Dear Sir or Madam

INQUIRY INTO THE OPERATION AND EFFECTIVENESS OF THE FRANCHISING CODE OF CONDUCT

I refer to the Joint Committee on Corporations and Financial Services' inquiry into the Franchising Code of Conduct ('the Code').

The Office of the NSW Small Business Commissioner (OSBC) is focused on supporting and improving the operating environment for small businesses throughout NSW. The OSBC advocates on behalf of small businesses, provides mediation and dispute resolution services, speaks up for small businesses in government, and makes it easier to do business through policy harmonisation and regulatory reform.

The OSBC is pleased to provide the ensuing comments and recommendations for the Committee’s consideration. Following our introductory statements regarding the business and regulatory context in which the inquiry is taking place, this submission is structured in line with the inquiry’s Terms of Reference.

Summary of recommendations

**Recommendation 1:** The Code should require prospective franchisees that have not previously entered into a franchise agreement to undertake education on the risks of franchising, the nature of franchise agreements, and basic due diligence and financial literacy. The ACCC should develop this training and offer it at no or low cost, on an ongoing basis.

**Recommendation 2:** The Code should provide that a franchisee that has not previously entered into a franchise agreement must obtain pre-contract advice where the franchise agreement is for significant value.

**Recommendation 3:** The Code should prohibit a franchise agreement from including a clause that a broker is not the franchisor’s agent.
**Recommendation 4:** The Code should provide that any ‘entire agreement’ clause in a franchise agreement is void to the extent that it applies to representations made by brokers concerning the disclosure document, franchise agreement, and related documentation.

**Recommendation 5:** Franchisors should be required to submit current pro forma franchise agreements and disclosure documents to the ACCC. The ACCC should develop, or fund the development of, a publicly available database for these documents, accessible at low or no cost.

**Recommendation 6:** The Code’s disclosure document should provide that a franchisor is required to provide a prospective franchisee with the names and contact details of former franchisees that have recently exited the system. This obligation should be subject to former franchisors’ right to refuse consent.

**Recommendation 7:** The Code’s disclosure document should provide that a franchisor must disclose historic earnings information for the franchised business (or, in the case of a new business, a similar business in the franchise system). This information should pertain to a period of at least two years prior to the time of disclosure.

**Recommendation 8:** The Code’s disclosure document should provide that a franchisor must disclose best and worst case earnings projections for the franchised business, based on reasonable assumptions. This information should pertain to a period of two years from the time of disclosure.

**Recommendation 9:** The Code should require that marketing and promotion funds provided by franchisees must be spent on activities that directly support the interests of those franchisees.

**Recommendation 10:** The Code should define ‘significant capital expenditure’ without reference to a franchisor’s subjective assessment.

**Recommendation 11:** The Code should include a standalone requirement that, prior to requiring significant capital expenditure, a franchisor must provide statements concerning the rationale for the investment, the capital required, and the expected outcomes, as well as the expected benefits and risks identified by an independent expert.

**Recommendation 12:** The ACCC should engage with franchisees and their representatives with a view to increasing awareness among franchisees of the right to seek mediation under the Code. In the alternative, the Office of the Franchising Mediation Adviser should be provided with additional resources to undertake such engagement.

**Recommendation 13:** The Code’s information statement should provide an overview of the dispute resolution options available under the Code.

**Recommendation 14:** The Code should be amended to provide that, where the parties to a dispute cannot agree on appointment of a mediator, a franchised business or franchisor based in NSW may refer the matter to mediation by the Office of the NSW Small Business Commissioner’s Dispute Resolution Unit.

**Recommendation 15:** The Code should be amended to empower the parties to a dispute under the Code, or under a franchising agreement, to seek both mediation and arbitration.

**Recommendation 16:** The ACCC should be empowered to publish guidance on the application of the Code, and the steps the parties to a franchising agreement must take to
comply, on the basis of a complaint. The ACCC should execute these functions while preserving the anonymity of a complainant to the full extent practicable.

**Recommendation 17:** The ACCC should be empowered to advise the parties to an informal dispute regarding the interpretation and application of the Code, on the basis of a complaint.

**Recommendation 18:** The Code should be amended to provide that a franchisor may only terminate a franchise agreement for breach of the agreement by the franchisee if the breach is sufficiently serious to justify termination. The Code should provide that matters sufficiently serious to justify termination include but are not limited to significant financial or reputational loss to the franchisor arising from the breach.

**Recommendation 19:** The Inquiry should consider the need for the development of dedicated provisions within the Code governing the relationship between motor vehicle dealers and manufacturers.

