



**Australian Government**

# Franchising sector reforms

Regulation Impact Statement

## **Franchising Taskforce**

Department of Employment, Skills, Small and Family Business

Department of the Treasury

Department of the Prime Minister and Cabinet

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The document must be attributed as the Regulation Impact Statement in relation to the *Fairness in Franchising* Report of the Parliamentary Joint Committee on Corporations and Financial Services.

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## Glossary

Abbreviation	Description
AAF	Australian Association of Franchisees.
ACCC	Australian Competition and Consumer Commission.
ACL	<i>Australian Consumer Law, as set out in Schedule 2 to the Competition and Consumer Act 2010 (Cth).</i>
AGD	Attorney-General's Department
Arbitration	A process in which the parties present arguments and evidence to an adjudicator who makes a determination which is enforceable by the authority of the adjudicator.
ASBFEO	Australian Small Business and Family Enterprise Ombudsman.
ATO	Australian Taxation Office.
CCA	<i>Competition and Consumer Act 2010 (Cth).</i>
Conciliation	A process in which the parties to a dispute, with the assistance of a conciliator, identify the issues in dispute, develop options, consider alternatives and endeavour to reach an agreement. The conciliator may have an advisory role on the content of the dispute or its resolution, but not a determinative role.
Decision RIS	A document prepared for the decision maker, containing a complete examination of the issues following consultation, assessing the costs and benefits of the options considered to address the issues, and recommending the options that yield the greatest net benefit to the community as a whole.
Department of Employment	Department of Employment, Skills, Small and Family Business.
FCA	Franchise Council of Australia.
Franchising Code	The Franchising Code of Conduct as set out in Schedule 1 to the <i>Competition and Consumer (Industry Codes – Franchising) Regulation 2014</i> .
FWO	Fair Work Ombudsman.
Issues Paper	The Franchising Taskforce's Issues Paper, published on 23 August 2019 and available from the Department of Employment, Skills, Small and Family Business' website.
Mediation	A process in which the parties to a dispute, with the assistance of a mediator, identify the disputed issues, develop options, consider alternatives and endeavour to reach an agreement. The mediator has no advisory or determinative role in regard to the dispute but may advise on or determine the process of mediation whereby resolution is attempted.
OFMA	Office of the Franchising Mediation Adviser.
Oil Code	The Oil Code of Conduct as set out in the <i>Competition and Consumer (Industry Codes—Oil) Regulations 2017</i> .
PJC	Parliamentary Joint Committee on Corporations and Financial Services.
Prospective franchisee	A person considering buying a franchise that is not currently involved with that franchising system.
Recommendations	Recommendations of the Parliamentary Joint Committee on Corporations and Financial Services in their Fairness in Franchising report.

<b>Abbreviation</b>	<b>Description</b>
<b>RIS</b>	Regulation Impact Statement.
<b>RIA</b>	Regulation Impact Analysis.
<b>Professional advisor</b>	A professional who is able to provide advice to a franchisee or franchisor. A professional advisor might be a lawyer, an accountant, a financial planner or general business advisor.
<b>Taskforce</b>	The Franchising Taskforce is comprised of senior officials within the Department of the Treasury, the Department of Employment, Skills, Small and Family Business, and the Department of the Prime Minister and Cabinet and has been tasked with providing advice to Government on the recommendations in the PJC's Fairness in Franchising report.
<b>Treasury</b>	Department of the Treasury

## 1. The Franchising Taskforce

On 14 March 2019, the Parliamentary Joint Committee on Corporations and Financial Services (**PJC**) handed down its *Fairness in Franchising* report, making 71 recommendations to improve the operation and effectiveness of the franchising sector.

In accordance with the PJC's first recommendation, an inter-agency Franchising Taskforce (the **Taskforce**) has been established. The PJC recommendation states:

...that the Australian Government establish an inter-agency Franchising Taskforce to examine the feasibility and implementation of a number of the committee's recommendations.<sup>1</sup>

The Taskforce is made up of senior officers from the Department of Employment, Skills, Small and Family Business (**the Department of Employment**), the Department of the Treasury (**Treasury**) and the Department of the Prime Minister and Cabinet. It is co-chaired by the Department of Employment and the Treasury.

The Taskforce released an Issues Paper in August to invite feedback to inform this RIS and advice to Government. The Taskforce has been encouraged by the response to the Issues Paper and the constructive engagement it has had from the full range of perspectives on franchising. The Taskforce received 75 responses to the Issues Paper and to date has met with around 80 stakeholders including franchisees, franchisors and professional advisors.

Noting the PJC's observations about representation of franchisees and their input into policy development (see Recommendation 5.1), the Taskforce made a special effort to meet with individual franchisees and their representatives to hear their stories.

This Regulation Impact Statement (**RIS**) represents the next stage in the Taskforce's consultation. The Taskforce will be accepting submissions on this RIS until 6 December 2019. Information obtained through this consultation will be used to inform advice provided to government.

## 2. About this Regulation Impact Statement

It is government policy that all regulatory proposals be accompanied by a RIS. The RIS process is designed to ensure that policy makers are properly considering the benefits and costs of any policy action that may be recommended to government. The RIS should be developed early in the policy making process and is a tool used to inform government decision making.

The purpose of this RIS is to obtain stakeholder views, supported with evidence where possible, on options to address the range of issues identified by the PJC in its *Fairness in Franchising* report.

This RIS should not be taken as an indication of the views of the PJC the Taskforce or the Government. Rather this document follows the structure of a RIS as set out in the Australian Government's Guide to Regulation.<sup>2</sup> It should also not be seen as limiting or prescribing the options that the government may decide to take in relation to the regulation of franchising.

The Taskforce has considered a range of issues raised by the PJC and, together with its consultation with stakeholders, identified a number of policy problems. This RIS then sets out policy options that could address these problems. Consistent with the general advice in the Guide to Regulation, at least

<sup>1</sup> Parliamentary Joint Committee on Corporations and Financial Services' *Fairness in Franchising* report, page xvi.

<sup>2</sup> Department of the Prime Minister and Cabinet, [The Australian Government Guide to Regulation](#)

three possible policy options are considered to address each of the identified problems. These options include the status quo, changes as envisaged by the PJC, and other options reflecting stakeholder feedback to the Taskforce.

This RIS follows the format of the Taskforce’s Issues Paper by considering the problems and options for government action under principles relevant to the franchising relationship. The questions in the RIS aim to identify whether the proposed options address the identified problems, and to collect information and data about the relative costs and benefits of each option. Some options will help to address multiple problems, although for readability this is not always made explicit in this document.

Though presented as alternative options, some options could form a cumulative response to the problems identified, and the options identified are not mutually exclusive. They are also not exhaustive, and stakeholders are encouraged to provide their views about viable alternative options to those identified in this RIS.

The RIS should be read together with the *Fairness in Franchising* report<sup>3</sup> and the Issues Paper.<sup>4</sup>

As with the Issues Paper, this RIS does not consider PJC recommendations which are being addressed in related policy processes, including unfair contract term protections for small businesses (Recommendations 9.1-9.6), automotive franchising (Recommendation 17.1), and whistleblower protections (Recommendation 3.1).<sup>5</sup>

It also does not consider PJC recommendations which relate to decisions of the Australian Competition and Consumer Commission (ACCC) in its role as independent regulator of the *Competition and Consumer Act 2010 (CCA)*, the Franchising Code of Conduct (**Franchising Code**) and the Australian Consumer Law (the **ACL**) (Recommendations 4.1, 4.2, 7.2, 13.1, 14.1 and 14.2).

Issues of protections of wages and entitlements are being considered through separate policy processes overseen by the Attorney-General’s Department.<sup>6</sup>

Consultation on the Issues Paper affirmed that the principles are a helpful way of grouping the PJC’s recommendations and should be used to guide further consultation. The revised principles based on feedback from the Issues Paper consultation are provided below.

Business phase	Principle
<b>Entering a franchising agreement</b>	<ol style="list-style-type: none"> <li>1 Prospective franchisees should be able to make reasonable assessments of the value (including costs, obligations, benefits and risks) of a franchise before entering into a contract with a franchisor</li> <li>2 Franchisees should have time to consider whether the relationship is right for them before committing to an agreement</li> </ol>
<b>Operating a franchise</b>	<ol style="list-style-type: none"> <li>3 Each party to a franchise agreement should be able to verify the other party is meeting its obligations and is generating value for both parties</li> </ol>

<sup>3</sup> [Fairness in Franchising Report](#)

<sup>4</sup> [Franchising Taskforce Issues Paper](#)

<sup>5</sup> See [Review of Unfair Contract Term Protections for Small Business](#), Department of the Treasury. Whistleblower protections were contained in the *Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019* which extended protections to corporations and their employees (PJC recommendation 3.1).

<sup>6</sup> [Attorney-General's Department, Industrial Relations Consultation page](#)

Business phase	Principle
	<p>4 A healthy franchising model fosters mutually beneficial cooperation between the franchisor and the franchisee, with shared risk and reward, free from exploitation and conflicts of interest</p> <p>5 Where disagreements turn into disputes, there is a resolution process that is fair, timely and cost effective for both parties</p>
<b>Exiting</b>	6 Franchisees and franchisors should be able to exit in a way that is reasonable to both parties
<b>Regulatory framework across all phases</b>	7 The framework for industry codes should support regulatory compliance, enforcement and appropriate consistency

### 3. How to provide feedback

You are invited to respond to the RIS through the online consultation form available at the Franchising Taskforce web page.<sup>7</sup> Alternatively, you may send your submission to the Taskforce at [franchising@employment.gov.au](mailto:franchising@employment.gov.au), or you can make a verbal submission by calling 1800 314 677. The deadline for responses to the Regulation Impact Statement is 5pm (AEST) on Friday, 6 December 2019.

**In order to make providing feedback on the RIS process as accessible as possible, the Taskforce has produced a short Fact Sheet on this RIS, which can be read as a standalone document, without needing to refer to this complete RIS document.**

#### Privacy Collection Statement

Any personal information contained in submission is protected by law, including the *Privacy Act 1988* (Cth).<sup>8</sup> Your personal information is collected by the Department of Employment through a Contract Service Provider, as part of a consultation process into franchising matters.

Your name may be used to attribute your ownership of your submission unless you indicate that you wish to remain anonymous. Your email address may be used to enable the department to contact you regarding your submission if it is incomplete or inaccessible.

Your personal information will not be used or disclosed for any other purpose unless authorised or required by law.

The Department of Employment's Privacy Policy contains more information about the way in which we will manage your personal information, including information about how you may access your personal information held by the Department and seek correction of such information.<sup>9</sup>

#### Confidential Information

The Department of Employment may publish submissions on its website, **unless the submission is marked as confidential**. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment and clearly identify the

<sup>7</sup> [Department of Employment, The Franchising Taskforce page](#)

<sup>8</sup> [Privacy Act 1988 \(Cth\)](#)

<sup>9</sup> [Department of Employment, Privacy page](#)



confidential text. If only part of your submission is confidential, you may also provide the Department with a non-confidential version of the submission which can be published on the Department's website.

