr Barry Jones	Acting Deputy Secretary	Department of Innovation, Industry , Science and Research
19 January 2011	Ms Rowena Clark	Managing Director	OvenClean
19 January 2011	Mr Mark Langford	Managing Director	Gametraders
20 January 2011	Ms Tracy Steinwand	Franchise Development Principal	Business Development Company
20 January 2011	Mr Nick James	Franchise Consultant/ Advisor	Franchise Central Australia Pty Ltd
20 January 2011	Mr Michael Renwick	Managing Director	Hotondo Homes
20 January 2011	Mr Gary Nye	Chief Operating Officer	Clark Rubber Franchising Pty Ltd
20 January 2011	Mr Gary Nye	Chief Operating Officer	Clark Rubber Pool & Spa Shop Pty Ltd
20 January 2011	Mr Gary Black	Executive Director	National Retail Association Limited
21 January 2011	Mr Simon Thiessen	Chief Executive Officer	The Real Learning Experience
21 January 2011	W G Joyner	Head of Franchise Administration	Raine and Horne Pty Ltd

21 January 2011	Mr Adam Bucknell	Managing Director	Horseland Pty Ltd
21 January 2011	Mr George Yammouni	Chief Executive Officer	Bathroom Werx Pty Ltd
21 January 2011	Mr Wayne Spencer	Executive Director	Retail Traders' Association of Western Australia
18 January 2011	Mr Gavin Culmsee	Chief Operating Officer	Bedshed Franchising Pty Ltd
21 January 2011	Mr Jared Allen	Franchise Owner	Car Care (WA) Burswood
21 January 2011	Mr Mark Lyons	Franchise Owner	Car Care (WA) Lesmurdie
21 January 2011	Mr Graeme & Mrs Anne Brown	Former Franchisees	Bakers Delight
21 January 2011	Mr Richard Solomon	Partner	Solomon Bampton
19 January 2011	Ms Stacey Fall	Director	Weeding Women
21 January 2011	Mr Rob Lewis	General Manager-Franchise	Godfreys Franchise Systems Pty Ltd
21 January 2011	Mr Glen Hawken	Chief Executive Officer	Touch Up Guys Australia Pty Ltd
21 January 2011	Mr Malcolm Wilson		Entcorp Malcolm Wilson
21 January 2011	T R Hantke	Managing Director	Franchising Solutions Pty Ltd
24 January 2011	Ms Sara Pantaleo	Chief Executive Officer	La Porchetta
24 January 2011	Mr Damian Kay	Managing Director	Telcoinabox Pty Ltd
20 January 2011	Mr Milton Cockburn	Executive Director	Shopping Centre Council of Australia

24 January 2011	Mr Colin Robinson	Franchise Owner	Car Care (WA) Kalamunda
24 January 2011	Ms Christine Swan	Franchising Legal Specialist	
24 January 2011	Mr Roger Wilson OAM MAICD		RBW Executive Corporate Services
21 January 2011	Mr Grant Vernon	Chief Executive Officer	Snap Franchising Ltd
24 January 2011	Mr Peter Lenny		Pastacup Australia
24 January 2011	Mr Terry Sherlock	Franchisee and General Manager	Jesters Jaffle Pie Company
24 January 2011	Mr David Rodwell	Master Franchisee	Housework Heroes WA
24 January 2011	Mr Rudi Selles	Group Legal Counsel	Jireh Group Pty Ltd (Gloria Jean's Coffees)
24 January 2011	Mr Allen J Drew	Director (Franchisee)	Snap Canning Vale
20 January 2011	Ms Sophie Valkan	Chief Executive Officer	Souvalikhut Pty Ltd
24 January 2011	Ms Amanda Jappu	Director	Housework Heroes WA
24 January 2011	Professor Andrew Terry Mr Cary Di Lernia	Professor of Business Regulation, Discipline of Business Law Associate Lecturer, Discipline of Business Law	University of Sydney University of New South Wales
24 January 2011	Ms Bronwyn Butcher	Franchisee	Frontline Recruitment Group Pty Ltd