**Context**

The OSBC recognises the code as an essential regulatory intervention to protect tens of thousands of small businesses across the economy from abuse of market power.

The Code itself provides that franchising is an industry in its own right. But it is more accurately characterised as a business model upon which a multitude of industries are partially or substantially dependent — such that it resembles an ‘industry within industries’. There are approximately 79,000 franchised business units operating in Australia, representing around 3.5% of all Australian businesses. Thousands of franchised businesses trade in each of the retail, accommodation and food, administration and support services, and financial and insurance services industries. However, franchised businesses also occupy a substantial though smaller presence across a very wide variety of additional industries. In 2016, the sector recorded turnover of $146 billion, and franchised businesses employed 74,900 workers. Indeed so popular is the franchising model that the Australian market houses over six times the number of franchised brands per capita than that of the USA.

However, despite its commonplace status across many industries, and broad economic significance, franchising is an atypical business arrangement in many respects. A franchised business is nearly invariably a small business; broadly, the inherent value of the franchisee to the franchisor is its accessible and personable qualities as a small business. In turn, a

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1 CI 4. *Competition and Consumer Act 2010 (Cth)*, s51AE
3 Australian Bureau of Statistics (2018), *Counts of Australian Businesses, including Entries and Exits, Jun 2013 to Jun 2017*, Table 13
5 Aggregate figure including turnover from franchisor-controlled business units; Frazer, L. Weaven, S. Grace, A. & Selvanathan, S. (2016), *Franchising Australia 2016*, Griffith University Asia-Pacific Centre for Franchising Excellence, p. 11
8 With the exception of franchised units controlled by the franchisor – a notable market presence, though irrelevant for the purposes of the code given the merger of parties and interests.
franchisor is in most cases a large business. This inequality is commonly reflected in an asymmetry of resources, business experience, education, and sophistication between franchisees and franchisors. Accordingly, it is widely accepted that an inequality in bargaining power exists between franchisees and franchisors.

Moreover, the parties to a franchise agreement are interdependent, and hope to realise mutual profitability. However, they also seek separate profitability. The relationship therefore gives rise to numerous conflicts of interest. The franchisor’s superior bargaining power allows it to control the manner in which such conflicts of interest are managed. Indeed, franchisors typically present franchisees with standard form contracts on a ‘take it or leave it’ basis.

Franchisors have commonly exploited these franchisee vulnerabilities – most prominently, through the imposition of unfair and exploitative terms, and abusive behavior around contractual interpretation and enforcement.

The Code cannot provide a complete solution to such issues. No code can be so prescriptive as to account for every aspect of a nuanced business relationship, or so powerful and well-understood as to engender undeviating compliance. Nonetheless, the Code is highly prescriptive. It is also the only regulatory instrument exclusively concerned with franchising in Australia.

The Code therefore plays a key role in addressing a legitimate market failure that places small business franchisees across the Australian economy at risk of adverse outcomes. Accordingly, this submission concerns reforms to the Code to safeguard franchisees against exploitative or predatory behaviour on the part of franchisors.

The OSBC acknowledges that much of the current public discourse around franchising concerns high profile cases of franchisees underpaying staff. The gravity of such egregious conduct should not be understated. Nevertheless, that at least five inquiries into franchising

20 ABC News (25 July 2017), ‘Eleven court penalties for exploiting workers tops $1 million, says Fair Work Ombudsman’; The Sydney Morning Herald (9 December 2017), ‘Cup of sorrow: The brutal reality of Australia’s franchise king’
were undertaken in the years prior to these revelations\textsuperscript{21}, reflects that issues around franchisor conduct remain relevant in the current climate. It is also possible to identify a correlation, if not a causal connection, between prominent underpayment cases and the issues with which this submission is concerned.\textsuperscript{22}

A. The operation and effectiveness of the Franchising Code of Conduct, including the disclosure document and information statement...in ensuring full disclosure to potential franchisees of all information necessary to make a fully-informed decision when assessing whether to enter a franchise agreement:

*Pre-contract advice and education*

Both the academic literature and the OSBC's own consultations suggest that the effectiveness of the Code's disclosure functions is significantly impeded by practices concerning the provision of advice to franchisees at the pre-contract stage.

Most prospective franchisees require professional advice from a solicitor, accountant, or business advisor prior to entering into a franchise agreement. The cost of procuring such advice is warranted by the major financial commitment required of franchisees. The median start-up cost to franchising is $95,000 for franchisees – a figure that rises to $287,500 for retail franchises.\textsuperscript{23}

Moreover, irrespective of the accuracy or detail of the documentation prescribed by the Code, the majority of prospective franchisees lack the business and educational background necessary to properly appraise it, or to conduct adequate due diligence.\textsuperscript{24} In many franchise networks, 25\% or more or all franchisees are of a culturally and linguistically diverse background\textsuperscript{25} – suggesting a fundamental linguistic barrier to comprehending the prescribed documentation may also apply in many cases.