## 4. Background

### **Franchising in Australia**

Franchising is a popular business model, and makes a significant contribution to the Australian economy. There are approximately 1,344 franchise brands in Australia, providing employment for more than 598,000 people. The sector's estimated revenue is \$184 billion.<sup>10</sup>

The franchising sector is diverse in terms of its constituent industry sectors and in the different approaches to the franchisor-franchisee relationship in individual systems. In addition, the changing economic environment – such as the generally tough retail environment, the emergence of the gig economy and the growth of alternative models for self-employment – have created challenges for the sector.

In Australia, around 90 per cent of franchisors, and almost all franchisees are small businesses.<sup>11</sup> Franchise systems involve a franchisor that is typically a larger business with experience in operating the brand, an understanding of the market and access to resources. Franchisees may by comparison be smaller operators, may not have the same understanding of the business nor the general business experience that the franchisor does, and are often from a culturally and linguistically diverse background. Sources suggest many franchisees enter into franchising from wage-dependent employment.<sup>12</sup>

### **Regulation of the franchising sector**

In Australia, the relationship between franchisor and franchisee is regulated primarily by the Franchising Code. The Franchising Code is a mandatory industry code prescribed by regulation under Part IVB of the CCA.

Information about industry codes can be found in the Policy Framework for Industry Codes.<sup>13</sup> The Franchising Code was first introduced in 1998 to promote positive relationships in the franchising sector.

Since 1998 the Franchising Code has undergone a number of policy reviews and legislative changes.<sup>14</sup> The Franchising Code was most recently revised with effect from 2015. Key features include a requirement for franchisees and franchisors to act in good faith, a requirement for franchisors to provide comprehensive disclosure to franchisees, and a dispute resolution mechanism involving a government-appointed mediation adviser.

In addition to the provisions provided by the Franchising Code, participants in the sector are also subject to the general laws governing business relationships and fair trading in Australia. These laws

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<sup>10</sup> IBISWorld, *Franchising in Australia*, Industry Report X0002 (September 2019).

<sup>11</sup> Franchise Council of Australia's submission to the PJC, page 5.

<sup>12</sup> Franchise Law Review, page 101, 2018 *Law Business Research Ltd*.

<sup>13</sup> [The Department of the Treasury, Industry Codes of Conduct Policy Framework](#)

<sup>14</sup> *Fairness in Franchising* report, Appendix 3, pages 319-320.

include prohibitions on unconscionable conduct, false or misleading representations, and the regulation of unfair contract terms in standard form contracts under the ACL. Some of the issues raised with the PJC and the Taskforce are not specific to franchising, and are faced by small businesses in general.

Changes to broader economic policy settings and laws are relevant to the franchising sector. For example, since the last review of franchising regulation in 2015:

- There have been amendments to the *Fair Work Act 2009 (FWA)* to extend liability to franchisors, in certain circumstances, for franchisee breaches of the FWA.
- The Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) was established in 2016 to advocate for, and provide assistance to, small business including franchisees and franchisors.

The Taskforce is also examining the extent to which franchise systems and their agreements involve sufficient co-investment and risk sharing in an enterprise such that they should be regulated in a similar nature to financial products (Recommendation 22.1).

Industry compliance with the Franchising Code is overseen by the ACCC, which has a range of enforcement options. These options include issuing infringement notices and taking court action seeking pecuniary penalties. More information about the ACCC's role in enforcing the Franchising Code, including its Compliance and Enforcement Policy, can be found on the [ACCC website](#).<sup>15</sup>

The ACCC's enforcement activity focuses on the most systemic and egregious breaches of the Franchising Code, the CCA or the ACL. Many stakeholders have identified that this can lead to a gap in enforcement, for cases that may not be systemic or egregious, but are nonetheless clear breaches. Stakeholders submitted that private action in the courts to remedy breaches is expensive and time consuming for franchisees and franchisors.

Parties to a dispute are able to approach ASBFEO for assistance with the Franchising Code mediation process. More information on franchising disputes and the role of the Franchising Mediation Adviser and ASBFEO can be found on the Department of Employment and [ASBFEO websites](#).<sup>16</sup> The parties to a franchise agreement are also able to take action through the courts to resolve disputes or pursue breaches of the Franchising Code.

Franchisees and franchisors have a range of interactions with government agencies:

- As at mid-October, franchising matters represent nearly 5 per cent of all current ACCC litigation. The ACCC has litigated 34 franchising-related matters and accepted 17 court enforceable undertakings since the Franchising Code was first introduced in 1998.<sup>17</sup>

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<sup>15</sup> [ACCC, Franchising Code page](#)

<sup>16</sup> See [Department of Employment, Franchising Mediation Adviser page](#) and [ASBFEO, Franchising Disputes page](#).

<sup>17</sup> Sourced from the Australian Competition and Consumer Commission.

- Since the ACCC was given the power to conduct industry code compliance checks on 1 January 2011<sup>18</sup>, the ACCC has issued 115 notices requiring documents or information to be provided under s51ADD of the CCA which relate to the Franchising Code.<sup>19</sup>
- Three infringement notices have also been issued and paid following amendments to the law in 2015 that allowed the ACCC to issue infringement notices for likely breaches of the Franchising Code.<sup>20</sup>
- As at mid-October 2019, the ACCC had received 467 franchising contacts and commenced 19 investigations into franchising.<sup>21</sup>
- ASBFEO took 187 calls in relation to franchising in the first quarter of 2019, and facilitated 37 cases of mediation.<sup>22</sup>
- The state small business commissioners also receive complaints in relation to franchising, for example.
  - The South Australian Small Business Commissioner received 28 franchising-related inquiries in 2016-17.<sup>23</sup>
  - The Small Business Development Corporation (Western Australia) received 20 franchise-related disputes in 2016-17.<sup>24</sup>
  - The Victorian Small Business Commissioner received 25 complaints relating to franchises between July 2016 and April 2018.<sup>25</sup>

A number of stakeholders have submitted that caution needs to be exercised in using these figures to infer the extent of disputes in the franchising sector. Many franchisee stakeholders have submitted that franchisees are reluctant to report concerns or poor behaviour to regulators.

More generally, a range of disputes between franchisees and franchisors are managed within the franchising relationship, without the need for regulator involvement:

- It is estimated that in 2016, approximately 25 per cent of franchised brands were involved in a dispute with a franchisee of sufficient formality to warrant the involvement of an external advisor. For these franchised brands, they were in dispute with a median number of 2 of their franchisee.<sup>26</sup>
- The same survey estimated that 1.8 per cent of franchisees are in dispute with their franchisor at any given time.<sup>27</sup>
- Franchisees are free to take private enforcement action, although the high cost of doing so means that this appears to be uncommon.

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<sup>18</sup> [ACCC, Franchise Legal Symposium Update page](#)

<sup>19</sup> Sourced from the Australian Competition and Consumer Commission.

<sup>20</sup> ACCC Submission to the PJC, page 1.

<sup>21</sup> Sourced from the ACCC and relates to the 2019 calendar year. Total number of contacts includes enquiries and complaints. Investigations also includes compliance checks, and may include investigations at different levels against a trader.

<sup>22</sup> ASBFEO, *Quarterly report Q1 [January-March] 2019*, page 8.

<sup>23</sup> Small Business Commissioner of South Australia, *Annual Report 2017/18*, page 24.

<sup>24</sup> The Small Business Development Corporation Submission to the PJC, page 2.

<sup>25</sup> The Victorian Small Business Commissioner's submission to the PJC, page 1.

<sup>26</sup> Griffith University, *Franchising Australia 2016* report, page 7. The survey was of 277 franchisors of an estimated population of 1089. If franchisors that were in dispute with their franchisees were less likely to respond to this survey, then the reported numbers will underestimate the extent of disputes.

<sup>27</sup> Ibid. How this estimate was made is not clearly explained in the report.

## Principle 1. Prospective franchisees should be able to make reasonable assessments of the value (including costs, obligations, benefits and risks) of a franchise before entering into a contract with a franchisor

Under the Franchising Code, a franchisor is required to provide extensive pre-entry disclosure to franchisees at least 14 days before entering into a franchise agreement.

However, the PJC identified that franchisees may not have had enough time to engage with due diligence and the required disclosure documents prior to entry. The mandated level of disclosure under the Franchising Code is intended to help prospective franchisees to make informed decisions.

The PJC identified three potential policy problems in relation to disclosure:

- Disclosure documents can be hard to comprehend, critical information may be hidden in detail and some information may not be provided.
- The reliability of information provided to prospective franchisees may be difficult to assess.
- Information gaps – a potential franchisee might be unaware of which information is crucial to inform their decision to enter an agreement.

A recent ACCC report also found that 40 per cent of prospective franchisees did not seek any independent professional advice before entering a franchise agreement.<sup>28</sup>

Options for each of the potential policy problems identified above are now considered in turn.

### Policy problems

#### **Problem 1.1: Disclosure can be hard to comprehend, critical information may be hidden in detail and some information is not provided**

The Franchising Code has specific disclosure document requirements.<sup>29</sup> However, these requirements can lead to lengthy disclosure documents. A range of stakeholders have stated that lengthy disclosure documents can be difficult to comprehend and make it hard to find critical information.

The PJC heard that some franchisors may not provide earnings information to prospective franchisees for fear that the previous franchisee's records are inaccurate, and they would then be subject to litigation.

The PJC also heard that there are a significant number of franchisees from culturally and linguistically diverse backgrounds. Stakeholder consultation suggested that this cohort of franchisees may have even greater difficulty in engaging with disclosure documents. Many franchisees and franchisors noted that disclosure documents could be more accessible.

#### **Financial disclosure**

The PJC heard that a large number of franchisees indicated that the specific financial information provided in disclosure documents was limited. Franchisors indicated that they are reluctant to provide detailed financial information because of a fear that the information they provide may be

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<sup>28</sup> Disclosure practices in food franchising: Key findings of targeted compliance checks of franchisors in the food services sector [ACCC, Disclosure practices in food franchising.](#) Note, this finding is based on the results of compliance checks on 12 different franchisors.

<sup>29</sup> [Franchising Code of Conduct, Annexure 1.](#)

found to be misleading. The Taskforce was told that not all franchisors have access to all information, as some is owned by the franchisee.

Under the existing arrangements a franchisor can decide not to provide specific financial information, or do so outside of the formal disclosure regime. In the absence of specific financial information, stakeholders have provided evidence that a franchisee may look to other less relevant or unreliable sources to ascertain the possible value of a franchise.

### Leasing disclosure

The PJC heard that a common leasing arrangement is for the franchisor to hold the head lease and then grant a licence to occupy to the franchisee. In most other cases, the lease is negotiated directly with the franchisee as head tenant, subject to the lease and site being approved by the franchisor.