24 January 2011	Mr Steven Terpstra		Enviro Chasing Services
24 January 2011	Ms Catriona Noble	Managing Director/Chief Executive Officer	McDonald's Australia Limited
24 January 2011	Mr Mark Lindsay	Chief Executive Officer	Quick Service Restaurant Holdings Pty Ltd
24 January 2011	Mr Kevin Gooch	Franchisee	The Coffee Club Midland
24 January 2011	Mr Richard Mercer	Commercial Manager	PoolWerx Corporation Pty Ltd
24 January 2011	Mr Sean O'Donnell	Partner	Thomsons Lawyers
24 January 2011	Mr Glenn Evans	General Manager	Croissant Express Franchising Pty Ltd
24 January 2011	Ms Lina Di Petro	Business Development Manager	Croissant Express Franchising Pty Ltd
24 January 2011	Mr Andrew Lovitt	Secretary	Franchisee Association of Western Australian Incorporated
24 January 2011	Mr Michael Kentros	Managing Director	The Lucky Charm Pty Ltd
24 January 2011	Mr Peter Berryman	Former franchisee	Ranger Outdoors (Geraldton)
20 January 2011	Mr Dean Franks	Director	Australian Franchising Systems
24 January 2011	Mr Derek Sutherland	Legal Practitioner Director	Icon Law
24 January 2011	Mr Jeff Harrison and Mrs Dianne Harrison	Former franchisees	Ranger Outdoors (Midland)
24 January 2011	Fonda Grapsas	Director	OTC Retail Group

24 January 2011	Mr Trevor Ghouse	Franchisee	Gutter-Vac
24 January 2011	Mr John Pellegrini	Finance Manager	Mortgage Choice
24 January 2011	Mr John W Smith	Director	MYO Australia Pty Ltd
24 January 2011	Mr Bob Larkman	Franchisee	Housework Heroes Hills
24 January 2011	Mr Bob Larkman	Franchisee	Housework Heroes Canningvale
24 January 2011	Mr Nigel Reid	Master Franchisee	Bucking Bull Roast and Grill (Western Australia)
19 January 2011	Mr Dale Burke	Director	What Scratch?
24 January 2011	Mr John & Mrs Stephanie Smith		Vacantia Nominees Pty Ltd
25 January 2011	Mr Bill Grant	Secretary-General	Law Council of Australia
25 January 2011	Ms Sarah Allen	Business Development Manager	Appliance Tagging Services Pty Ltd
20 January 2011	Mr Stephen Finn	Franchisee	Mr Rental
25 January 2011	Mr Luke Baylis	Managing Director	Sumo Salad
25 January 2011	Mr Steve Wright	Executive Director	Franchise Council of Australia
27 January 2011	Mr Fadi Mikhael	Franchisee	Looksmart Alterations
27 January 2011	Mr Ian Parker	Group General Manager	Competitive Foods Australia Limited
27 January 2011	Ms Narelle Walter	Former Franchisee	Bakers Delight
27 January 2011	Mr Nigel Warr	Managing Director	Auto Masters Australia Pty Ltd

19 January 2011	Mr Robert (Bob) Turner	Managing Director	Flamin' Sharp
27 January 2011	Giuseppe Lazzara Mark Borrello	Director Director	Borrello Legal Pty Ltd
28 January 2011	Mr Ray Borradale		
28 January 2011	Mr David Bombara	Former Franchisee	Bakers Delight
18 January 2011	Mr Damian Barr	Franchisee	Cappuccino Xpress - Maddington (WA)
31 January 2011	Mr Simon Young	Solicitor	Cooloola Law Pty Ltd
24 January 2011	Mr Nick Bryden	Chief Legal Officer	Yum! Restaurants Australia Group
01 February 2011	Mr. Hylton Quail	President	The Law Society of Western Australia
01 February 2011	Professor Lorelle Frazer Mr Jason Gehrke	Director, Franchise Advisory Centre Director	Asia Pacific Centre for Franchising Excellence Franchise Advisory Centre
02 February 2011	Mr Bruce Doyle	President	Queensland Law Society
02 February 2011	Mr Brian Bradley	Director General	Department of Commerce
03 February 2011	Mr Matthew Blackman	Master Franchisee	Kleenit Victoria
31 January 2011	Associate Professor Frank Zumbo	Australian School of Business	University of New South Wales
01 February 2011	Ms Jacky Finlayson	Acting Managing Director	Small Business Development Corporation