Despite the need to obtain professional advice, is it well-established that many prospective franchisees do not seek advice prior to entering into a franchise agreement.\textsuperscript{26} The Code enables franchisees to waive the requirement that they obtain advice from a solicitor, accountant, or business advisor.\textsuperscript{27} Indeed it is credibly suggested to OSBC that around half of all franchisees do not obtain professional advice prior to entering into a franchise agreement. More concerning still is the suggestion that new franchisees with limited business experience and educational backgrounds are the least likely cohort to obtain

\textsuperscript{22} See, for example, *The Sydney Morning Herald* (9 December 2017), *Cup of sorrow: The brutal reality of Australia's franchise king*
\textsuperscript{27} Cl 10(2)
advice. Franchisees that do not obtain advice are often guided instead by intuition and emotion.

As a result, the OSBC notes prominent support in both the literature and its own consultations for reforms to the Code that require all franchisees that have not previously entered into a franchising agreement to undertake franchising education at the pre-contract stage. This education should cover:

- The common business risks of franchising, from a franchisee perspective;
- The limited discretion afforded to franchisees in franchise agreements;
- The importance of franchisee due diligence at the pre-contract stage;
- The basics of how to conduct due diligence; and
- Basic financial literacy.

So as to minimise its function as a barrier to market entry, this education should be made widely available to franchisees at a no cost or low cost basis. It is noted that the franchising sector’s most prominent industry body, the Franchise Council of Australia, predominantly represents franchisor interests. Given its non-partisan position as regulator, as well as its expertise, visibility, and high public standing, the ACCC is best placed to deliver this training.

Moreover, the Code should not allow a prospective franchisee that has not previously entered into a franchise agreement to contract out of the requirement to obtain pre-contract advice – at least when the franchise agreement is for significant value. In determining ‘significant value’, the ACCC could have regard to the median start-up costs of a new franchise.

**Recommendation 1:** The Code should require prospective franchisees that have not previously entered into a franchise agreement to undertake education on the risks of franchising, the nature of franchise agreements, and basic due diligence and financial literacy. The ACCC should develop this training and offer it at no or low cost, on an ongoing basis.

**Recommendation 2:** The Code should provide that a franchisee that has not previously entered into a franchise agreement must obtain pre-contract advice where the franchise agreement is for significant value.

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35 Franchise Council of Australia n.d., ‘Current FCA members’.
Franchise agreement brokers

A similarly recurring theme of both the literature and OSBC’s consultations is the problematic role played by brokers at the pre-contract stage. Brokers are third-party operators seeking commission from franchisors for facilitating the formation of a franchise agreement. They have no interest in either the terms of the contract or the enduring welfare of the signatories. Indeed franchise agreements commonly make the detachment of brokers from the substance of the agreement explicit, by including a clause to the effect that a broker is not an agent of the franchisor, as well as an ‘entire agreement’ (merger) clause providing that the written agreement represents the complete agreement between the parties.\(^\text{37}\) It is widely reported that brokers commonly make misinformed or knowingly unreliable warranties to prospective franchisees, contradicting the disclosure documentation and franchise agreement.\(^\text{38}\) We suggest that the role of brokers both incentivises this behaviour and shields them from the consequences.

Such practices clearly diminish the Code’s disclosure function, as they engender misguided expectations among franchisees, irrespective of the quality of the documentation provided pre-contract as per the Code’s requirements. A number of franchisees have posited that such conduct occurs with the acquiescence and even the positive knowledge of franchisors.\(^\text{39}\) Despite the serious issues surrounding their conduct, the OSBC understands that brokers are commonly used,\(^\text{40}\) and potentially becoming more commonplace.

The legislative provisions concerning misleading and deceptive conduct in trade or commerce\(^\text{41}\) formally prohibit brokers from engaging in such conduct. But the regulation of brokers would be enhanced by contemplation of their role within the Code, as an incident of a franchise agreement. The Code should prohibit the use of ‘no agent’ clauses and ‘entire agreement’ clauses in franchise agreements. This would incentivise franchisors to ensure they are not being misrepresented by brokers. Diligent franchisors may ‘pass on’ a contractual obligation to brokers not to misrepresent the franchise agreement, and would avoid engaging brokers known to contravene such obligations.

**Recommendation 3:** The Code should prohibit a franchise agreement from including a clause that a broker is not the franchisor’s agent.

