

➤ 'Fairness in franchising': what you need to know

The Parliamentary Joint Committee on Corporations and Financial Services has completed its inquiry into the operation and effectiveness of the Franchising Code, making 71 wide-ranging recommendations. We take a look at the key proposals below and the implications for businesses.

PENALTIES AND REGULATORY POWERS



RECOMMENDATIONS

- Civil pecuniary penalties and infringement notices should be available for all breaches of the Franchising Code.
- Penalties for breach of the Franchising Code should be significantly increased to reflect the penalties currently available under the Australian Consumer Law (ACL).
- The repeated sale of a failed franchise site to a new franchisee ('churning'), and continually opening new franchises ('burning'), have the potential to cause significant detriment to franchisees. The ACCC should monitor large franchisors for systemic churning and burning, and be given the power to intervene and prevent the marketing and sale of franchises during an investigation.

IMPLICATIONS

- The recommendations signal that contraventions of the Franchising Code should be regarded as seriously as contraventions of the ACL. At present, not all contraventions of the Franchising Code attract pecuniary penalties, and the maximum penalty for any contravention is 300 penalty units (currently \$63,000). This falls short of the maximum penalties available under the ACL, which were recently increased to the greater of \$10 million, or three times the value of the benefit received (or 10 per cent of annual turnover if the benefit cannot be determined).
- Businesses can expect a higher level of scrutiny in the franchising sector. The Committee noted it 'expects the ACCC to undertake a series of investigations to root out misconduct and exploitative behaviour in the franchise sector'. It is also suggested ASIC proactively monitor and take action if it detects issues in franchisor corporate governance.

UNFAIR CONTRACT TERMS



RECOMMENDATIONS

- The unfair contract terms regime should apply to all franchise agreements, irrespective of the size of the franchise or the price paid for the franchise.
- Unfair contract terms in small business contracts and franchise agreements should be both illegal and subject to civil pecuniary penalties and infringement notices.
- The ACCC requires additional resourcing to enable it to appropriately investigate all complaints or whistleblower reports about illegal unfair contract terms.

IMPLICATIONS

- The recommendations significantly broaden the application of the unfair contract terms regime, which is currently limited to 'small businesses' with fewer than 20 employees where the upfront price payable under the contract is less than \$300,000 (or \$1 million for contracts longer than 12 months in duration). All franchisors will need to review their franchise agreements for unfair contract terms issues.
- The effectiveness of the unfair contract terms regime is a key regulatory focus. Recent reforms have broadened the ACCC's and ASIC's powers to investigate whether terms may be unfair. Unfair contract terms (and protections for franchisees more generally) have also been identified as an enforcement priority for the ACCC in 2019.
- A review of the unfair contract terms regime is currently underway. The ACCC has long advocated for unfair contract terms to be illegal and subject to penalties. The report lends further support to those calls for reform.

DISCLOSURE



RECOMMENDATIONS

- A public register of franchise systems should be established and operated by the ACCC or another agency. Franchisors would be required to provide updated disclosure documents and template franchise agreements annually for inclusion on the register.
- Increased disclosure of supply arrangements and pricing is required, including disclosure by franchisors (in percentage terms) of all supplier rebates.
- There should be increased disclosure of earnings information:
 - Where a franchised business is being sold or transferred, the prospective franchisee should be provided with two years of earnings information regarding the business.
 - For a greenfield franchise, the prospective franchisee should be provided with two years of earnings information regarding a comparable franchise.
- Greater disclosure for marketing funds is required. For example, financial statements for any marketing fund should be provided to franchisees on a quarterly basis.

