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### **Changes to the Franchising Code: November 2020**

The proposed amendments and all 3 versions of the mock-up Key Facts further mislead prospective franchisees into thinking that franchising is a safe, profitable alternative to independent business ownership. This is often not the case.

Australia has over 80,000 franchisees who have in some cases invested over \$1million. It has about 1200 franchisors who control the systems these franchisees buy into. Some but not all franchisors are honest, competent and operating within the law.

I attach an article by a prominent American legal economist that I encourage everyone involved in setting franchise policy to read. Gillian K Hadfield ‘Problematic Relations: Franchising and the Law of Incomplete Contracts’ (1990) 42 *Stanford Law Review* 927. The causes of inequalities in the relationship between franchisors and franchisees are clearly explained in this article. They can never be resolved by repeatedly tweaking the Code.

Once the franchisor has the franchisees’ money and signatures on contracts and franchisees have invested sunk costs the franchisor can amend the system, sell its business to a buyer that does not understand franchising, and conduct its own affairs without regard to the impact of those activities on the profitability of franchisees. The inequalities can never be resolved either by the franchisor representative body becoming more inclusive of franchisees. Inevitably the franchisor representative body will favour the interests of franchisors over those of franchisees when the numerous conflicts of interest inherent in franchising arise.

The relationship will only become more balanced, less capable of being exploitative when franchisees are granted recognition as a form of investor under the Corporations Act. The Code, sitting under the Competition and Consumer Act, can never do the job alone. Fundamental reform is needed.

I will leave the drafting inconsistencies to people who act for parties that will need to comply.

I make the following comments on the **EXPOSURE DRAFT**. I will focus on the proposed changes that fall short of curtailing the most egregious franchisor behaviour. I will leave it to others to comment on the incremental improvements that the revisions offer.

<b>Clause/sub-clause</b>	<b>Problem</b>
<b>4A ASBFEO</b>	The functions of ASBFEO should be expanded to include responsibility for forming, hosting and managing the proposed public register of franchisors. This would emulate the model in California, Minnesota and Wisconsin, and in several other foreign jurisdictions.

	Creating and hosting of this register should not, under any circumstances, be outsourced to the private sector.
<b>Schedule 1 – Dispute resolution</b>	There should be an explicit statement that the franchisor may not include a prohibition against multi-party dispute resolution in the franchise agreement. This is essential because it is common for US franchise agreements to forbid franchisees from engaging in multi-party dispute resolution/ class actions of any kind, including class action arbitration.
<b>40B (2)</b>	‘in the same way’ ... This is ambiguous and open to abuse by a franchisor that wants to avoid a multi-party dispute. They can claim to be adhering to the letter of the law if, for example, they agree to mediate/ conciliate/ arbitrate with all franchisees, (ie: ‘in the same way’), not as a class, but separately.
<b>40A (3) and (4), 40B (3) (4), 41A (1)</b>	Some multi-party disputes are conducted using more than one ‘ADR practitioner’ so this needs to be acknowledged. If there are 60 franchisees in dispute with one franchisor then it is likely that 2 or more ADR practitioners will work together to enable all parties to be heard.
<b>Schedule 2 - Disclosure</b>	Tinkering with Disclosure will just place a greater compliance burden on franchisors, without providing better security for franchisees. Franchisees’ investments will not become better protected until changes are made to legal and operational matters that occur well after initial disclosure.
<b>2, subclause 9(1) of Schedule 1. New (1) (e)(ii) and (iv)</b>	Franchisors often take head leases. They do not always sub lease to franchisees. They also <u>licence</u> franchisees to occupy premises, or the <u>franchisees may occupy without any form of contractual tenure</u> . The sub clause should not be restricted to sub leases but should oblige the franchisor to provide to the relevant franchisee a copy of the executed head lease, and any disclosure that was provided to the franchisor to comply with state/territory leasing legislation, regardless of the tenure it grants to the franchisee. See: J. Buchan and B. Butcher, ‘Premises occupancy models for franchised retail businesses in Australia: factors for consideration’ (2009) 17.2 <i>Australian Property Law Journal</i> 143.
<b>13, insert 17B.2</b>	Not all franchisors are honest, law-abiding and solvent. <u>Franchisees need explicit termination rights</u> that mirror all of the franchisor’s termination rights. They also need the right to require the franchisor to buy back stock and to release franchisees from franchisor-related leases (eg: premises and shop fittings) if the franchisor ceases to be able to provide goods or services as a franchisor.
<b>Annexure 2 – Information statement</b>	<b>Due diligence -</b> Franchisees buying into a system whose franchisor / master franchisee