**Recommendation 4:** The Code should provide that any ‘entire agreement’ clause in a franchise agreement is void to the extent that it applies to representations made by brokers concerning the disclosure document, franchise agreement, and related documentation.


\(^{41}\) Competition and Consumer Act 2010 (Cth), Schedule 2, ss2, 18; ACCC n.d., ‘Advertising and selling guide’
**Pre-contact document publication**

The Code's disclosure function is further limited by practical impediments. Most notably, 'informational regulation' such as the Code's disclosure provisions is only useful to the extent that it allows the vulnerable party to exercise informed choice in the relevant market.\(^{42}\)

The extent to which the Code allows a franchisee to exercise informed choice is currently limited: A franchisee cannot contextualise a disclosure document or franchise agreement - assessing its merits and pitfalls against the alternatives - because equivalent examples are not publicly available.\(^{43}\)

The Code's disclosure functions would therefore be enhanced by the development of a public database of all franchisors' current disclosure documents and pro forma franchise agreements.\(^{44}\) In order to maximise the efficacy of this database, it would need to be accessible at low or no cost to prospective franchisees. It is noted that equivalent databases currently operate in the US States of California, Wisconsin, and Minnesota.\(^{45}\) These have delivered a previously unmatched level of data to prospective franchisees,\(^{46}\) enabling more informed decision-making around the decision to enter into a franchise agreement.

At first instance, the requirement to maintain a database of this nature may appear to represent a considerable burden on franchisors. However, it would in fact require no more than limited maintenance, as both disclosure documents and franchise agreements are largely static in form. The Code is highly prescriptive as to the requisite form and content of disclosure documents,\(^{47}\) and only obliges a franchisor to update the document once a year (less in some instances).\(^{48}\) Likewise, the utility of a pro forma contract is that it does not require modification with the execution of each new agreement.

In addition, the database would serve as an invaluable resource for both researchers and regulators, allowing these stakeholders to attain an improved understanding of the sector.

**Recommendation 5:** Franchisors should be required to submit current pro forma franchise agreements and disclosure documents to the ACCC. The ACCC should develop, or fund the development of, a publicly available database for these documents, accessible at low or no cost.

**Former franchisor contact details**

The Code currently provides that a franchisor must provide a prospective franchisee with the names and contact details of current franchisees in the relevant jurisdiction.\(^{49}\)

The literature suggests that the efficacy of this obligation would be significantly enhanced if a franchisor was further required to disclose the contact details of former franchisees that have

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\(^{43}\) Buchan, J. (2009), *Consumer protection for franchisees of failed franchisors: Is there a need for statutory intervention?*, QUT Law and Justice Journal, vol 9, p. 242


\(^{45}\) Buchan, J. (2017), *What is going rotten in the franchise businesses plagued by scandals*, The Conversation


\(^{47}\) Part 2, Annexure 1

\(^{48}\) Cl 8

\(^{49}\) Annexure 1, Cl 6
exited the network. This is affirmed by the OSBC’s own consultations. Such a requirement would afford a prospective franchisee access to a wider spectrum of feedback in relation to doing business in the relevant network. Perhaps most relevantly, it would allow access to the perspectives of franchisees that have experienced dysfunction, operational difficulties, or conflict of a sufficiently serious nature to result in their exiting the system.

Indeed the code itself already contains a prominent and explicit endorsement of the need for prospective franchisees to contact former franchisees: "Entering a franchise is a big decision. Before you do so, you should: Conduct due diligence – this means researching the franchise system and talking to current and former franchisees." 

A franchisor is best placed to provide the contact information a prospective franchisee requires to conduct this important element of the due diligence process.

Expanding this obligation to franchisees that have recently exited the system would ensure the enduring relevance of any feedback provided. Moreover, to preserve their privacy and discretion, former franchisees should be empowered to refuse consent for their details to be provided to prospective franchisees.

Recommendation 6: The Code’s disclosure document should provide that a franchisor is required to provide a prospective franchisee with the names and contact details of former franchisees that have recently exited the system. This obligation should be subject to former franchisors’ right to refuse consent.

i. Including information on the likely financial performance of a franchise and worse-case scenarios.

The Code prescribes minimal disclosure requirements concerning the likely financial performance of a proposed franchise. The Code’s disclosure document requires the franchisor to provide a statement of solvency, as well as its financial reports for the preceding two financial years. These requirements only permit a prospective franchisee to attain a very limited understanding of the franchise’s financial performance. In addition to confirming its solvency – a baseline obligation for doing business - a franchisee may only achieve a high level, generalised understanding of the performance of the franchise as a whole.