<b>Options to address Problem 1.1:</b> Disclosure is hard to comprehend and critical information may be hidden or not included in the disclosure document.	
Option	Description
Option 1.1.1	<p><b>Status quo</b></p> <p>Under this option there would be no changes to the disclosure requirements. Franchisees would continue to receive information consistent with the existing disclosure document format as prescribed by the Franchising Code.</p> <p>Some provisions of the Franchising Code which improved disclosure were only introduced in 2015 and have arguably had insufficient time for their effects to be fully felt within the industry, noting that the average term of a franchise agreement is five years.<sup>30</sup></p>
Option 1.1.2	<p><b>Changes to the Franchising Code to increase disclosure</b></p> <p>The option would include implementation of Recommendations 6.1 (electronic disclosure), 6.2 (separate information statement), 6.3 and 6.4 (increased and formal financial disclosure), 18.1 (provision of the ACCC franchisee manual) and 20.2 (leasing disclosure).</p> <p><b>Option 1.1.2 (a) Electronic and hard copy disclosure</b></p> <p>Under this option franchisors would be required to provide disclosure documentation in electronic form. Having access to an electronic copy would allow prospective franchisees to more easily share disclosure documentation with relevant professional advisors. An electronic version would also allow readers to more easily search for information.</p> <p>Stakeholders have not raised any significant concerns with this recommendation to the Taskforce.</p> <p><b>Option 1.1.2 (b) Separate information statement</b></p> <p>Under this option it would be made clear the information statement should be provided as a separate document to the rest of the disclosure material.</p>

<sup>30</sup> [FranchiseEd, \*Managing Franchise Agreements Transfers and Renewals\*](#)

Option	Description
	<p>This change is intended to make it more likely the information statement will be read before the prospective franchisee commits to entering the agreement.</p> <p>Stakeholders have not raised any significant objections to this recommendation to the Taskforce.</p> <p><b>Option 1.1.2 (c) Increased and formal financial disclosure</b></p> <p>Under this option the seller of a franchise would be required to provide a greater level of financial information. The PJC recommendation contemplates that the prior two years' Business Activity Statements and other financial information be provided for the relevant franchise business, or where that does not exist, it be provided for a comparable franchise opportunity. The franchisor would also be required to provide this information with the disclosure document.</p> <p>This option includes Recommendation 18.3, requiring the franchisor to provide a prospective franchisee with 'a reasonable estimate of [their] personal workload' in running the franchise business.</p> <p>This option is in response to evidence submitted to the PJC that franchisees often have too little financial information about a franchise unit before they enter into that agreement, or receive financial information that it is not the information that they most need.</p> <p>Franchisors have raised concerns with the Taskforce that such a recommendation may raise difficulties where information is not available to them, and/or there are commercial in confidence concerns relating to that disclosure.</p> <p><b>Option 1.1.2 (d) Provision of the ACCC's Franchisee Manual</b></p> <p>Under this option the franchisor would be required to provide the prospective franchisee with the ACCC's Franchisee Manual when it first provides the disclosure document.</p> <p>This recommendation was made by the PJC as one of two recommendations aimed at improving education of prospective franchisees before they enter the agreement.</p> <p>Concerns were not raised with the Taskforce in relation to this recommendation. It is expected to have only a most minimal regulatory burden on franchisors.</p> <p><b>Option 1.1.2 (e) Leasing disclosure</b></p> <p>Under this option franchisors would be required to provide greater disclosure about the nature of leasing arrangements that are associated with a particular franchise.</p>

Option	Description
	<p>This option is intended to ensure the prospective franchisee has important information about one of its largest cost items before entering the agreement.</p> <p>The PJC heard from a number of franchisees where a franchisor’s ownership of a lease or association with a landlord led to conflicts of interest and disputes. Stakeholders indicated to the Taskforce that this could help address information asymmetries around the owner of the lease and the term of the lease. However, stakeholders also indicated that site negotiation can take a significant period of time and some details may not be settled at the point of disclosure.</p>
Option 1.1.3	<p><b>Simplified disclosure requirements. Require that a simplified disclosure document, which provides all materially relevant information needed to assess the franchise business, is provided to prospective franchisees</b></p> <p>Under this option franchisors would be required to provide all information that is materially relevant to a franchisee to assess the franchise business in a concise disclosure document.</p> <p>A broad range of stakeholders submitted that franchisees are not currently able to engage effectively with disclosure documents because of their length and complexity.</p>

**Problem 1.2: The reliability of information provided to prospective franchisees may be difficult to assess**

Verifiable and reliable information is crucial for prospective franchisees to make informed decisions.

While misleading or deceptive conduct is prohibited under the ACL, the PJC and the Taskforce heard allegations from a number of franchisees that they were provided with inaccurate or misleading information. In addition, the PJC found that a number of franchisees feel they are not receiving reliable information about a franchise unit before they enter into a franchise agreement.

Many franchisees have told the Taskforce that relevant financial data is the most important disclosure a franchisee can receive. Nonetheless, there was a range of views on what information is most useful to prospective franchisees and how easy it is for franchisors to provide that information. Some franchisors have indicated that they are reluctant to provide the detailed information for fear of misrepresentation. However, professional advisors suggested to the Taskforce that even in the case of transfer of an existing franchise, franchisors have some level of involvement in the sale of the business, and will usually have access to some types of financial information.

**Options to address Problem 1.2:** The reliability of information provided to prospective franchisees may be difficult to assess.

Option	Description
Option 1.2.1	<p><b>Status quo</b></p> <p>Under this option, franchisors would still need to provide prospective franchisees with a detailed disclosure document following the format outlined in the Franchising Code. They must also maintain the disclosure document, including by updating the disclosure document within four months after the end of each financial year (clause 8 of the Franchising Code).</p>
Option 1.2.2	<p><b>Requiring franchisors to verify financial statements and introducing a national franchise register</b></p> <p>Under this option, the government would require franchisors to verify financial statements (Recommendation 6.5), would establish a national franchise register (Recommendation 6.14) and prohibit ‘no agent’ and ‘entire agreement’ clauses in franchise agreements (Recommendation 6.6).</p> <p><b>Option 1.2.2 (a) Franchisors would be required to include a statement about the accuracy of financial statements</b></p> <p>Under this option the franchisor would be required to make a statement confirming that, ‘to the best of the franchisor’s knowledge’, financial statements provided in the disclosure document are ‘accurate, correct and compliant’ with the Franchising Code and accounting standards.</p> <p>Some stakeholders have suggested that this statement is not required, as franchisors are already banned from making false or misleading representations by the ACL. Others suggested it would serve to remind franchisors of their obligations and promote confidence in disclosure amongst prospective franchisees.</p> <p>Franchisors have indicated that they often do not own the financial information of their franchisees. Several franchisors raised concerns that they feel they open themselves to liability if they provide franchisees with financial information that may be misleading.</p> <p><b>Option 1.2.2 (b) National franchise register</b></p> <p>Under this option a national franchise register would be established by government, and all franchisors would be required to lodge their disclosure documents and template franchise agreements.</p> <p>A number of stakeholders have suggested that introducing a register may help to address a range of issues in the franchising sector. For example, stakeholders have stated it would allow prospective franchisees to compare systems before making a commitment to a particular brand and that it would increase regulators’ and academics’ knowledge of the franchising sector. While the Taskforce has heard support for a franchise register from a cross-section of stakeholders, concerns have been raised by stakeholders that a register may require the disclosure of business secrets and other</p>



Option	Description
	<p>commercial-in-confidence information to the detriment of the franchising business model.</p> <p>Franchisors voiced concerns that this would be an additional compliance burden. Some stakeholders have also raised concerns that a register would lead some prospective franchisees to believe that the franchise system and any documents or statements on the register have been vetted and can be relied upon. It has been suggested that this may, in turn, result in reduced due diligence by prospective franchisees.</p> <p><b>Option 1.2.2 (c) Third party brokers</b></p> <p>Under this option, franchisors would be prohibited from including ‘no agent’ and ‘entire agreement’ clauses in franchise agreements, so as to avoid any responsibility for representations made by third party brokers acting for the franchisor.</p> <p>A number of franchisees raised concerns about misrepresentations by third party brokers with the PJC and the Taskforce before they entered the agreement.</p> <p>Stakeholders did not raise this option as a potential compliance burden, though it would have some regulatory impact on franchisors if it resulted in them taking over all sales of franchises. This option could result in fewer disputes between franchisors and franchisees over representations. This option does not prevent franchisors using third party brokers.</p>
Option 1.2.3	<p><b>Pre-entry education</b></p> <p>Under this option, government would take further steps to encourage or compel pre-entry education for franchisees. A range of stakeholder submissions made to the Taskforce supported this approach, and some indicated that this pre-entry education could be industry led. The Franchise Council of Australia (<b>FCA</b>) has indicated that franchisors who compel their prospective franchisees to undertake pre-entry education have fewer instances of disputes in the franchise system.<sup>31</sup></p> <p>There are several free training courses already available to franchisees, some of which are supported by government, such as, the pre-franchise online program provided by FranchiseEd and supported by the ACCC.<sup>32</sup> As such encouraging or compelling pre-entry education would not necessarily need to involve an explicit financial burden on franchisees.</p>

**Problem 1.3: Information gaps – a potential franchisee might be unaware of which types of information are materially relevant to inform their decision to enter an agreement**

The PJC heard from several franchisees who said they were not provided with information that would have been materially relevant in making a decision as to whether or not to enter a franchise agreement. Stakeholders submitted that franchise agreements are often complex, and that seeking

<sup>31</sup> [Parliamentary Joint Committee on Corporations and Financial Services Submissions](#), Submission 29.1, page 9.

<sup>32</sup> [FranchiseEd, Pre-entry Franchise Education](#)

professional advice is important to ensure that, prior to signing, a franchisee appropriately understands the nature of the agreement. Despite this, the ACCC recently found that over 40 per cent of prospective franchisees in the food services sector did not seek any independent professional advice before entering a franchise agreement.<sup>33</sup> Further, a number of stakeholders were not fully aware of the rights and support available to them under the Franchising Code or from bodies such as ASBFEO and the ACCC.

Currently the ACCC, ASBFEO, the Fair Work Ombudsman (FWO), business.gov.au, and the Australian Taxation Office (ATO) have a range of information to support franchisees on their websites.

