



Licensing Taskforce
Justice and Licensing Reviews Branch
Small and Family Business Division
The Treasury
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By email: franchisingtaskforce@treasury.gov.au

To whom it may concern,

Thank you for the opportunity to provide feedback on the consideration of a licensing regime for the franchising sector. The NSW Small Business Commission ('the Commission') is an independent statutory office of the NSW Government. It provides strategic advice, advocacy and affordable dispute resolution across NSW.

While the Commission does not have any specific function with respect to franchising, my office occasionally receives representations from small businesses relating to franchising issues as well as franchising-related disputes filed for mediation. Previous matters raised with my office have included:

- Concerns raised about the structure and/or transparency of franchising royalties
- Lease disputes, including matters involving franchisees or franchisors considered by my office in accordance with the *Retail Leases Act 1994* (NSW)
- General conduct or business practices within the franchising sector.

In addition, my office observes challenges can emerge or be exacerbated by a lack of awareness of rights and obligations as either a franchisee or franchisor as well as misaligned expectations about the franchising business model.

The need for a licensing regime can only be considered once a clear conceptual basis, including the nature of the problem and associated policy objectives, has been identified. At this stage, the Commission is not persuaded of the need for a licensing regime but recognises the value of this consultation in exploring whether such a mechanism could effectively address enforcement challenges, improve access to justice and deliver meaningful improvements to the regulatory framework.

Problem statement should be clearly defined

The Commission notes the consultation paper does not present a proposed licensing regime, however intends to seek views on the need for such a regime, including with regards to the potential to enhance regulatory oversight, dispute resolution, disclosure of information, business model preconditions to franchise, and education and resources.

It is difficult to ascertain the merits of a licensing regime without first establishing a clear articulation of the problem to be addressed and the objectives of such a regime. A 'light touch' licensing regime could be introduced a mechanism to enhance dispute resolution options, however a more interventionist approach which establishes business model preconditions would require more detailed policy development. In either case the need for policy intervention should be first established, with a licensing

regime considered as an option to achieve intended outcomes rather than considering the narrower question as to whether a licensing regime is feasible.

It is noted that the *Review of the Franchising Code of Conduct Final Report* recommended further work to evaluate the merits of introducing a licensing regime to enable a shift towards ex ante enforcement, on the basis this would assist in addressing persistent issues within the sector. However, the various tools and possible features of a licensing regime have the potential to introduce substantial new obligations and requirements which go beyond ensuring effective enforcement of the existing franchising code (which was found to be generally fit for purpose).

Potential challenges with a licensing framework

While a licensing framework has the potential to facilitate additional enforcement options, it would not solve all challenges commonly attributed to the franchise model.

Poor outcomes in the franchise sector are not always the result of inherent flaws in the franchisor's business model. The franchise business model can sometimes create a misperception that it offers a risk-free path to business ownership. This can sometimes lead to underestimation of the commercial realities and responsibilities of running a business and result in a lack of due care and preparation. A licensing regime could unintentionally exacerbate this challenge, through perceived government endorsement of a licensed franchise, which could undermine efforts encouraging prospective franchisees to undertake their own due diligence and to be properly prepared before entering a franchise agreement.

Licensing frameworks are often justified on the basis that certain groups require protection, with the intent of ensuring that only responsible and qualified parties can participate in the market. A highly interventionist licensing regime would be required to eliminate all forms of conduct that could result in harm to franchisees and would be a significant diversion from the current regulatory approach. The Commission's view is that such an approach is unwarranted and would pose significant risk to the potential to innovate and upscale effective business models. It would also be incongruous with approaches taken in the broader commercial ecosystem which recognises trade-offs between risk and reward, and freedom of enterprise.

A more passive licensing approach with a requirement to satisfy existing obligations, with minimal additional barriers, could offer a more balanced approach. However, such a model would still require careful assessment and analysis of what measures are needed to optimise the enforcement regime to confirm the suitability of the approach.

Mandatory arbitration

The consultation paper notes the potential for licensing to underpin a compulsory arbitration regime.

The Commission's view is that mediation should remain the preferred mechanism to resolve franchising disputes. Mediation fosters collaborative problem-solving, enabling parties to reach mutually agreeable solutions that better preserve long-term relationships and enhance satisfaction with the outcomes. Because agreements reached through mediation are voluntary, parties are more likely to comply, having played an active role in crafting the resolution. In contrast, compliance with arbitrated decisions may be less certain, as outcomes are imposed rather than chosen.

While arbitration can assist in some circumstances where mediation has failed, it may have the unintended consequence of weakening the role of mediation by discouraging early negotiation or voluntary resolution of disputes. Parties may bypass opportunities for constructive dialogue knowing a binding decision will be imposed later.

There are some other inherent disadvantages with arbitration. Arbitration is typically more costly than mediation as parties often require legal representation to meaningfully participate. Given the proportion of franchisees that are small businesses, this would cause significant financial stress and pressure and

may exacerbate power imbalances. Further drawbacks involve the limited right to appeal and the potential for questionable fairness.

Arbitration may also be less suited to resolving issues where the challenge lies not in objective facts or questions of law, but in reconciling competing interests to achieve efficient outcomes. Such outcomes are often best negotiated directly by the parties themselves, rather than imposed by an arbitrator. For instance, while disputes over the interpretation of specific terms in a franchising agreement might lend themselves to adjudication, concerns related to how a franchise agreement has been drafted are more appropriately addressed through a facilitated negotiation process like mediation.

It may be worthwhile to re-examine the merits of licensing and mandatory arbitration after Recommendations 16 – 21 of the franchising review have been implemented. This would allow for their impact and any deficiencies to be assessed.

Thank you for the opportunity to make a submission. If you require further information, please contact my Executive Officer, Megan Bennett, at either commission@smallbusiness.nsw.gov.au or (02) 9372 8767.

Yours sincerely

Mark Frost
Acting Commissioner
NSW Small Business Commission

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