24 January 2011	Mr Peter Cumins	Managing Director	Cash Converters Pty Ltd
25 January 2011	Mr David Lieberman		David Lieberman & Associates
25 January 2011	Mr John Fenton		Miniquip
24 January 2011	Ms Leanne Shaw		ActionCOACH
24 January 2011	Mr Nicholas Baragwanath	Franchisee	The Lucky Charm Pty Ltd
25 January 2011	Mr Costa Raftopoulos	Franchisee	The Lucky Charm Express
25 January 2011	Mr Tony Melham		
25 January 2011	Mr James Nixon-Smith	Chief Executive Officer	The Coffee Club Group
24 January 2011	Mr Don Randall	Federal Member for Canning	
28 January 2011	Mr John Park	Director	Park Legal Solutions
31 January 2011	Mr Michael Johnston	Manager Public Policy	ANZ Mobile Lenders
21 January 2011	Mr Ian Krawitz	Head of Intelligence	10 Thousand Feet
15 February 2011	Mr Mark Attard	Chief Executive Officer	Chocolateria San Churro
16 February 2011	Mr Chris Malcolm	Managing Director	Retail Franchise Systems

APPENDIX TWO

HEARINGS

Date	Name	Position	Organisation
04 April 2011	Ms Sarah Russell	Deputy Chair, Competition and Consumer Committee, Business Law Section	Law Council of Australia
	Mr William Keane	Member, Competition and Consumer Committee, Business Law Section	Law Council of Australia
04 April 2011	Mr Steve Wright	Executive Director	Franchise Council of Australia
	Mr Michael Stringer	Member	Franchise Council of Australia
	Ms Bronwyn Butcher	Member	Franchise Council of Australia
	Ms Tamra Seaton	Solicitor	Norton Rose (Representing the Franchise Council of Australia)
04 April 2011	Mr John (Jack) Cowin	Chairman	Competitive Foods Australia Pty Ltd
	Mr Timothy Castle	Lawyer	Competitive Foods Australia Pty Ltd
06 April 2011	Ms Anne Driscoll	Commissioner for Consumer Protection	Department of Commerce
	Mr Duncan Mackay	Director, Policy, Consumer Protection	Department of Commerce
	Ms Catherine Scott	Legal Policy Officer	Department of Commerce
11 April 2011	Associate Professor Frank Zumbo	Australian School of Business	University of New South Wales

11 April 2011	Mr Derek Sutherland	Chair, Franchising Law Committee	Queensland Law Society
	Mr Tony Conaghan	Member, Franchising Law Committee	Queensland Law Society
	Mr Fred Potgieter	Member, Franchising Law Committee	Queensland Law Society
	Ms Louise Pennisi	Policy Solicitor	Queensland Law Society
11 April 2011	Mr Mark Lindsay	Chief Executive Officer	Quick Service Restaurant Holdings Pty Ltd
	Mr Brett Charles Dingli	In-house Legal Counsel/ Company Secretary	Quick Service Restaurant Holdings Pty Ltd
11 April 2011	Ms Jacqueline Finlayson	Acting Managing Director	Small Business Development Corporation
	Ms Juliet Gisbourne	Director, Policy and Advocacy	Small Business Development Corporation
	Mr Martin Hasselbacher	Assistant Director, Policy	Small Business Development Corporation
13 April 2011	Mr Wayne Spencer	Executive Director	Retail Traders' Association of Western Australia
	Mr Leo Tsaknis	Barrister, Francis Burt Chambers	Representing the Retail Traders' Association of Western Australia
13 April 2011	Mr Nicholas Bryden	Legal and Corporate Affairs Director, KFC/Yum	Yum! Restaurants Australia Group
05 May 2011	Dr Michael Underdown	Special Counsel	Representing the Law Society of Western Australia

APPENDIX THREE

LEGISLATION

Legislation	State (or Country)
Competition and Consumer Act 2010 (formerly Trade Practices Act 1974)	Commonwealth
Australian Consumer Law, as a schedule to the Competition and Consumer Act 2010	Commonwealth
Trade Practices (Industry Codes- Franchising) Regulations 1998 (Franchising Code of Conduct)	Commonwealth
Commonwealth of Australia Constitution Act	Commonwealth
Fair Trading Act 2010	Commonwealth
Small Business Development Corporation Act 1983	Commonwealth
Commercial Tenancy (Retail Shops) Agreements Act 1985	Commonwealth
Australian Securities and Investments Commission Act 2001	Commonwealth
Environment Protection and Biodiversity Act 1999	Commonwealth
Constitution Act 1889	Western Australia
Arthur Wishart Act (Franchise Disclosure) 2000	Ontario, Canada
Iowa Code 2011	Iowa, United States of America

MINORITY REPORT

Bill Johnston MLA

350. While the majority report is a well-researched document, in my view it does not deal sufficiently with the Terms of Reference of the inquiry.