<b>Options to address problem 1.3:</b> A potential franchisee might be unaware of which information is crucial to inform their decision to enter an agreement.	
<b>Option</b>	<b>Description</b>
Option 1.3.1	<p><b>Status quo</b></p> <p>Under this option, parties can continue to access pre-entry education, and generic advice about franchising, through a range of government and non-government websites, universities, and private training providers. Prospective franchisees can also engage professional advisors at their own expense.</p>
Option 1.3.2	<p><b>A new government online educational resource for the franchising sector</b></p> <p>Under this option, government would develop a website, consistent with Recommendation 18.2 of the PJC's <i>Fairness in Franchising</i> report.</p> <p>The proposed website could:</p> <ul style="list-style-type: none"> <li>• bring together existing information and educational material relevant to conducting due diligence and starting a franchise business (including, for example, the information referred to by the PJC in Recommendation 6.16);</li> <li>• contain information relevant to dispute resolution and the general rights and obligations of parties in the franchising sector when operating a franchise;</li> <li>• contain information relevant to all stages of the franchise relationship such as information on due diligence when entering into a franchise agreement to information on options to exit the franchise system;</li> <li>• present material for prospective franchisees from culturally and diverse backgrounds, in different languages;</li> <li>• provide business and financial literacy skills training, particularly for prospective franchisees with little or no prior business experience;</li> </ul> <p>and</p>

<sup>33</sup> Disclosure practices in food franchising: Key findings of targeted compliance checks of franchisors in the food services sector [ACCC, Disclosure practices in food franchising](#). Note, this finding is based on the results of compliance checks on 12 different franchisors.

Option	Description
	<ul style="list-style-type: none"> <li>• signpost users to relevant online content of other regulators and useful websites such as the FWO, the ACCC, the ATO and business.gov.au.</li> </ul> <p>Many stakeholders indicated that parties may not be aware of what information is crucial to their making an informed decision on entering a franchise agreement, or where to find relevant information. They indicated that a website could bring together crucial sources of information in one location.</p>
Option 1.3.3	<p>Mandate all prospective franchisees receive legal and financial advice before entering into a franchising agreement</p> <p>Under this option franchisees would be required to obtain independent legal and financial advice before they sign a franchise agreement.</p> <p>A range of stakeholders have raised mandatory legal and financial advice as an option to address a range of the problems identified by the PJC.</p> <p>Franchisees are currently either required to receive advice, or sign a statement that they have been told that advice should be sought but they have decided not to seek it.<sup>34</sup> Despite this, a range of stakeholders have submitted that a number of franchisees do not seek independent professional advice.</p> <p>This option would have no impact on prospective franchisees who are already required to obtain such advice by their franchisor. Franchisees who are not currently receiving advice, would be required to seek and obtain advice increasing the cost of their entry into a franchising agreement.</p>

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<sup>34</sup> See *Franchising Code of Conduct*, clause 10.

## Questions

1. What are the critical pieces of information that should be contained in a summary document?
2. If a national franchise register is established, what information should it contain? What would be the benefits and costs of a national franchise register?
3. There are a number of existing educational resources on franchising. What additional education options for prospective franchisees should be made available? If there was an online educational resource which brought together the available franchising education options, what would its costs and benefits be?

## Principle 2. Franchisees should have time to consider whether the relationship is right for them before committing to an agreement

The Franchising Code provides franchisees with a cooling off period of seven days to exercise an early right to terminate a franchise agreement. This *cooling off period* is separate to the 14 day *disclosure period* which operates before a franchise agreement is entered into, renewed or extended.<sup>35</sup>

Cooling off and disclosure periods give franchisees time to consider whether a franchising relationship is right for them before an agreement becomes final.

The PJC identified three potential policy problems in relation to cooling off periods:

- Cooling off rights may expire before franchisees and franchisors have adequate time to appropriately reflect on their business arrangements after entering the agreement.
- Cooling off rights may expire before lease arrangements are disclosed.
- Cooling off rights in transfers, extensions and renewals can be unclear, including with respect to franchisee to franchisee sales.

Options for each of the potential policy problems identified above are now considered in turn.

### Policy problems

#### **Problem 2.1: Cooling off rights may expire before franchisees and franchisors have adequate time to appropriately reflect on their business arrangements after entering the agreement**

The PJC heard a range of evidence on cooling off period provisions. For example, stakeholders expressed views to the PJC that cooling off periods can complete before a proper assessment of a business can be made.

A common view expressed by a number of stakeholders to the Taskforce is that an appropriate disclosure period to allow for due diligence to be undertaken prior to signing an agreement is important and that termination during the cooling off period is uncommon.

A number of stakeholders suggested that extending the cooling off period from seven to 14 days would extend the time that franchisors face uncertainty in regards to whether the franchisee will become part of the franchise system. Stakeholders submitted that this would be likely to increase costs to the franchisor, which could ultimately be borne by franchisees.

**Options to address Problem 2.1:** Cooling off rights expire before franchisees and franchisors have adequate time to review materials at entry, and reappraise their business arrangements after entering the agreement

Option	Description
Option 2.1.1	<p><b>Status quo, with clarification of the operation of existing cooling off requirements in the Franchising Code</b></p> <p>Under this option there would be no substantive changes to the regulation surrounding cooling off periods. However, clarification would be provided in the Franchising Code that the cooling off and disclosure periods are measured in calendar days (Recommendation 10.1) and that the 14 day</p>

<sup>35</sup> A 'cooling off period' is the time given to the franchisee to cancel the agreement without suffering a penalty; the 'disclosure period' is the time given to a franchisee to consider the disclosure document before they can enter an agreement.

Option	Description
	disclosure period must begin at least 14 days before the signing of a franchise agreement (Recommendation 10.3).
Option 2.1.2	<p><b>Extend cooling off to 14 days and modify the circumstances which trigger the commencement of the cooling off period</b></p> <p>Under this option franchisees would have 14 days, in contrast with the current seven days, for cooling off. This time would start after the last of the following has occurred: a franchise agreement being signed, payment to the franchisor being made, disclosure documents being received, or a copy of the lease being received (Recommendation 10.2).</p> <p>Some stakeholders have submitted that extending the cooling off period would increase uncertainty and costs for the franchisor which could ultimately be borne by the franchisee.</p>
Option 2.1.3	<p><b>Amend the Franchising Code to extend the disclosure period to 21 days, with the ability to waive part or all of this period with written agreement of both parties</b></p> <p>Under this option an extended disclosure period of 21 days would apply to new franchise agreements.</p> <p>Stakeholders have stated that franchisees could benefit from more time to undertake due diligence in assessing a franchise agreement and disclosure documents <i>prior</i> to entering an agreement.</p> <p>A longer disclosure period would not suit all franchisees, and could impose an unnecessary burden when franchisees already have business experience and/or a relationship with their franchisor. In those cases, the disclosure period could be waived by agreement between the parties.</p> <p>However, this option could also result in less disclosure time if both parties agree. Stakeholders raised that this could be problematic for some parties if they feel pressured to waive this period.</p>

## Problem 2.2: Cooling off rights may expire before lease arrangements are finalised

Evidence provided to the PJC indicated that cooling off periods could expire before lease arrangements are finalised. Stakeholders submitted that lease and site costs and terms and conditions of occupation are essential costs to be factored in when considering the viability of a business. Some stakeholders submitted that it is not possible to make reasonable assessments of the value (including costs, obligations, benefits and risks) of many types of franchise businesses without reasonable estimates of leasing costs.

Options to address Problem 2.2: Cooling off rights may expire before lease arrangements are disclosed	
Option	Description
Option 2.2.1	<p><b>Status quo</b></p> <p>Under this option there would be no substantive changes to the regulation surrounding cooling off rights and leases.</p>
Option 2.2.2	<p><b>Extend cooling off periods, transparency, and termination rights in relation to leases</b></p> <p>Under this option, lease terms (where there is franchisor involvement) would be disclosed prior to the commencement of the cooling off period, and where the disclosure does not occur the franchisee will have a right to terminate the franchise agreement (Recommendations 10.2 and 20.1).<sup>36</sup></p> <p>Franchisors have indicated that site negotiation can take a significant period of time, such that providing franchisees with a right to ‘cool off’ until a site is agreed (including the cost) would see the franchisor faced with an extended period of uncertainty. Further, where a franchisor signs a head lessee and then the franchisee utilises their cooling off right, this may leave the franchisor with a premises, but no franchisee to run the business.</p> <p>However, franchisees raised concerns that they cannot make reasonable assessments of the value (including costs, obligations, benefits and risks) of a franchise business without knowing the terms of the lease.</p>
Option 2.2.3	<p><b>Provide a new cooling off period of seven days where lease terms are 10 per cent above maximum estimates provided in disclosure documents</b></p> <p>This option would ensure that franchisees have the opportunity to reassess their agreement if leasing terms vary significantly from estimates provided in the disclosure documentation.</p> <p>Unlike Option 2.2.2, franchisors would not be penalised if they give a reasonable estimate of lease costs. This is likely to encourage franchisors to provide accurate estimates of leasing costs, helping prospective franchisees make an informed decision during the disclosure period.</p>

<sup>36</sup> Recommendation 20.1 proposes six, lengthy amendments to clause 13 of the Franchising Code and for that reason is not set out here.

Option	Description
Option 2.2.4	<p><b>Improve education and awareness around leasing and franchising</b></p> <p>Stakeholders have stated that they have often been unaware of the importance of leasing costs, and their rights and obligations in relation to these costs.</p> <p>Under this option action would be taken to improve awareness amongst franchisees of their rights under the Franchising Code and other legislation in relation to leasing arrangements, bearing in mind that leasing arrangements are within the jurisdiction of states and territories.</p>

**Problem 2.3: Cooling off rights in transfers, extensions and renewals can be unclear, including with respect to franchisee to franchisee sales**

Under the Franchising Code, cooling off periods are not provided for extensions and renewals of existing franchise agreements. However, the disclosure period does apply to renewals and extensions; franchisors are required to provide relevant disclosure documents at least 14 days before renewal or extension of the agreement.

Cooling off periods are also not available under the Franchising Code for the transfer of a franchise agreement as the current code only regulates the franchisee-franchisor relationship. Stakeholders have provided evidence that allowing a prospective franchisee a cooling off period when buying an established business from another franchisee would create uncertainty for existing franchisees who are looking to sell their business. For example, should the prospective franchisee utilise their right to cool off against the current franchisee, the current franchisee would have to continue operating the business until a new buyer could be found or the agreement other ends.

<b>Options to address Problem 2.3: Cooling off rights in transfers, extensions and renewals are unclear</b>	
Option	Description
Option 2.3.1	<p><b>Status quo</b></p> <p>Under this option there would be no changes to the regulation surrounding cooling off rights in transfers, extensions and renewals.</p>



Option	Description
Option 2.3.2	<p><b>Extend cooling off to transfers, extensions and renewals</b></p> <p>Under this option cooling off periods would be available to franchisees entering or re-entering a franchise that is transferred, renewed or extended (Recommendation 10.4).</p> <p>Stakeholders have indicated that where unilateral variations have taken place or aspects of the franchise business have changed over the life of the agreement, the franchisee may want more time to consider continuing in the relationship.</p> <p>A number of stakeholders have indicated that extending the right to a cooling off period to these scenarios could increase uncertainty and costs to the franchisor and/or the franchisee.</p>
Option 2.3.3	<p><b>Extend cooling off to transfers only</b></p> <p>Under this option cooling off periods would be extended to franchises that are transferred from an existing franchisee (part of Recommendation 10.4) only.</p> <p>Stakeholders raised concerns that allowing a prospective franchisee a cooling off period when buying an established business from another franchisee creates uncertainty and costs for the franchisee who is selling the business. Should the prospective franchisee utilise their right to cool off against the current franchisee, the current franchisee would have to continue operating the business until a new buyer could be found.</p>

## Questions

4. What are the practical implications (costs and benefits) for prospective franchisees and franchisors of increasing cooling off or disclosure periods?
5. How easy is it for franchisors to provide reasonable estimates of leasing costs before they are finalised?
6. How often are leasing arrangements finalised after the cooling off period expires? What are the implications of having the cooling off period commence after a lease is finalised?