However, the Code’s disclosure document does contemplate the provision of both historic and projected earnings information for the franchised business, or another franchise within the relevant system. Such information goes to the heart of effective disclosure as to the likely financial performance of a franchised business. It is clearly of much greater relevance and utility to a prospective franchisee than the franchisor’s financial reports. However, the clause only provides for such disclosure on an opt-in basis, affording discretion to the franchisor not to disclose.

The efficacy of the Code’s projected earnings provisions would be significantly enhanced if it provided that a franchisor must provide this information. In order to ensure this disclosure is as relevant as possible, the franchisor should be required to provide earnings information for the franchised business itself in the case of a pre-existing business. In the case of a new

51 Annexure 2
52 Annexure 1, Cl 21
53 Annexure 1, Cl 20
franchised business, the franchisor should be required to provide earnings information for a similar business to the fullest extent possible.

Additionally, in the case of projected earnings disclosed, the franchisor is currently required to also provide the assumptions upon which the projections are based. However, a prospective franchisee and even a professional advisor will typically be poorly placed to assess the credibility of these assumptions, and particularly their potential volatility. The Code should require earning projects to include both best and worst case scenarios, to afford franchisees a more useful picture of both their reliability and potential volatility. To further enhance the reliability of projections, and ensure best practice in their preparation, the Code should require that projections are based on reasonable assumptions.

In order to deliver certainty around these obligations without imposing an unreasonable burden on franchisors, the Code would also need to prescribe the period of time that the earnings information required must cover. ASIC generally considers financial projections relating to an existing business to be ‘reasonable’ when they relate to a period not exceeding two years from the time of the projection. The OSBC therefore suggests that earnings pertaining to two years from the time of disclosure (in the case of projections), and at least two years prior to disclosure (in the case of historic earnings) would meet these requirements.

While it would certainly enhance the code’s financial disclosure functions, earnings information alone cannot provide an impression of a business’ financial position of adequate detail to justify a major investment. The efficacy of these requirements would be significantly enhanced if the Code also required a franchisor to disclose a balance sheet and cash flow statement. This would allow the franchisee to appraise any material changes that have occurred, or which are expected to occur, that will materially impact the financial performance, financial position, or cash flows of the business.

**Recommendation 7:** The Code’s disclosure document should provide that a franchisor must disclose historic earnings information for the franchised business (or, in the case of a new business, a similar business in the franchise system). This information should pertain to a period of at least two years prior to the time of disclosure.

**Recommendation 8:** The Code’s disclosure document should provide that a franchisor must disclose best and worst case earnings projections for the franchised business, based on reasonable assumptions. This information should pertain to a period of two years from the time of disclosure.

**ii. Including information on the contractual rights and obligations of all parties.**

**Marketing funds**

The Code imposes obligations upon franchisors with respect to the use of marketing and advertising fees charged to franchisees, and the collection of funds for significant capital expenditure not disclosed prior to the agreement. From a franchisee perspective, these are important provisions, as they seek to prevent the franchisor from making improper use of franchisee monies throughout the life of the relationship.

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56 Cl 31; Annexure 1, Cl 15
57 Cl 30
Both obligations would be notably strengthened with amendments that deliver equity as to the permissible circumstances in which a franchisor may require expenditure.

The OSBC’s consultations suggest that franchisor abuse of marketing funds is common. In particular, the Code requires that marketing funds are used for “legitimate” marketing and advertising expenses. However, it does not define ‘legitimate’. While the OSBC acknowledges that such expenses may be expected to encompass a wide range of potential activities, the vagary of the clause allows for franchisor abuse. For example, a franchisor - typically holding unfettered control of the marketing fund - may regard expenditure to on-sell a vacant business, or support its own online sales, as entirely legitimate. The franchisees paying for these activities but receiving no direct benefit, or even a potential detriment, are likely to disagree. The Code should require that funds provided to a marketing fund by franchisees are spent on activities directly supporting the interests of those franchisees (subject to the existing proviso that franchisees may agree to expenditure for a separate purpose).

Recommendation 9: The Code should require that marketing and promotion funds provided by franchisees must be spent on activities that directly support the interests of those franchisees.

Significant capital expenditure

The Code defines ‘significant capital expenditure’ as that which the franchisor “considers necessary” - as justified by a statement concerning the rationale for the investment, the capital required, and expected outcomes, benefits, and risks. The provision of documents justifying such expenditure does serve a useful disclosure function. However, the fact that expenditure is defined with reference to the franchisor’s own assessment affords the franchisor near-absolute discretion to dictate what constitutes necessary spending. The Clause thus allows for both unjustified spending and outright franchisor abuse.