351. The Terms of Reference was straight-forward:

> On 18 November 2010, the Franchising Bill 2010 was referred to the Economics and Industry Standing Committee for consideration and report no later than 26 May 2011.
>
> The Committee will consider 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";
>
> ii. civil monetary penalties;
>
> iii. injunctions;
>
> iv. redress orders; and
>
> v. damages;
>
> (b) enhance the purpose of the Franchising Code of Conduct, which is to regulate the conduct of participants toward each other; and
>
> (c) result in a cost impact on the State or participants in franchising

352. It is clear from reading of the submissions and transcripts of evidence that the Bill is not inconsistent with the Trade Practices Act and the Franchising Code of Conduct, as indicated in Finding 10 of the majority report. However, in my view this is the most important finding of the inquiry, and this Finding should come first.

353. Further, it is my view that the proposed Bill would enhance the operation of the Code. Further, despite of the majority Findings 20 and 21, my view is that the evidence shows the proposed Bill would not result in significant cost impacts.

354. Having determined that the Bill is not inconsistent, and has those other benefits, the Report should then consider whether the Bill should be supported.

355. It is of course possible for a Member, having weighed the evidence, to determine that the Bill should not be supported. However, in my view the Bill should be supported (with amendment).

356. I would now like to comment on certain Findings and Recommendations of the Report.

Finding 1

357. It is not unreasonable for commercial law in Australia to be regulated at the Commonwealth level, although it should be done co-operatively with the States.

358. However, this does not mean that the State is prevented from legislating on such matters.

Finding 3

359. While I support Finding 3, the question of how "widespread" is "misconduct" is only one aspect of the need for an obligation for "good faith" in franchise relationships.

360. Examination of the transcript of evidence from the Retail Traders Association, and a review of the material handed-up by the Association, demonstrates that there are genuine issues to be resolved by this Bill.

361. On the other hand, one of the least educative evidence on this topic that was provided to this Inquiry was that quoted at paragraphs 73 and 74 in the majority Report from the SBDC. The SBDC were unable to provide the sealed submissions to the Bothams Report for proper reasons.

362. However, then one of the SBDC employees attended this Inquiry and has the audacity to allege that he can paraphrase those submissions. Not only could he do that, he could place himself in the mind of those other persons and decide not just what they *said*, but also what they really *meant*!

363. It is outrageous that a public servant deems it appropriate to re-interpret evidence provided by others – particularly when the agency he represents was unable to provide the source information to this Inquiry.

364. Many franchise relationships are in fact very similar to employment relationships. Additionally, almost all franchise relationships underpin other employment relationships. Where there is a conflict in the relationship, all these essential relationships are in danger of fracturing, and it is not unreasonable for a Parliament to do what it can to assist in the stability of these relationships.

Finding 5

365. Again, while I recognise this Finding as trite, it is beside the real issues that the proposed Bill seeks to regulate. This Finding relates to disclosure prior to the creation of a franchise relationship, while the Bill primarily seeks to regulate the on-going relationship once a franchise agreement has been created.

Finding 7

366. Once again, this Finding does not address the whole issue that is to be confronted by the proposed Bill. While it is true that the post-Ripoll amendments have improved the regulation of franchise relationships, they have not dealt with the issue of including the specific requirement of "good faith".

Finding 9

367. This is the principle finding of the Inquiry, and I specifically oppose this Finding.

368. I welcome the Committee majority decision not to reject the Franchising Bill 2010. However, I disagree with the Committee's majority decision to take no action on the Bill at this time.

369. In December 2008 the Commonwealth Parliament's Joint Committee on Corporations and Financial Services tabled a Report titled "Opportunity not opportunism: improving conduct in Australian franchising", widely known as "The Ripoll Report", after its Chairman, Mr Bernie Ripoll MP. This Report is recognised by all participants in the industry as being the seminal review of the circumstances of the industry.

370. Recommendation 8 of this report states:

"The Committee recommends that the following new clause be inserted into the Franchising Code of Conduct:

> **"6 Standard of Conduct**
>
> **"Franchisors, franchises and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement."**

371. The Franchising Bill 2010 does no more than attempt to implement that recommendation in Western Australia.

372. Much of the evidence presented to the Committee in opposition to the proposed Bill related to two arguments regarding implementing "good faith".