### **Principle 3.** Each party to a franchise agreement should be able to verify the other party is meeting its obligations and is generating value for both parties

Franchisees can be required to contribute funds for shared purposes across the franchise (such as for national marketing and advertising). Generally these funds are controlled by the franchisor.

Evidence presented to the PJC suggested that some franchisees receive limited information about how franchisors use marketing and advertising funds and whether they are receiving value from the use of those funds. The PJC also heard a range of allegations that some franchisors had used the funds for expenses not related to marketing and advertising.

The issues identified by the PJC could be characterised as a potential problem in relation to the transparency of marketing funds. Options to address this problem are considered below.

#### **Policy problems**

##### **Problem 3.1 Marketing funds are not always transparent**

Almost all franchise systems engage in marketing and advertising of some description, and many utilise a central marketing fund to support these activities. Marketing funds are typically made up of fees paid by franchisees to franchisors.

Evidence submitted to the PJC suggested that the operation of marketing funds are in many cases not sufficiently visible to the franchisee. This can make it difficult for franchisees to verify that the fund is being used for legitimate and reasonable purposes.

Stakeholders have provided the view that limited visibility on the use of marketing funds tends to reduce confidence in a franchise system and may result in disputes.

The Franchising Code was amended in 2015 to increase transparency around the operation of marketing funds. It requires franchisors to hold separate accounts for marketing funds and to require these funds be used for legitimate marketing expenses (clause 31). Franchisors are required to disclose information on the operation of the marketing fund (Annexure 1, Item 15) and provide an annual financial statement of the marketing fund with 'meaningful information' (clause 15).

A majority of franchisees and their representatives, and some franchisors and professional advisers, supported additional transparency on how marketing funds are used. A small number of franchisees also suggested that funds should only be used with the agreement of franchisees.

Franchisors noted that there would be a significant administrative and cost burden if more frequently audited financial statements for funds were required. In some cases, franchisors indicated they may cease operating funds, preferring to increase royalty fees to cover marketing costs.

<b>Options to address Problem 3.1</b> Transparency of marketing funds	
<b>Option</b>	<b>Description</b>
Option 3.1.1	<p><b>Status quo</b></p> <p>Under this option, there would be no changes to the Franchising Code. Over time, additional case law could work to improve the understanding of legitimate marketing expenses.</p>
Option 3.1.2	<p><b>Address inconsistency in the Franchising Code on the treatment of marketing funds and increase reporting standards</b></p> <p>Under this option the Government would improve consistency within the Franchising Code in relation to the treatment of marketing funds, particularly clauses 15 and 31 (Recommendation 6.7), introduce civil pecuniary penalties for a breach of clause 31 (Recommendation 6.8), increase the frequency and standards of reporting of marketing funds (Recommendation 6.9), require master franchisors to meet requirements of marketing funds (Recommendation 6.10), and clarify the distribution of marketing funds in the event of franchisor insolvency (Recommendation 6.12).</p> <p><b>Option 3.1.2 (a) Improve consistency within the Franchising Code about the treatment of marketing funds, particularly clauses 15 and 31</b></p> <p>The Franchising Code would be changed to clarify obligations with respect to marketing funds, possibly by clarifying what would be ‘meaningful information’ for the purposes of clause 15 of the Franchising Code. This could assist parties in understanding their obligations.</p> <p><b>Option 3.1.2 (b) Introduce civil pecuniary penalties for a breach of clause 31</b></p> <p>Creating a civil pecuniary penalty for marketing fund provisions in clause 31 will deter breaches of the Franchising Code. Penalties for non-compliance may boost confidence in the operation of marketing funds.</p> <p><b>Option 3.1.2 (c) Increase the frequency and standards of reporting of marketing funds</b></p> <p>Franchisors are currently required to produce annual statements for the use of marketing funds. By increasing the frequency of required reporting to quarterly (Recommendation 6.9), franchisees would have access to more up to date information on the use of marketing funds than is currently required. Stakeholders have submitted that franchisees may have to bear the cost of increased reporting but may not receive an overall benefit from increased information.</p>

Option	Description
	<p><b>Option 3.1.2 (d) Require master franchisors to meet requirements of marketing funds</b> Improved understanding will likely arise from making the requirements consistent between clause 15 and 31 and ensuring their application to master franchisors (Recommendation 6.10).</p> <p><b>Option 3.1.2 (e) Clarify the distribution of marketing funds in the event of franchisor insolvency</b> Clarifying the distribution of unspent marketing funds (Recommendation 6.12) would give provide greater transparency of the operation of marketing funds in the event of franchisor insolvency.</p> <p>A number of stakeholders have stated that a potential unintended consequence of increasing the administration requirements of managing marketing funds is that, should the costs and risks of administration become too onerous, franchisors may choose not to operate shared marketing funds and instead recoup marketing costs through other means (such as franchise system fees).</p>
Option 3.1.3	<p><b>Increase awareness and provide guidance around existing legal obligations</b> Under this option, additional efforts would be made to educate the franchising sector on their existing legal obligations on the use of marketing funds, and clearer guidance could be provided around the preparation of financial statements (Recommendation 6.11).</p> <p>Stakeholders have suggested that improved interpretation of the existing provisions may reduce the incidence of disputes over the use of marketing funds. Case law and court decisions which interpret ‘legitimate marketing expenses’ will provide examples and clearer guidance to the franchising sector.<sup>37</sup></p>

## Questions

7. What would ‘meaningful information’ look like in terms of marketing fund disclosure?
8. How does the benefit of increased frequency of reporting of marketing funds compare to the costs of increased administration?

<sup>37</sup> Recent authorities on the nature of marketing funds include *Ultra Tune Australia Pty Ltd v Australian Competition and Consumer Commission* [2019] FCAFC 164, and *Re Stay In Bed Milk & Bread Pty Ltd (In Liq)* [2019] VSC 181.

## Principle 4. A healthy franchising model fosters mutually beneficial cooperation between the franchisor and the franchisee, with shared risk and reward, free from exploitation and conflicts of interest

Franchise agreements should provide the basis for healthy ongoing cooperation between franchisors and franchisees where both parties work towards offering products and services that deliver value to customers. Consistent with this principle, the Franchising Code contains an obligation on the parties to a franchise agreement to act with good faith towards one another.

The PJC identified three potential policy problems around supplier rebates, capital expenditure and unilateral variations:

- supplier rebates can lead to conflicts of interest;
- conflicts of interest in the context of capital expenditure; and
- unilateral variations can lead to conflicts of interest and exploitation.

A potential conflict of interest may arise when one party has an incentive to act in a way that would benefit itself at the expense of the another party.

Options for each of the potential policy problems identified above are now considered in turn.

### Policy problems

#### Problem 4.1 Supplier rebates can lead to conflicts of interest

The PJC heard evidence from franchisees about problems in relation to supplier rebates arising from a potential conflict of interest between franchisors and franchisees. Supplier rebates are a feature across a number of franchising models. Many franchisors receive rebates based on the purchases made by its franchisees from suppliers. These rebates may then be shared between the franchisee and franchisor, passed through to the franchisee, or kept in whole by the franchisor. A conflict arises when supplier rebates are kept by the franchisor, as this can create an incentive for the franchisor to source products with high rebates, rather than products that are of the best value for a franchisee.

The Franchising Code already seeks to address potential conflicts of interest with supplier rebates through disclosure requirements. Current requirements include disclosure of whether the franchisee is to maintain a level of inventory or acquire an amount of goods or services, any restrictions on acquisition of goods, and whether rebates or other financial benefits will be received from the supply of goods or services to franchisees. However, franchisors are not required to disclose the amount of any rebates that they may receive.

Options to address Problem 4.1 Supplier rebates can lead to conflicts of interest	
Option	Description
Option 4.1.1	<b>Status quo</b> Under this option, there would be no changes to the Franchising Code in relation to supplier rebates.

Option	Description
Option 4.1.2	<p><b>Address conflicts of interest in the handling of supplier rebates to franchisors by requiring increased disclosure</b></p> <p>Under this option, the Franchising Code would be amended to increase disclosure requirements for supplier rebates, with franchisors required to disclose:</p> <ul style="list-style-type: none"> <li>• provision of data on resale pricing and purchase prices of items sold by franchisees (Recommendation 7.1)</li> <li>• all supplier rebates as a percentage of purchase price for franchisees (Recommendation 8.1)</li> <li>• the relative proportions of the supplier rebate retained by the franchisor and directed to franchisees (Recommendation 8.2), and</li> <li>• supplier rebates received by the master franchisor, if there is one (Recommendation 8.4).</li> </ul> <p>Stakeholders have indicated that there may be practical difficulties in providing this disclosure, particularly around commercial-in-confidence information, which suppliers in particular may not want shared.</p>
Option 4.1.3	<p><b>Prohibition of supplier rebates in circumstances where franchisor specifies maximum franchisee sale prices</b></p> <p>Under this option, supplier rebates will be prohibited under certain conditions, such as where the franchisor controls the franchisee’s sales prices and the suppliers available to the franchisee.</p> <p>Franchisees have indicated that in circumstances where franchisors specify maximum sale prices, supplier rebates can be particularly problematic, and lead to decreased profitability.</p> <p>A number of stakeholders have submitted that such changes could have a significant impact on business models, and could also lead to the use of even less transparent funding approaches.</p>

**Problem 4.2 Conflicts of interest in the context of capital expenditure**

The PJC noted that some capital expenditure is ‘necessary in order for a franchise system to remain competitive and respond to changing market conditions’. However, evidence presented to the PJC indicated it can also have significant negative impacts on franchisees who may be required to invest, but not be able to recoup the value of that investment (for example, when the franchise agreement is not renewed).