IMPLICATIONS

- Enhancing transparency and accountability is a key theme running through the report. It is intended that further disclosure around supplier rebates and historical earnings will enable prospective franchisees to better assess the profitability and viability of a proposed franchised business.
- In its 2008 report on franchising, the Committee recommended the establishment of a public franchise register. In response to that report, the Government indicated the costs of the registration system would outweigh the benefits. It is not clear whether the Government will take the same view again. If a public register is established, it will increase the administrative burden on franchisors.
- While the Committee sees 'merit' in having a public franchise register, it's not clear which agency would be responsible for its administration. The ACCC expressed concerns that an ACCC-administered register of franchise systems could result in less due diligence being carried out by prospective franchisees, as the ACCC could be seen to endorse the compliance of the registered disclosure documents and agreements with franchising regulations.

DISPUTE RESOLUTION AND TERMINATION



RECOMMENDATIONS

- The ACCC's proposed class exemption to permit franchisees of any size to collectively bargain with their franchisor should be implemented.
- The Committee expressed concern that some franchisors do not engage in mediation in good faith, given that franchisees are unlikely to pursue court action if mediation fails. The Franchising Code should be amended to include the option of arbitration where mediation is unsuccessful. Mediators and arbitrators should also be expressly permitted to assist with the resolution of multi-franchisee disputes.
- The franchisee's right to terminate during the cooling off period should be extended to apply in respect of transfers, renewals and extensions. Also, the cooling off period should be lengthened, and greater clarity should be provided regarding the trigger events for the cooling off period.
- Franchisees should be given additional termination rights, including where the franchisee is suffering personal hardship or making a loss from the franchised business, or the franchisor enters liquidation, is convicted of fraud or serious offences, or is deregistered by ASIC.
- The proposed inter-governmental taskforce should examine whether franchising agreements should be required to set out how the franchisee will be compensated (if at all) for franchisee goodwill at the expiry of the franchise agreement or an associated lease.

IMPLICATIONS

- The Committee assumes arbitration is 'far cheaper' than court proceedings. This is not always the case. However, franchisees might initiate dispute resolution procedures more often if they know they can get a binding decision without having to go to court.
- The proposed changes to the cooling off period, coupled with the proposed increased disclosure requirements, would assist prospective franchisees in their due diligence exercises. On the other hand, those changes would result in increased uncertainty and more red tape for franchisors.
- Giving franchisees the right to terminate agreements when shock events occur is intended to address the power imbalance between franchisees and franchisors, and to ensure franchisees are not locked into businesses that are not profitable or viable. The proposed changes would cause some uncertainty and loss of control for franchisors.

ALIGNMENT OF INDUSTRY CODES



RECOMMENDATIONS

- The terms of the Franchising Code and Oil Code should be harmonised wherever possible, including any changes made to the Franchising Code following the inquiry.
- The Franchising Code should mirror a number of protections from the Food and Grocery Code, including banning unilateral variations and retrospective variations, and requiring franchisors to provide training on the Franchising Code to franchisees.
- While a separate industry code for motor vehicle dealerships is not recommended, Government should consider whether motor vehicle dealers require additional protections regarding repurchase of stock, and longer notice periods for non-renewal of dealer agreements.
- In progressing discussions about amendments to the industry codes, consideration will be given to ensuring an appropriate level of input from franchisees. Additionally, extending the whistleblower protections to franchisees and their employees has been recommended, to allow them to raise concerns without fear of retaliation.

IMPLICATIONS

- Ensuring the various mandatory codes remain in sync is important for franchise systems that sometimes fall under more than one regime. For example, shops which sometimes operate as part of a petrol station, and other times as freestanding stores, are currently subject to conflicting regulations under the Oil Code and Franchising Code. Of course, this is likely to mean stricter, more onerous regulations will be placed on franchisors across the board, as the harmonisation process should not result in watering down protections.
- For now, there will be no drastic change to regulation of motor vehicle dealerships. However, the Committee noted it won't object 'to a separate automotive industry code that deals with non-franchising matters'. This means additional regulation in the motor vehicle industry, such as an 'access to service and repair information code', may be implemented in the future.
- We may also soon see the creation of a separate peak body representing franchisee interests. This is not unusual, with similar franchisee associations already established in the United States. These may serve as a template for how franchisees work together to inform the regulatory landscape in Australia.