The obligation to disclose documents justifying the expenditure sought should be removed from the definition of what constitutes ‘significant capital expenditure’, to instead function as a standalone requirement. This would allow for the possibility that the franchisee may dispute the need for significant capital expenditure when the documents disclosed suggest otherwise.

Likewise, the fact that the provision allows for the assessment of anticipated benefits and risks to be undertaken by the franchisor itself gives rise to a potential conflict of interest. A party seeking to justify an investment cannot be expected to have necessarily undertaken a dispassionate assessment of its benefits and risks. To enhance the integrity and reliability of the statement of anticipated benefits and risks, the Code should require that such an assessment is undertaken by independent expert.

Recommendation 10: The Code should define ‘significant capital expenditure’ without reference to a franchisor’s subjective assessment.

Recommendation 11: The Code should include a standalone requirement that, prior to requiring significant capital expenditure, a franchisor must provide statements concerning the rationale for the investment, the capital required, and the expected outcomes, as well as the expected benefits and risks identified by an independent expert.

58 For example, in the case of online sales; Cl 12
59 Cl 31(3)(a)(ii)
60 Cl 31(2)(e)
B. The effectiveness of dispute resolution under the Franchising Code of Conduct and the Oil Code of Conduct.

The efficacy of the Code's dispute resolution regime is an issue of vital importance to both franchisees and franchisors. The power imbalance between the parties to most franchise agreements, as well as the confluence of mutual and conflicting interests, suggest an arrangement conducive to disputes. The published data also suggests disputes are commonplace. In 2016, approximately 25% of franchised brands were involved in a dispute with a franchisee of sufficient formality to warrant correspondence from a solicitor, mediation, or litigation; indeed, the literature contends that conflict within a franchise system is in fact inevitable.

Alternative dispute resolution (ADR) is also significantly more cost and time-efficient than litigation, and thus generally desirable to resource and time-constrained franchisees.

Mediation

The Code establishes that both franchisees and franchisors may seek mediation for any dispute related to the franchise agreement or the Code, provided they have first attempted to resolve the matter informally. It is appropriate that the option of mediation is provided to the parties by way of right - including when a franchise agreement contains a discrete complaint handling procedure. However, the accessibility of the Code's mediation provisions could be improved in multiple respects.

Primarily, the OSBC's consultations credibly suggest that awareness of the right to seek mediation is poor among franchisees. It is therefore probable that franchisees are failing to pursue mediation for reason of simple ignorance.

This is an issue best addressed by direct measures to engage with franchisees and their representatives as to the availability of mediation under the Code. While the Office of the Franchising Mediation Adviser is the public authority directly engaged in the franchise mediation space, it is a small operation. Moreover, the Adviser's role is defined by the Code in precise and narrow terms which do not directly contemplate promotional activities. It may therefore be more appropriate that the ACCC, with its vastly wider remit, superior resources, and profile, and high standing in the franchising sector, be tasked with this engagement.

The information statement prescribed by the Code provides a general overview of the potential risks faced by franchisees and key terms commonly found in franchise

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63 Stinanowich (2004), 'ADR and the "Vanishing Trial": The growth and impact of "Alternative Dispute Resolution"', Journal of Empirical Legal Studies, Vol 1, no 3, pp. 5-7;
64 Cl 35(b), 40-43
65 Cl 35
66 Office of the Franchising Mediation Adviser n.d., 'Franchising Mediation Adviser'
67 Cl 44-45
agreements. An amendment to also describe the dispute resolution options available under the Code would assist in increasing awareness of the right to seek mediation among new franchisees, while complementing this existing content. 

**Recommendation 12:** The ACCC should engage with franchisees and their representatives with a view to increasing awareness among franchisees of the right to seek mediation under the Code. In the alternative, the Office of the Franchising Mediation Adviser should be provided with additional resources to undertake such engagement.

**Recommendation 13:** The Code’s information statement should provide an overview of the dispute resolution options available under the Code.

When the parties to a franchising dispute cannot agree on the appointment of a mediator, the Code provides that the parties ask the Franchising Mediation Adviser to make the appointment. Amending the Code to allow for the involvement of the OSBC’s Dispute Resolution Unit (DRU) at this stage, where one or both parties is based in NSW, would facilitate increased access to affordable, efficient, and effective mediation.

DRU provides mediation services for commercial disputes at a fraction of the cost of equivalent services active in the franchising space. It offers its mediation services at $760 for a formal, five-hour mediation, as well as pro rata rates if the parties reach agreement in a shorter time. DRU is also highly versatile. It has assisted parties to over 80 types of commercial dispute, touching on both Commonwealth and NSW law, in the current financial year alone. Its experience extends to a significant number of franchisee-franchisor mediations. DRU is also an industry leader in effective dispute resolution. 91% of parties that undertake formal mediation through DRU are able to reach agreement on the relevant dispute; one study reports a success rate of 74% across all franchising mediations.