In 2015, a prohibition on the imposition of significant capital expenditure was introduced into the Franchising Code. However, there are a number of exceptions to what is considered ‘significant capital expenditure’ for the purposes of the prohibition, including expenditure which is disclosed and

expenditure the franchisor considers necessary ‘as a capital investment in the franchised business’, but only if the expenditure is justified by a written statement with prescribed requirements.<sup>38</sup>

<b>Options to address Problem 4.2 Conflicts of interest in the context of capital expenditure</b>	
<b>Option</b>	<b>Description</b>
Option 4.2.1	<p><b>Status quo</b></p> <p>Under this option, there would be no change to regulatory settings.</p> <p>New provisions placing constraints on capital expenditure introduced in 2015 will remain in place for all new franchising agreements.</p>
Option 4.2.2	<p><b>Modify the Franchising Code to define significant capital expenditure and provide rights for franchisees to recoup the value of significant capital expenditure</b></p> <p>Under this option, the Franchising Code would be amended to define ‘significant capital expenditure’ and to introduce an obligation on the franchisor to ensure franchisees receive a return on capital expenditure (Recommendation 21.1). Annexures 1 and 2 to the Franchising Code would be amended in accordance with the resultant change to clause 30 (Recommendations 21.2 and 21.3).</p> <p>Inadvertently reducing the ability of a business to be responsive to changes in consumer demands is a potential unintended consequence of narrowly defining ‘significant capital expenditure’. Stakeholders raised concerns that increased regulation of capital expenditure will increase compliance costs and reduce flexibility in franchise businesses to respond to a changed business environment.</p>
Option 4.2.3	<p><b>Clarify franchisee rights when significant capital expenditure is required</b></p> <p>Stakeholders are often unclear on their rights. This option would amend clause 30 to clarify and support franchisee rights in the imposition of significant capital expenditure.</p> <p>While the current prohibition on imposition of expenditure would remain (clause 30(1)), the exceptions in clause 30(2) would be amended to clarify the rights of franchisees to review or challenge capital expenditure, particularly where the exception in clause 30(2)(e) is used.</p>

<sup>38</sup> See clause 30 of the Franchising Code.

### Problem 4.3 Unilateral variations can lead to conflicts of interest and exploitation

Stakeholders have submitted that franchise agreements often permit the franchisor (but not the franchisee) to vary the terms of the agreement, without the explicit consent of the franchisee. This is often referred to as a ‘unilateral variation’ of the franchise agreement.

The PJC and the Taskforce received evidence that the practice of unilateral variation of franchise agreements (and associated documents such as operations manuals) is widespread in the franchise sector.

The current Franchising Code requires franchisors to disclose the circumstances in which the franchisor has unilaterally varied a franchise agreement in the last three financial years (including, if applicable, financial years before this code came into force). Variations of a minor nature are excluded from this requirement.

Options to address problem 4.3 Unilateral variations can lead to conflicts of interest and exploitation	
Option	Description
Option 4.3.1	<p><b>Status quo</b></p> <p>Under this option, there would be no changes to regulatory settings.</p>
Option 4.3.2	<p><b>Banning or limiting the circumstances in which franchisors can unilaterally vary franchise agreements</b></p> <p>Under this option, the Franchising Code would be amended to ensure unilateral variations to franchise agreements can only be made with the agreement of the majority of franchisees or representatives elected by a majority of franchisees (Recommendation 9.7). It would also restrict unilateral variations to franchise <i>manuals or policies</i> without the agreement of the majority of franchisees or representatives elected by a majority of franchisees (Recommendation 9.8). Finally, it would include the proposed prohibitions on franchisors passing on the legal cost of preparing and executing documents, unilateral variation of terms of conditions of the agreement (including retrospective variations) and franchisors charging wastage and shrinkage payments (Recommendation 16.2).</p> <p>Many stakeholders have submitted that limiting or prohibiting the use of unilateral variation would reduce or eliminate the incidence in which a contract change undermines a franchise agreement or relationship.</p> <p>However, a range of stakeholders have also submitted that there are likely to be significant unintended consequences as a result of this option. Stakeholders have submitted that limiting unilateral variations would inhibit or slow down decisions that benefit the franchise network. Franchisors, for example, argued unilateral variations are necessary to meet changing legal requirements or unexpected market developments. Even simple business changes may need to be negotiated, increasing costs and slowing down the</p>



Option	Description
	<p>responsiveness for franchisees and franchisors. The inability to respond to market changes quickly or at all could leave business models unviable.</p>
Option 4.3.3	<p><b>Increase awareness around legal rights</b></p> <p>Under this option, additional efforts would be made to educate the franchising sector on legal rights and obligations around contract and business change.</p> <p>A number of stakeholders were unclear about their legal rights in relation to unilateral contract variation.</p> <p>New regulation of unilateral variation would not be introduced, but parties to a franchise agreement would be better informed of their rights and ability to negotiate. This additional education and awareness raising could be made through the use of government and industry association websites, as well as professional advisors.</p>

## Questions

9. What information should franchisors disclose in relation to supplier rebates? Are there any barriers to providing this?
10. If franchisors are required to ensure franchisees get a return on their significant capital expenditure, how might this be done in practice?
11. If franchisees are given a right to review capital expenditure business cases (which must be presented to franchisees by the franchisor under clause 30(2)(e) of the Franchising Code for expenditure that the franchisor considers is necessary for capital investment), how would this right be exercised?

## Principle 5. Where disagreements turn into disputes, there is a resolution process that is fair, timely and cost effective for both parties

Negotiations and disagreements between franchisors and franchisees can be part of a healthy business relationship. When disputes arise, accessible, affordable and effective dispute resolution processes are important.

The PJC heard that franchisees are often unaware of dispute resolution processes that are available to them and observed that the various channels for dispute resolution can be confusing. It also heard many alleged instances of franchisors not mediating in good faith. The PJC noted that cost-effective and timely dispute resolution may not be a realistic option for many parties when mediation fails.

The PJC expressed the view that in certain circumstances a determinative procedure such as arbitration is required. Arbitration is more expensive than mediation, however it can deliver a binding outcome for parties. Many stakeholders suggested that it is likely to be cheaper and more flexible than pursuing court action.

The PJC identified a potential policy problem around dispute resolution. Options to address this problem are considered below.

### Policy problems

#### **Problem 5.1: Some disputes are not being resolved in a fair, timely and cost effective manner**

Statistics from ASBFEO indicate that disputes are resolved with consistently high success and satisfaction rates.<sup>39</sup> A number of stakeholders have cautioned the interpretation of these statistics, noting that although the majority of cases are resolved, they may not be on terms that are reasonable for the franchisee. The PJC heard that a number of disputes had not been resolved effectively through mediation.

While a number of franchisees and franchisors appear to have had success with mediation, this is not everyone's experience.

Under the current system, where disagreements cannot be resolved, parties can get information and assistance with non-court dispute resolution services under the mediation provisions of the Franchising Code (administered by ASBFEO), ASBFEO (which allocates a dedicated case manager to each matter to guide parties through the process), state small business commissioners, and private providers.

Under the dispute resolution system administered by ASBFEO, the average length of mediation processes is around seven hours, with an additional three hours required for the administration of and preparation for the mediation. Average costs of a mediator under this scheme are between \$2,000 and \$3,000, with a Commonwealth capped fee of \$300 per hour.<sup>40</sup>

A wide range of stakeholders have raised concerns around access to justice in cases where mediation fails. Stakeholders have submitted that determinative dispute resolution through the courts is in most cases prohibitively expensive. They see the introduction of an additional pre-litigation dispute resolution mechanism, such as conciliation or arbitration, as useful for facilitating

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<sup>39</sup> Advice from the Australian Small Business and Family Enterprise Ombudsman, October 2019.

<sup>40</sup> Advice from the Australian Small Business and Family Enterprise Ombudsman, October 2019.

dispute resolution outside of court in cases where mediation fails, but they stress the need for any such processes to remain low-cost and time efficient.

Stakeholders also raised concerns that it is unclear whether existing provisions in the Franchising Code enable multi-party mediations.

<b>Options to address Problem 5.1:</b> Some disputes are not being resolved in a fair, timely and cost effective manner	
<b>Option</b>	<b>Description</b>
Option 5.1.1	<p><b>Status quo</b></p> <p>Under this option, parties would continue to be able to get information and assistance with non-court dispute resolution services under the Franchising Code mediation process administered by ASBFEO, state small business commissioners, and private providers.</p>
Option 5.1.2	<p><b>Expand options for dispute resolution, and streamline mediation procedures and services</b></p> <p>Under this option, government would merge the Office of the Franchising Mediation Adviser (<b>OFMA</b>) and ASBFEO (Recommendation 15.1), strengthen third party involvement in dispute resolution (Recommendations 15.1 and 15.2), clarify the availability of multi-party mediation (Recommendation 15.2) and require that mediation and then arbitration commence within a specified time period once a mediator or arbitrator has been appointed (Recommendation 15.2).</p> <p><b>Option 5.1.2(a) Merge OFMA and ASBFEO</b></p> <p>Under this option the Mediation Adviser role under the Franchising Code would be merged with the dispute resolution functions conducted by ASBFEO. This would formalise existing administrative arrangements. Funding a combined body, including through an industry levy based on numbers of complaints, and enabling the referral of systemic or serious matters to regulators would also be considered under this option.</p> <p>This option could provide more clarity around dispute resolution services available to parties, and their rights around mediation.</p> <p>Many stakeholders indicated in consultation that they were not aware of dispute resolution processes when disputes arose in their franchise.</p> <p><b>Option 5.1.2(b) Strengthen third party involvement in dispute resolution, including pathways for binding dispute resolution</b></p> <p>Under this option, dispute resolution options could be expanded by explicitly providing for arbitration in the Franchising Code. The Taskforce notes that this recommendation involves complex legal considerations, which may limit, or even prevent, the ability of the Commonwealth to compel parties to participate in arbitration.</p>

Option	Description
	<p>Stakeholders have indicated that these options are likely to provide a more time and cost-effective alternative to court when mediation fails.</p> <p><b>Option 5.1.2(c) Clarify the availability of multi-party mediation</b>  Under this option, existing dispute resolution and industry bodies would be encouraged to provide further information about dispute resolution services, and the availability of multi-party options. This may also involve amending the Franchising Code to clarify the existing policy intent that multi-party mediation be available to resolve disputes.</p> <p>Many stakeholders indicated that they were unaware of their ability to engage in multi-party mediation. This could increase transparency and result in greater power for franchisees in dispute resolution.</p> <p><b>Option 5.1.2(d) Require that mediation and then arbitration commence within a specified time period once a mediator or arbitrator has been appointed</b>  Under this option, the Franchising Code would explicitly require that mediation and (if adopted) arbitration commence within a specified time period.</p> <p>This option could ensure that disputes are handled in a more timely manner.</p>
Option 5.1.3	<p><b>Clarify the complaint handling procedure requirements in the Franchising Code, to require dispute resolution processes be included in franchise agreements. Provide best practice guides for these processes (including options and timeframes).</b></p> <p>Under this option, best practice guidelines would be developed for the management of dispute resolution. This option would sit in addition to existing guidance provided within the Franchising Code.</p> <p>This option could allow for voluntary binding arbitration, a potentially lower cost dispute resolution option than the courts or drive its uptake where it already exists. This could also ensure that disputes are handled in a timely manner, by specifying timeframes.</p>

## Questions

12. A number of stakeholders have told the Taskforce that the cost of arbitration can be comparable to going through the court system, and that conciliation may be a preferable alternative alongside mediation. In what circumstances could conciliation be an effective alternative dispute resolution process?
13. Would you consider including arbitration to resolve disputes in your franchising agreement, if a clear voluntary option were provided?