373. The first argument was that negotiations between a franchisor and a franchisee were commercial negotiations where each party wanted to protect its commercial rights, and therefore they had the right to pursue their interests regardless of the effect on the other party.

374. For example, Mr Keane of the Law Council of Australia says "If you simply place an unqualified obligation to cooperate in circumstances where there will necessarily be, in commercial relationships, conflicts, that is a recipe for dispute".[360]

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[360] Mr Bill Keane, Member, Competition and Consumer Committee of the Business Law Section of the Law Council of Australia, *Transcript of Evidence*, 4 April 2011, p. 4.

375. The second view, which contradicts the first view, is that there is already an implied, common law obligation to good faith, and therefore it was either unnecessary or too difficult to define "good faith".

376. As example, Mr Steve Wright of the Franchise Council of Australia says "Do we have a new definition with this act, or do we have the existing one which exists under the common law and has been tested, including by companies including Competitive Foods?"[361]

377. In respect of the first view, the idea of including "good faith" in statute law is not new. Aside from my own experience with industrial law, Mr Tsaknis on behalf of the Retail Traders' Association set out a strong argument on the development of various statutes that refer to "good faith" obligations.[362]

378. Indeed, a reading of the submissions and evidence of the Retail Traders Association provides one with a compelling and comprehensive argument in support of a statutory "good faith" obligation.

379. In particular, Mr Tsaknis develops a strong argument of the fact that "good faith" negotiations does not mean that the fruits of the negotiations will be "fair", only that the context of the negotiations should demonstrate "good faith".[363]

380. This is a critical issue.

381. The idea that all negotiations must result in objective "fairness" is a nonsense.

382. What is not unreasonable is for people to act with good faith towards each other in commercial negotiations.

383. The idea that to pursue your own economic interests is the same as acting without good faith towards the other party is just as ridiculous idea as those that seek some objective fairness test.

384. In industrial law, the undoubted imbalance of power between the employer and employee is well recognised in Australian industrial law. This belief is behind the overwhelming public opposition to the Workplace Agreements Act and Workchoices.

385. Equally, it is clear that there is also an imbalance in power between franchisors and franchisees. As evidence for this, one can look at the number of franchisors that specify a standard-form agreement, which all franchisees must sign to enter the particular franchise system.

386. While nothing in the proposed Bill would change the right of a franchisor to offer a standard-form agreement, it would ensure a legal framework for regulating the relationship between the franchisee and the franchisor.

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361 Mr Steve Wright, Executive Director, Franchise Council of Australia, *Transcript of Evidence*, 4 April 2011, p. 4.

362 Mr Leo Tsaknis, Barrister, appearing on behalf of Retail Traders' Association of Western Australia, *Transcript of Evidence*, 13 April 2011, p. 10.

363 ibid., p. 7.

387. Finally, I would also like to address the suggestion that an obligation to act with "good faith" would increase disputation in the franchising sector.

388. What these submissions actually mean is that there would be an increase use of disputes procedures – because the cause of the disputation is already there, but there is currently no remedy.

389. By way of explanation, just because an existing franchisee currently does not have a remedy against the capriciousness of a franchisor does not mean there is not a dispute; it just means they currently have no remedy. The purpose of the Franchising Bill 2010 is to provide the framework to provide a remedy.

Recommendation 1

390. Given the discussion above, I would recommend to the Legislative Assembly to support the Franchising Bill 2010, with amendments.

Finding 14

391. Organisations that oppose including "good faith" obligations in franchising arrangements often then go onto say that if an obligation is to be imposed, it should be done by the Commonwealth.

392. This is the effect of the Committee majority in Finding 14.

393. However, this is a contradictory finding. If there is support for the Commonwealth to include "good faith" obligations, then that is an argument for the State to act.

394. While I acknowledge that it would be preferable for the Commonwealth to act, in the absence of Commonwealth action then the consideration of the value of "good faith" obligations remains the same: either they are worthwhile of they are not worthwhile. An acknowledgement that the Commonwealth should act is in fact support for action by the Parliament of Western Australia.

Recommendation 4

395. There was extensive discussion during hearings on the issue of the definition of "good faith". To repeat discussion above, Mr Tsaknis on behalf of the Retail Traders' Association set out a strong argument on the development of various statutes that refer to "good faith" obligations.[364]

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[364] Mr Leo Tsaknis, Barrister, appearing on behalf of Retail Traders' Association of Western Australia, *Transcript of Evidence*, 13 April 2011, p. 10.