The OSBC notes that DRU is resourced as a high-volume service, capable of absorbing a significant increase in caseload arising from referrals under the Code. It has undertaken approximately 260 mediations over the last 12 months, and provided ongoing assistance in an average of approximately 950 total disputes per year since 2015.

Providing the parties to a franchising agreement with a right to refer a dispute to mediation by DRU would not limit access to the Franchising Mediation Adviser, or otherwise restrict the functions of that office. Rather, it would improve the accessibility of the Code’s mediation processes by increasing the accessibility of a service offering unique benefits, of particular utility to small businesses.

**Recommendation 14:** The Code should be amended to provide that, where the parties to a dispute cannot agree on appointment of a mediator, a franchised business or franchisor based in NSW may refer the matter to mediation by the Office of the NSW Small Business Commissioner’s Dispute Resolution Unit.

**Further dispute resolution reforms**

The Code’s dispute resolution regime provides that the parties must attempt informal dispute resolution prior to proceeding to mediation, but is otherwise concerned with the mediation

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68 Annexure 2  
69 CI 40(4)  
While the right to seek mediation of a franchising dispute is unquestionably valuable to both franchisees and franchisors, it is not a panacea. There is plentiful evidence to suggest that mediation is not the optimal dispute resolution method for all franchising disputes.

In particular, numerous studies and expert reflections suggest that franchisors often approach mediations in bad faith. This was affirmed in the OSBC’s consultations. A noteworthy example conveyed to OSBC is the practice of a franchisor insisting that any agreement reached in mediation comprise terms exceedingly favourable to itself. The franchisor is confident in making such demands by virtue of the power imbalance in the relationship. It is well placed to impose its will without compromise and even in the event the franchisee resists, it is also much better resourced for any subsequent litigation. Such practice is clearly not conducive to dispute resolution; much less what might reasonably be considered satisfactory resolution from the standpoint of either a franchisee or a regulator.

Arbitration affords franchisees a potential solution to the issue of franchisor bad faith in mediations. A franchisor may be entitled to act in bad faith in the course of arbitration. However, as an expert third party, an arbitrator would not be guided by such behaviour in reaching an outcome. The Food and Grocery Code of Conduct – regulating relations between supermarkets, grocery wholesalers, and their suppliers – empowers the parties to a dispute under the code to seek both mediation and arbitration, provided these processes are not sought concurrently. The Franchising Code’s dispute resolution regime should be expanded to include equivalent provisions.

Recommendation 15: The Code should be amended to empower the parties to a dispute under the Code, or under a franchising agreement, to seek both mediation and arbitration.

Irrespective of the design of any mediation or arbitration provisions, it is likely that a franchisor’s superior bargaining and financial power functions as a disincentive to many franchisees seeking formal dispute resolution at all. In 2016, less than one third of franchising disputes formalised through either ADR or solicitor correspondence were initiated by a franchisee. In addition, many franchisees have expressed an outward preference for informal dispute resolution.

Strengthening the Code’s provisions relating to informal dispute resolution could therefore strengthen its dispute resolution regime - empowering franchisees that are reluctant to formalise a dispute. In this regard, the approach taken by the Oil Code of Conduct is instructive. The Oil Code allows the parties to a dispute regarding petroleum supply to obtain a non-binding determination from an expert advisor. Similarly, the British Government has

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71 CI 37, 38(1)-(2)
75 Competition and Consumer (Industry Codes – Food and Grocery) Regulation 2015, cl 38-39
78 Competition and Consumer (Industry Codes - Oil) Regulation 2017, cl 41-43
established an expert ‘Adjudicator’ to oversee its own supermarket-suppliers code of conduct. The Adjudicator may:

- Publish guidance concerning the application of any part of the code;
- Publish guidance concerning steps that retailers must take in order to comply with the code; and
- Directly advise retailers and suppliers on any matter relating to the code - i.e. including its interpretation and application.

The Adjudicator is also required to preserve the identity of a complainant if disclosure might cause someone to believe a person has complained about non-compliance with the code.

Similar provisions under the Franchising Code of Conduct would afford franchisees a potential solution to the fear of accessing mediation. An authority could be empowered to publish expert guidance on the application of any part of the Code, or advise the parties to a dispute as to how the Code should be applied, after receiving a complaint from a franchisee. It could do so without formalising the dispute or, in the case of publishing guidance, necessarily revealing the complainant at all. As both the regulator and the recipient of a high volume of franchising complaints, the ACCC is once more the most appropriate body to exercise this function.