## Principle 6. Franchisees and franchisors should be able to exit in a way that is reasonable to both parties

The Franchising Code requires that the disclosure document contain information about what will happen at the end of the franchise agreement (Annexure 1, Item 18 of the Franchising Code). The Franchising Code also contains provisions limiting the use of restraint of trade clauses where the franchisee is not compensated for goodwill (among other requirements) (clause 23 of the Franchising Code), and procedural requirements that the franchisor must follow in terminating the franchise agreement (clauses 27 – 29 of the Franchising Code).

The PJC has identified three potential policy problems around exit arrangements:

- Reasonable exit arrangements may not be, or may not be perceived to be, available or accessible for some franchisees.
- Excessive restraint of trade clauses may inhibit lawful pursuit of subsequent business interests.
- There are different expectations around the treatment of goodwill in franchise arrangements.

Options for each of the potential policy problems identified above are now considered in turn.

### Policy problems

#### **Problem 6.1 Reasonable exit arrangements may not be, or may not be perceived to be, available or accessible for some franchisees**

Stakeholders indicated to the PJC that franchise agreements may not provide a clear pathway for franchisee-initiated exit, and that in many cases franchisees have difficulty exiting franchise agreements without large financial losses. The Franchising Code describes termination only by franchisor instigation, and there is no requirement that franchise agreements provide a process for exit.

The Taskforce heard from a number of stakeholders on exit arrangements. Franchisors were generally opposed to termination rights for franchisees, arguing that they should not bear the entire risk of a franchise site and that increases in franchisor risk would be reflected in higher franchise fees (e.g. franchise royalties).

The PJC identified that under the current provisions, franchisees may exit the franchise system via one of the following five avenues:

- contract termination by the franchisor;
- non-renewal of the franchise agreement by the franchisor or franchisee;
- re-acquisition of the franchised outlet by the franchisor;
- abandonment of the store by the franchisee; and
- transfer of the store to a new franchisee.

**Options to address Problem 6.1:** Reasonable exit arrangements may not be, or may not be perceived to be, available or accessible for some franchisees

Option	Description
Option 6.1.1	<p><b>Status quo</b></p> <p>Under this option, there would be no changes to the regulation surrounding exit arrangements.</p> <p>Actual franchisee-exit rights would continue to be determined primarily by the franchise agreement itself (with the exception of the right to ‘cool off’, discussed under Principle 2) and the general law relating to termination of contracts.</p>
Option 6.1.2	<p><b>Limit termination in circumstances where the franchisee seeks mediation, and/or breaches have occurred for fraud or public health and safety reasons, and introduce statutory termination rights into the Franchising Code</b></p> <p><b>Option 6.1.2(a) Additional requirements where the franchisor is terminating in special circumstances</b></p> <p>Under this option, government would amend the Franchising Code to limit termination in special circumstances (as defined in clause 29 of the Franchising Code). This would involve allowing a franchisee to lodge a notice of dispute with an external party when a franchisor proposes to terminate in special circumstances (for example because the franchisee has been convicted of a serious offence), and preventing the termination from having effect until the dispute is resolved (Recommendation 11.4), and limiting termination in relation to fraud or public health and safety issues unless fraud is proved or breaches remain remedied (Recommendation 11.5).</p> <p>Some stakeholders have argued that limiting franchisor-initiated termination could allow franchisees to more effectively negotiate breach claims with their franchisor.</p> <p>Stakeholders, primarily franchisors, have raised concerns that franchisors need to have effective termination provisions in order to protect the franchise brand – delaying or preventing termination may cause reputational damage that effects the entire franchise network and its remaining franchisees.</p> <p><b>Option 6.1.2(b) Provide statutory termination rights to franchisees</b></p> <p>Under this option, government would amend the Franchising Code to provide pathways for franchisee-initiated exit in circumstances of hardship, exploitation or business failure (Recommendation 11.1), and to align with the special circumstances provisions regarding franchisor termination (Recommendation 11.2).</p>

Option	Description
	<p>Some stakeholders have agreed with the PJC’s view that there should be a franchisee initiated termination process under the Franchising Code. It is argued that without termination rights, franchisees are entirely subject to the franchisor for the duration of the agreement.</p> <p>Some stakeholders, primarily franchisors and professional advisors, claim that introducing franchisee termination rights may affect the franchisor’s ability to make long-term investment decisions due to the reduced certainty of the contract, and may also lead to a higher turnover in franchise systems.</p> <p>Furthermore, some stakeholders claim that not all franchisees exit their franchise in good faith, arguing that franchisees should not be permitted an easy exit from their contract for reasons outside the franchisor’s control, such as unfavourable economic conditions.</p> <p><b>Option 6.1.2(c) Holding rent payments from franchisees in trust</b> Under this option franchisors would be required to hold rent payments from franchisees in trust and only use those payments for the franchisee’s rental expenses, including if the franchisor is wound up (Recommendation 20.3).</p>
Option 6.1.3	<p><b>Clarify the termination processes available to franchisees and support greater awareness of negotiation pathways</b> Under this option, government would clarify the termination processes available to franchisees and support greater awareness of negotiation pathways through education and the incorporation of common law principles into the Franchising Code. In brief, the common law principle is that a restraint of trade clause is only enforceable to the extent that it is necessary to protect the legitimate interests of the party seeking to enforce it.</p> <p>A number of stakeholders have indicated that current termination processes and pathways are unclear, or that they are unaware of their current rights. Educational material could be developed to help franchisees understand what processes and negotiation pathways are available in relation to the termination of a franchise agreement, including those under the common law. This material could be provided through a platform such as a government website or through additional pre-entry material provided to prospective franchisees by the franchisor. Education material would stress that parties should obtain their own legal advice before taking any action.</p> <p>Stakeholders have suggested that this could assist franchisees and franchisors to make more informed decisions with regards to their franchise agreement. It may also simplify exit arrangement negotiations between franchisees and franchisors by making the franchisee’s termination rights more explicit.</p> <p>Examples of franchisee-initiated termination processes under the common law include cases of franchisor misrepresentation. This may occur if a</p>



Option	Description
	franchisor has falsely misrepresented franchisee costs (for example set-up costs or capital expenditure), or have failed to disclose information that is vital to the viability of the franchisee's business.

**Problem 6.2 Excessive restraint of trade clauses may inhibit lawful pursuit of subsequent business interests**

Franchise agreements may contain restraint of trade clauses which restrict the ways in which a franchisee may engage in certain business activities once the franchise agreement has ended.

The PJC heard that restraint of trade clauses may unreasonably limit future trade opportunities for ex-franchisees who cannot contest these clauses due to financial constraints. In some cases this had a considerable impact on the ex-franchisees future prospects and ability to pay back existing debt. Preventing franchisees from independently re-entering the market can also be a competition issue where it acts to materially reduce the level of competition that would have otherwise existed.

The Franchising Code and the common law regulate the use of restraint of trade clauses. Clause 23 of the Franchising Code outlines when a restraint clause has no affect. Some submissions to the PJC and the Taskforce argue the current provisions do not go far enough. The PJC noted that clause 23 has only been in operation for a few years, and further time may be needed to assess its effectiveness.

**Options to address problem 6.2:** Excessive restraint of trade clauses may inhibit lawful pursuit of subsequent business interests.

Option	Description
Option 6.2.1	<p><b>Status quo</b></p> <p>Under this option, there would be no changes to the regulation surrounding restraint of trade clauses. The common law would continue to apply as it does now.</p>
Option 6.2.2	<p><b>Amend franchising agreement requirements and clarify wording of clause 23 of the Franchising Code</b></p> <p>Under this option, government will amend the Franchising Code to include that franchising agreements must explain that if they are not in compliance with clause 23 of the Franchising Code, restraint of trade clauses are of no effect and not enforceable by the franchisor (as per the intent of Recommendation 13.2). Clarification of what constitutes a breach for the purposes of clause 23(1)(b) will be provided and 'at time of expiry' will be inserted at the beginning of paragraph 23(1)(b) (Recommendation 13.3).</p> <p>Stakeholder consultation has identified that many franchisees are unaware of their rights in relation to restraint of trade. Raising awareness of current restraint of trade provisions may reduce disputes over restraint clauses.</p>

Option	Description
	On the other hand, some franchisors have argued that restraint of trade clauses also protect other franchisees from unfair competition by former franchisees, who seek to use the system's intellectual property against them.
Option 6.2.3	<p><b>Codify common law that restraints of trade should go no further than reasonable to protect legitimate interests</b></p> <p>Under this option, the Franchising Code would be amended to include common law principles to protect franchisees against unreasonable restraints of trade clauses within their franchise agreement.</p> <p>Franchisees have expressed that introducing common law principles into the Franchising Code will bring attention to the rights that franchisees are already entitled to but that they may be unaware.</p>

**Problem 6.3 There are different expectations around the treatment of goodwill in franchise arrangements**

Currently, the Franchising Code does not provide guidance in relation to goodwill, other than to clarify how goodwill may affect restraints of trade under clause 23. Stakeholders have stated that generally, franchise agreements do not provide for the franchisee to be compensated for goodwill at the end of their term.

Some franchisees expressed to the PJC that they had paid for goodwill upon entering the franchise but were not compensated for it at the end of their agreement. Many franchisees submit that they are responsible for building goodwill in the business through the quality of their customer service and local contacts. Franchisors on the other hand, generally argue that it is the brand and the system that is responsible for any goodwill, not the franchisee.

<b>Options to address problem 6.3:</b> There are different expectations around the treatment of goodwill in franchise arrangements.	
Option	Description
Option 6.3.1	<p><b>Status quo</b></p> <p>Under this option, there would be no changes to the regulation surrounding the treatment of goodwill in franchise arrangements. Franchisee's goodwill arrangements would continue to be determined by the franchise agreement itself.</p>
Option 6.3.2	<p><b>Clarify the franchisees' rights in regard to goodwill, if any, in the franchise agreement</b></p> <p>Under this option, franchisors will be required to fully clarify the franchisee's rights in relation to goodwill in the franchise agreement (as per the intent of Recommendation 12.1 and 12.2).</p> <p>Stakeholders have indicated this would make it more likely that franchisees' and franchisors' expectations are aligned at disclosure, and assist franchisees in making a more informed decision before entering into the franchise</p>

Option	Description
	<p>agreement. Stakeholders have indicated this could help minimise disputes at the end of, or at a later point in the agreement.</p> <p>Assuming the franchisee is entitled to goodwill, this option will still require the development of a method for goodwill calculation. The PJC and the Taskforce’s consultation has identified that this is a complex task.</p>
Option 6.3.3	<p><b>Increase awareness of how goodwill is handled in franchising</b></p> <p>Under this option, prospective franchisees would be encouraged to seek information on franchise systems’ handling of goodwill through pre-entry advice and other educational material, which could be made available through channels such as the proposed franchising information website.</p> <p>This option could address misalignment of expectations surrounding franchise goodwill, without increasing the regulatory burden or lengthening the disclosure document.</p>

## Questions

14. Under what circumstances should franchisees be allowed a no-fault exit from the franchise system?
15. If goodwill was required to be fully clarified in the franchise agreement, how might this be done in practice? What would be the costs and benefits of this approach?