396. My interpretation of the submissions and evidence is that the term "good faith" has a clear meaning in the common law, and absent a definition the Courts would have no trouble to interpret the term. This would mean the majority Committee recommendation could stand.

397. However, for the reason that legislation should be able to be easily understood by the "common person", in my view by using specific terms it would make it easier for non-technical people to interpret the obligation.

398. One of the most amusing passages of evidence was to listen to the Franchising Council of Australia arguing why a lay person could not understand the concept of honesty! For example, Mr Stringer states:

> *There will be a lot of discussion over those terms of reasonable, honestly and cooperatively as a franchisor that we need to clearly understand.*[365]

399. The idea that an ordinary person does not understand what it is act fairly, honestly, reasonably and cooperatively is completely ridiculous. On the other hand, I recognise that a lawyer might spend a week in Court to argue about the same issue.

400. For that reason, I do think there should be flexibility for the Courts to finely examine the facts in any particular case, I would suggest that the word "means" in Clause 11 of the proposed Bill be amended to read "includes".

401. This would mean that a lay person reading the proposed Bill would have clear guidance as to what constitutes "good faith", while not burdening the Court with having to "split legal hairs" in considering the facts in any particular matter.

Finding 15 and Finding 16

402. Regardless of the passage of the proposed Bill, the majority of disputes in franchising will be resolved through the existing dispute procedures.

403. Of course, the passing of the proposed Bill will provide valuable additional tools for the parties to a dispute, and the relevant mediator, to help them resolve the dispute.

404. Just like all the changes to the Franchising Code made in 2010 following the Commonwealth's response to the Ripoll Report, only a Court will be able to finally determine what these changes mean. However, it does not stop the mediators in any particular dispute relying on the obvious meaning of words in the Code in assisting the parties to reach a conclusion.

405. While this Finding is trite, it does not mean that all disputes relating to "good faith" will necessarily or automatically have to be resolved by the Courts. Nothing in the proposed Bill sets aside the existing disputes procedures.

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[365] Mr Mike Stringer, Co-director, MPower Franchising Pty Ltd appearing with Franchise Council of Australia, *Transcript of Evidence*, 4 April, 2011, p. 13

Finding 18

406. It is important to note that Finding 18 is a rejection of the argument that the proposed Bill would allow for "double jeopardy". While there would need to be procedures between the investigating organisations, there is no questions that the Courts would not entertain action in two jurisdictions.

Recommendation 8

407. One of the most unsavoury aspects of the franchising industry is the issue of the capricious manner in which a franchisor can refuse to renew a franchisee.

408. If a franchisee is failing to meet standards, not acting cooperatively, or there is some other good reason, then of course a franchisor should not be obliged to renew a franchise agreement.

409. However, the ability of a franchisor to refuse to renew an agreement, and then sell an identical or comparable franchise arrangement to a third party, is outrageous. The difference between the value of a business as a going concern compared to the value of the business as just "fixtures and fittings" is well known to all in industry.

410. In that regard, the evidence of Mr Bryden for Yum! is instructive:

> *Mr Bryden: …In 2003 we said, "You will not get new agreements, so you must either sell your stores to another franchisee", and we made an offer as well.*
>
> *The DEPUTY CHAIRMAN: So you are happy to renew the agreements for those stores, as long as CFAL is not the franchisee?*
>
> *Mr Bryden: Correct.*[366]

411. The view by Yum! that the difference between the business as a going concern and the "fixtures and fittings" is their brand is an interesting argument. However, it is just an assertion.

412. The value of the brand is recovered in the franchise fee paid during the life of the agreement. To try to recover more value from the process of one franchisee selling their business to a third party gives the appearance of extortion. It is not just Yum! that is involved in these types of behaviour, but Yum! is one of the few franchisors that is clearly saying that they want to extract value out of the sale of a business from a second party to a third party.

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366 Mr Nick Bryden, Legal and Corporate Affairs Director, Yum! Restaurants International, *Transcript of Evidence*, 13 April 2011, p. 5.

413. To take this issue further, one of the concepts behind the sale of many franchise systems is "to be your own boss". How is that compatible with the idea that the franchisor can take back the goodwill of their franchisee and then on-sell that goodwill to a third party?