**Recommendation 16:** The ACCC should be empowered to publish guidance on the application of the Code, and the steps the parties to a franchising agreement must take to comply, on the basis of a complaint. The ACCC should execute these functions while preserving the anonymity of a complainant to the full extent practicable.

**Recommendation 17:** The ACCC should be empowered to advise the parties to an informal dispute regarding the interpretation and application of the Code, on the basis of a complaint.

**E. The adequacy and operation of termination provisions in the Franchising Code of Conduct.**

The Code provides franchisors a very wide right of termination for breach of the agreement by the franchisee. This right is subject only to an obligation to provide the franchisee up to 30 days to remedy the breach, and minor procedural requirements. This conceivably allows a franchisor to terminate an agreement under which a franchisee has expended hundreds of thousands of dollars for a breach that is trivial in nature yet not remedied immediately. Any such outcome would be plainly inequitable. Moreover, franchisors potentially seeking to generate revenue by ‘churning’ through franchisees for an established franchised business may find the provision facilitative of this particularly unscrupulous practice.

A general provision providing that the franchisor may only terminate when the purported breach is sufficiently serious to justify termination would mitigate any such inequity. Such a

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79 *Groceries Code Adjudicator Act 2013 (UK), ss15-16, Schedule 1*
80 *Groceries Supply Code of Practice 2009 (UK)*
81 *Groceries Code Adjudicator Act 2013 (UK), s12(3)(a)*
82 *Groceries Code Adjudicator Act 2013 (UK), s12(3)(b)*
83 *Groceries Code Adjudicator Act 2013 (UK), s11*
84 *Groceries Code Adjudicator Act 2013 (UK), s18(2)*
85 *The Sydney Morning Herald (23 March 2018), ‘600 Complaints: Regulator has franchise sector in its sights’*
86 *C 27*
provision is already used in other regulatory instruments that, like the Code, govern contractual relations between parties to which a power imbalance typically applies.\(^8\) The OSBC acknowledges that the spectrum of breaches that a franchisor may allege to be sufficiently serious to warrant termination is very broad. Thus, the Code could further prescribe that matters sufficiently serious to warrant termination include, but are not limited to, breaches causing significant financial or reputational loss to the franchisor. This would provide additional clarity to the provision without limiting its operation.

**Recommendation 18:** The Code should be amended to provide that a franchisor may only terminate a franchise agreement for breach of the agreement by the franchisee if the breach is sufficiently serious to justify termination. The Code should provide that matters sufficiently serious to justify termination include but are not limited to breaches causing significant financial or reputational loss to the franchisor.

### H. Any related matter

*Motor Dealership Franchise Agreements*

The Code explicitly provides that a motor vehicle dealership agreement is a franchise agreement.\(^9\) However, OSBC consultations suggest that such agreements give rise to a number of peculiar issues. For example:

- Financial services are a key revenue generator for many dealerships,\(^9\) but agreements often restrict dealerships in this regard by requiring them to use specific financial service providers and products.
- Agreements often restrict the profit that dealerships can derive from new vehicle sales - requiring Key Performance Indicators concerning sales to be met before manufacturers pay dealerships with a 'margin bonus'.
- Agreements typically provide that a manufacturer's warranty period commences when a vehicle is registered by a dealership as a demonstrator model — not when that vehicle is on-sold to an end user.

In his 2013 review of the Code, Mr. Alan Wein identified a need to develop regulation prescribing standard contractual terms for dealership agreements\(^9\) - though the Commonwealth did not act upon this recommendation.

It may therefore be valuable for the Inquiry to gather and consider evidence concerning the merits of developing dedicated provisions within the Code applicable to motor vehicle dealership agreements, including by way of prescribing standard terms. The OSBC acknowledges that such efforts may extend beyond the capacity of the Inquiry.

**Recommendation 19:** The Inquiry should consider the need for the development of dedicated provisions within the Code governing the relationship between motor vehicle dealers and manufacturers.

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\(^8\) For example, *Residential Tenancies Act 2010* (NSW), ss87, 103; *Residential Tenancies Act 1995* (SA), s87

\(^9\) Cl 5(2)

\(^9\) Deloitte (2014), *'2014 Australian motor industry overview'*

To discuss this submission, please contact Thomas Mortimer, Advisor, Advocacy and Strategic Projects, on (02) 8222 4196 or thomas.mortimer@smallbusiness.nsw.gov.au.

Kind regards

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10 May 2018