## Principle 7. The framework for industry codes should support regulatory compliance, enforcement and appropriate consistency

The *Industry Codes of Conduct Policy Framework* sets a high threshold for government to intervene in a market with an industry code of conduct. The Framework sets out that these codes are not intended to regulate every aspect of an industry. Each code is designed to target a specific problem in a defined industry in order to limit government intervention in a market.

The PJC's Terms of Reference (part (a)) asked for an examination of the effectiveness of the Oil Code and the Franchising Code. Specifically in relation to differences between these codes, part (d) directed the PJC to examine:

whether the provisions of other mandatory industry codes of conduct, such as the Oil Code, contain advantages or disadvantages relevant to franchising in comparison with terms of the Franchising Code of Conduct.

The PJC acknowledged submissions from franchisors noting inconsistencies between the Oil Code and the Franchising Code. Evidence presented to the PJC indicated that despite these often minor inconsistencies that the Oil Code operates well and has some industry specific content that is not replicated in the Franchising Code. Some submissions advocated strengthening the penalty regime that applies to both codes in order to encourage compliance, although little evidence was given that non-compliance with the Oil Code is a general concern.

The PJC identified two potential policy problems around the industry code framework:

- Some franchisors experience additional regulatory burden from having to comply with both the Franchising Code and the Oil Code; and
- Compliance with the Franchising Code, Oil Code and where relevant the CCA, remains imperfect.

Options for each of the potential policy problems identified above are now considered in turn below.

### Policy problems

#### **Problem 7.1: Some franchisors experience additional regulatory burden from having to comply with both the Franchising Code and the Oil Code**

The PJC observed that the Franchising and Oil Codes have evolved separately since 2006 when they were developed as separate regulatory mechanisms. Before this time they were combined in one regulatory framework. While each code regulates unique industry specific issues and business practices, there are some requirements of the codes that are different but not unique to each industry, for example disclosure and termination processes.

Franchisors that operate non-fuel sites under the Franchising Code and fuel sites under the Oil Code may face inconsistencies between the two codes. These inconsistencies are found in disclosure requirements, termination provisions, cooling off periods, and marketing funds and fees. Other differences include the absence of civil penalties for breaches and lack of a good faith provision in the Oil Code. Submissions noted these inconsistencies. However, they did not present evidence of the confusion or identify these differences as a primary concern or point of regulatory failure within the framework and it is common for businesses to operate under different regulations.

Some submissions identified that having two separate codes avoids complexity as single retailers and wholesalers need only comply with one code. Submissions indicated a mixed response to the current availability of civil penalties across the codes. Submissions noted that the 2016 review of the Oil Code noted the absence of a good faith provision in the Oil Code and the conclusion that this was appropriate for the fuel industry. No evidence was presented to support the proposition that penalties in the Oil Code are needed to support its operation which is seen to be effective.

A small number of franchisors must simultaneously comply with both the Franchising Code and the Oil Code. This occurs when franchisors have franchisees operating fuel and non-fuel sites. Similarly, franchisees operate under two codes if they have one franchise fuel site and one franchise non-fuel site. This is a much less likely scenario.

The Franchising Code has been reviewed and amended multiple times. In comparison the Oil Code has been reviewed only twice since 2006 and its original provisions remain largely unchanged. Each code was designed to apply to unique industries and the content has evolved separately and in consultation with each industry. There is no mechanism that ‘couples’ the content, in full or part, of the two codes. Inconsistencies may be intentional due to the codes regulating two distinct industries with different requirements such as fuel sales and occupational health and safety requirements. In many cases inconsistency across codes may have no material effect. The 2016 review of the Oil Code concluded that it was operating effectively.

**Options to address Problem 7.1:** Some franchisors experience additional regulatory burden from having to comply with both the Franchising Code and the Oil Code

Option	Description
Option 7.1.1	<p><b>Status quo</b> Under this option there would be no changes to the regulatory framework.</p>
Option 7.1.2	<p><b>Increase the number of common provisions between the Oil and Franchising Codes to reduce the regulatory burden for some franchisors</b> Under this option, one or more of the following recommendations made by the PJC would be adopted:</p> <ul style="list-style-type: none"> <li>(a) Align the Oil Code with the Franchising Code in relation to marketing funds and fees (Recommendation 6.13)</li> <li>(b) Align the Oil Code disclosure provisions with the Franchising Code (Recommendations 10.5 and 10.6)</li> <li>(c) Align clause 36 of the Oil Code for termination in special circumstances with clause 29 of the Franchising Code (Recommendation 11.3)</li> <li>(d) Implement ACCC-recommended penalty regime, including significantly increasing the quantum of civil pecuniary penalties for a breach of the Franchising Code and introducing the same civil penalties to the Oil Code (Recommendation 16.1)</li> <li>(e) Align the Oil Code with the Franchising Code where any amendments are made to the Franchising Code (Recommendation 16.3)</li> <li>(f) Ensure that industry codes remain aligned over time (Recommendation 17.2)</li> </ul>

Option	Description
	<p>Under this option the regulatory burden would be reduced for a small number of franchisors that must comply with both codes. This could reduce any confusion experienced by franchisors that operate both non-fuel related franchises and fuel-retailing franchises, however it is uncertain whether these benefits outweigh the costs given the small number of franchisors that must comply with both codes.</p> <p>Eliminating some inconsistencies but maintaining separate Franchising and Oil Codes would mean that, as conditions change, and new regulatory issues arise in each industry, these issues can be dealt with on a case-by-case basis. To avoid this consistency being isolated to a 'point in time', notes could be included in each Code to indicate which provisions are harmonised across the codes. This would act as a potential safeguard to avoid unintended further inconsistencies.</p>
Option 7.1.3	<p><b>Repeal the Oil Code of Conduct and add specific fuel retailing provisions (such as terminal gate pricing) to the Franchising Code</b></p> <p>Under this option the Oil Code would be repealed and specific fuel retailing provisions (such as terminal gate pricing regulations) would be added to the Franchising Code. In effect, the Franchising Code would be applied to fuel supply agreements. Fuel retailing specific regulations would be added to the Franchising Code to ensure equivalent protections as are available under the current Oil Code.</p> <p>This option may reduce regulatory compliance costs associated with needing to comply with separate and inconsistent industry codes. Regulations applying to franchising and fuel supply arrangements would also remain consistent over time.</p> <p>However, one cost of this option could be that regulation of each sector may become less industry-specific and more generalised. Compromises may need to be made to balance the specific needs of the non-fuel retailing franchise sector and fuel retail/supply industry.</p> <p>There may also be significant costs associated with the introduction of a new framework. Fuel retailers, suppliers and potentially non-fuel retailing franchisees/franchisors would incur once-off regulatory compliance costs associated with switching over to a new and unfamiliar regulatory regime. There would also be a significant upfront resource investment required by the Government to comprehensively review and amend or repeal the Franchising and Oil Codes respectively.</p>

**Problem 7.2: Compliance with the Franchising Code, Oil Code and where relevant the Competition and Consumer Act and the Australian Consumer Law, remains imperfect**

Industry participants operating under the Franchising and Oil Codes must comply with these codes as well as the obligations set out in the CCA and the ACL. Evidence submitted to the PJC indicates that there is in many cases a low level of consideration of the consequences for failing to comply with the Codes. While the PJC found clear evidence of a range of misconduct in the franchising sector, compliance with the Oil Code is generally considered good.

Non-compliance undermines the intent of industry codes to raise standards of business conduct by guarding against misconduct and opportunistic behaviour. Codes are also designed to complement the objectives of the CCA and the ACL to enhance the welfare of Australians through the promotion of competition and fair trading. The PJC heard evidence of how misconduct in the sector can harm small business, stifle competition and can have costs for consumers.

Submissions to the PJC indicated that some parties in the franchising sector may factor the cost of penalties into their cost of doing business, indicating that the current penalties do not encourage compliance.

In 2014, the Government amended the CCA to allow civil pecuniary penalties and infringement notices to be imposed for breaches of an industry code. There are currently 24 instances where civil pecuniary penalties are applied in the Franchising Code. There are no civil penalties for breaches of the Oil Code.

The maximum penalty for breach of an industry code provision is 300 penalty units (currently \$63,000). These amendments also allowed for the ACCC to issue infringement notices where it has reasonable grounds to believe a person (or body corporate) has contravened a civil penalty provision of an industry code. Infringement notice amounts are 50 penalty units (currently \$10,500) for a body corporate and 10 penalty units (currently \$2,100) in any other case.

The ACCC is responsible for enforcement of the Franchising Code. In the past two decades, in regards to franchising, the ACCC has litigated 34 matters and has accepted 17 court enforceable undertakings. Three infringement notices have also been issued and paid since 2015.

Some stakeholders suggested that the scope and quantum of penalties for breaches of the Franchising Code may not encourage compliance. Penalties in the Oil Code may encourage reporting of misconduct, although evidence suggests that compliance with the Oil Code is generally high.

Against this context, the Franchising Taskforce is also mindful of and considering PJC Recommendation 5.2 regarding reports and updates on the effectiveness of regulatory settings.

<b>Options to address problem 7.2: Compliance with the Franchising Code, Oil Code and where relevant the CCA and ACL remains imperfect</b>	
<b>Option</b>	<b>Description</b>
Option 7.2.1	<b>Status quo</b> Under this option, the status quo would be maintained.
Option 7.2.2	<b>Application and enhancement of civil penalties to all breaches of the Franchising and Oil Codes</b> Under this option, civil penalties would be applied to all breaches of the Franchising and Oil Codes, the maximum available penalties would be increased (Recommendation 16.1), and civil penalties would also be

Option	Description
	<p>introduced for non-compliance with ACCC compulsory information gathering notices (Recommendation 6.15).</p> <p>Stakeholders have submitted that the prospect of higher penalties could encourage greater compliance with the Franchising and Oil Codes. Although, the strength of this incentive would depend on the level at which penalties are set and the likelihood of enforcement. Note, stakeholders have not raised concern about the levels of compliance with the Oil Code.</p>
Option 7.2.3	<p><b>Improved education and guidance on expectations around compliance with the code</b></p> <p>Under this option, more communication and guidance would be provided by government to identified sectors of the industry that could improve their compliance with the Franchising and Oil Codes. This information would also clearly identify actions and penalties that may result from non-compliance with the codes and relevant sections of the CCA.</p> <p>Stakeholders have submitted that further guidance and promotion of the ACCC's role in improving compliance, such as the programme of compliance checks, could promote expectations to industry about behaviour that is considered to be misconduct.</p>

## Questions

16. What are the implications of amending the Oil Code of Conduct to increase the number of common provisions between the Oil and Franchising Codes? What would be the costs and benefits of this approach?
17. What are the implications of repealing the Oil Code of Conduct and adding specific fuel retailing provisions to the Franchising Code?