414. If a franchisor is saying that they have some right to the "good will" of a business, then what are the franchise payments for? It is untrue to say that the only thing that forms part of "good will" is the brand of the franchisor, which is what Yum! states in its evidence.

415. While the proposed Bill does not make agreements "perpetual", it does propose to allow Courts an extraordinary power to require the agreements to be extended on the Court's terms. Given what I see as the appalling attitude of certain franchisors (such as exampled by Yum!'s evidence) to try and seize the "good will" of their franchisee, this extraordinary power is appropriate.

416. It is also important to note that while this proposed power is extraordinary, it is not unique. Industrial laws have given the power to Courts and Tribunals the power to restore employment contracts for a very long period of time.

417. Given that in many cases franchise arrangements are in fact in the nature of employment relationships (particularly those in low-cost/low-income franchise arrangements), it does seem appropriate to give the Courts a power analogous to the one that has long been provided to industrial courts and Tribunals.

Finding 20

418. The submissions by the DoC and SBDC on the question of costs are clearly widely speculative. They are certainly not what would be included in any cabinet submission if the proposed Bill was to be enacted.

419. The reality if that if the Bill was to be enacted, Government would only allocate small additional resources to administer the new obligations, if any, and would largely expect the agencies to absorb work load into their existing resources.

Finding 21

420. The majority Committee's findings on this topic are open to them, but clearly take the views of the proposed Bill's opponents.

421. All regulatory change brings some costs, as parties consider their rights. But the proposed Bill is a quite small change in participants' obligations, particularly given the view of a number of witnesses that there is already a common law obligation to act with "good faith" in respect of franchising relationships.

422. In this regard, Mr Castle of CFAL noted that the Commonwealth's estimate of the costs of participants dealing with the much more extensive 2010 Commonwealth changes was $10.00 per franchise agreements.[367]

423. On balance, the changes are highly unlikely to lead to major direct costs on participants in the industry.

424. Further, given the incredible attractiveness of the commercial opportunities in Western Australia, it is just not credible to argue that franchisors will abandon the field to their competitors and abandon Western Australia.

425. It is simply inconceivable that the circumstances described in paragraphs 322 to 326 would come to pass. It is not credible to make a "capital flight risk" argument in relation to the modest changes in the proposed Bill.

Chapter 6

426. It is important to comment on the Report's final chapter, where there are no Findings or Recommendations.

427. Chapter 6 deals with the State Government's intention to legislate separately to the Commonwealth in respect of franchise businesses and other businesses, following the model of Victoria.

428. It is interesting to note that there has been no "hue and cry" by opponents of the proposed Bill to the creation of the Small Business Commissioner (WA).

429. When introducing the Small Business Bill to Parliament, the Parliamentary Secretary said:

> *But the Barnett government wanted to go further than this and deliver to small businesses in this state a service that would assist them to resolve all types of business disputes relating to unfair market practices. This could include, for instance,* ***disputes between franchisors and franchisees*** *or disputes over payment terms or over the timely delivery of products. The bill I am introducing today will deliver on these aims by establishing a Small Business Commissioner in this state who will work to reduce the vulnerability of small businesses to unfair market practices.*[368]

430. It seems extraordinary that the Government acts to give additional rights to franchisees through the Small Business Bill and there has not been a murmur from the opponents of the Franchising Bill 2010.

431. What is the potential extra cost for industry participants from the proposed disputes procedure?

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[367] Mr Tim Castle, Lawyer, Competitive Foods Australia Pty Ltd, *Transcript of Evidence*, 4 April 2011, p. 3.

[368] Mrs Liza Harvey, MLA, Parliamentary Secretary to the Minister for Small Business, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 16 March 2011.

432. According to the Parliamentary Secretary, there have been 8,000 disputes dealt with by the Victorian system since 2003.[369] What cost to business does this represent?

433. How many disputes are expected to be dealt with in Western Australia? What will the costs be to industry participants? Where are those disputes currently being resolved? Or are these disputes that would have otherwise festered, unresolved? How many are about commercial terms? How many are about "good faith" issues in on-going business relationships?

434. None of these questions are known, nor were there any submissions on these issues. The point of course is when one examines the exaggerations made on the effect of the proposed Bill on costs to industry participants, the silence on the potential costs of the Small Business Commissioner is educative.

[369] Mrs Liza Harvey, MLA, Parliamentary Secretary to the Minister for Small Business, Western Australia, Legislative Assembly, *Parliamentary Debates* (Hansard), 12 April 2011.