	<p>is an <b>Exempt Proprietary Company</b> (EPC) under the <i>Corporations Act</i> CANNOT conduct due diligence on that entity. It is impossible. EPC status means the franchisor has not had to file annual returns with ASIC since the early 1990s. Operating as a franchisor should automatically mean the franchisor's entity becomes disqualified from the EPC status.</p> <p>Nor can franchisees whose franchisor includes a <b>trust</b> conduct due diligence beyond the identity of the trustee/s. It is also impossible.</p> <p><b>And add, under due diligence, advice that prospective franchisees should</b></p> <ul style="list-style-type: none"> <li>• <b>Search</b> - the product or service that the franchisor sells, and all of the people who are involved in the franchisor on the internet.</li> </ul>
<b>Annexure 2 – Information statement</b>	<b>Consider other options</b> – why not also direct people to consider a non-franchised business?
<b>Annexure 2 – Information statement</b>	As a result, you <del>may</del> will be limited ... (Replace may with will)
<b>Annexure 2 – Information statement</b>	<p>'To be successful you need to have a good relationship with the franchisor.'</p> <p>This is patronising. It's very difficult for franchisees to 'have a good relationship' with a franchisor who is appalling.</p> <p>More important is that</p> <p>'The franchisor needs to be committed to the success of the franchise brand and its franchisees'. Good franchisors are.</p>
<b>The risks of franchising</b>	<p>It is great to identify churning and burning but if the franchisee can't find out it exists in the particular system (confidential ADR with no public record), and won't receive compensation when it becomes apparent, the warnings are hollow.</p> <p>Add the following risk:</p> <p>Some franchisors fail. You should get accounting and legal advice about what would happen to:</p> <ul style="list-style-type: none"> <li>• your business</li> <li>• your obligations under the franchise agreement</li> <li>• your obligations under contracts other than the franchise agreement (eg: sub-lease)</li> <li>• the unspent money you have paid to the marketing fund if the franchisor (or your master franchisee) enters administration or is wound up insolvent.</li> </ul>
<b>What you should find out</b>	<p>Whether you will have a sole and exclusive territory ... (ie: if the system operates using territories can the franchisor compete with you in any way?)</p> <p>Whether the franchisor can terminate the agreement ...? If they can, what compensation the franchisor must pay you. eg: if you buy a 5 year right and they terminate after 2 years, do you get 2/5 of your</p>

	<p>initial franchise fee back automatically? Or do you get nothing?</p> <p>Whether you can terminate the agreement if the franchisor does not deliver, or commits a crime or an administrator is appointed to the franchisor?</p> <p>What information franchisees in the system can access in relation to the franchisor's financial status.</p>
<p><b>What you should find out</b></p>	<p>Marketing funds –</p> <p>To write ‘Whether you will be entitled to a share of any cooperative funds you have been paying into, such as marketing funds, if the franchisor becomes insolvent’ is misleading because you will not be unless the fund is held in trust.</p> <p>Problems -</p> <ul style="list-style-type: none"> <li>• ‘The ACCC received 49 complaints [in the period 2009 – 13] about how franchisors are spending marketing funds’. (ACCC, submission to the Wein Review of the Franchising Code of Conduct, 2013)</li> <li>• ‘Contributions to marketing funds from individual franchisees should be <b>held on trust</b> for franchisees ..., with the franchisor to have wide discretion as to how to expend the funds’ (Wein Review, Recommendation 8(b), p 57) – not adopted.</li> <li>• The opaqueness of franchise marketing funds and the consequential franchisor opportunism in relation to how these funds are accounted for to franchisees, and spent were recurrent themes in the 2018 PJC review into ‘Fairness in Franchising’</li> </ul> <p>What Mr Wein had predicted came to pass in 2019 <i>In the matter of Stay in Bed Milk &amp; Bread Pty Ltd (In Liq) [2019] VSC 181</i></p> <p>Issue - Could the \$789,391 marketing fund be returned to the 91 franchisees that had paid into it, (and presumably the franchisor if it had contributed) or could the Commonwealth access it for the franchisor's 259 employees who were owed \$4,263,654 in outstanding entitlements.</p> <p>Held -</p> <ul style="list-style-type: none"> <li>• because the marketing funds were not held in trust, the franchisees who had paid into the fund had no right to get their unspent marketing funds back.</li> <li>• the money was deemed to be an asset of the franchisor and was available to fund the shortfall of wages and entitlements owing to the franchisor's employees and was thus payable to the Commonwealth under the FEG scheme.</li> </ul>
<p><b>What you should find out</b></p>	<p>How many confidential disputes via ADR the franchisor has engaged in in the previous 24 months?</p> <p>How many franchisees were involved in these disputes?</p>
<p><b>Schedule 3 – Termination cl 2 (1)</b></p>	<p>This right should apply to both franchisees <b>and franchisors</b> – as recommended by the PJC</p>

<b>Cooling off</b>	
<b>Schedule 3 ... cl 2 (1) (b) and (c)</b>	are incomplete. ... or right ...?
<b>CI 29</b>	The franchisee should have mirror rights to terminate the franchise agreement if the franchisor does any of the things identified in CI 29 (1) - not all franchisors are competent business operators or saints.
<b>Schedule 5 Clause 15 (1) and 15 (2) and 31 (2)</b>	See above re Marketing funds – it is imperative that the franchise agreement state these are held ON TRUST for all who have paid into them. This means that when a franchisor becomes insolvent the money can be returned to the franchisees, and the franchisor on a pro rata basis. The annual financial statement and any audit of the fund must be presented <u>per brand</u> if the franchisor controls more than one franchised brand – not just lumped in together because there is one franchisor. If presented on a per franchisor basis, which is what sometimes happens, it is meaningless for franchisees of the individual brands of a group like Retail Food Group that is franchisor of several brands.

Regards



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