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Submission on Franchise Disclosure Register Exposure Draft

Overview

The Franchise Council of Australia (FCA) appreciates the opportunity to provide input to the development of the Franchise Disclosure Register. The FCA is the sector's peak industry body, representing over 400 member businesses including franchisors, franchisees and advisers to the sector. In preparing this submission, the FCA has consulted the views of franchisors, franchisees and legal advisers on a range of issues.

The FCA supports efforts to provide clearer information and improved resources for prospective franchisees that will assist them to make an informed decision about whether purchasing a franchise business is the right decision for them. The FCA also supports initiatives that provide improved data on the franchise sector to assist government, community and business to better understand the sector.

The FCA fields regular requests for information and assistance from prospective franchisees and provides a range of education and best practice resources. The FCA has prepared and published a free resource; *The Franchisee's Guide*, which provides a simple and clear checklist of due diligence considerations and information, for prospective franchisees to consider.

The FCA strongly recommends prospective franchisees engage professional advice before looking to purchase a business, and engage legal and financial advice from accredited professionals practicing in the area of franchising as their field of expertise.

As part of its Response to the 2018 Parliamentary Inquiry into the Franchising Code of Conduct, the Federal Government announced the establishment of a Franchise Register, and subsequently designated \$4.3 million for its establishment in the 2021 Federal Budget.

According to the Government's stated objectives:

The Register will assist prospective franchisees to make an informed decision before entering a franchise agreement.

Primary considerations

There are a number of serious unintended consequences that must be better addressed in the development of the Register.

- The objective is to give information to prospective franchisees. This is variously stated in the supporting documents as to "assist prospective franchisees to make an informed decision before entering a franchise agreement", to "motivate high quality of disclosure practices, improving the comparability and symmetry of franchising information", to "enhance the ability of prospective franchisees to make informed decisions about franchise systems that they are considering purchasing, by enabling them to easily compare information about different franchise systems".
- The Register should in no way compel a franchisor to have to disclose any confidential or commercially sensitive information. Before a franchisor provides a disclosure document or sample franchisee information, the vast majority of franchisors require a confidentiality agreement and/or non disclosure agreement to be signed. This is a legally enforceable document so as to protect a franchisor's confidential information or commercially sensitive information being misused and disseminated into the public domain. While self-evident, it is necessary to emphasise that the Government should not introduce any legislation which has the effect of putting a franchisor's confidential information or commercially sensitive information into the public domain under the guise of a publicly available Register.
- Obligations which do not support that objective should be seriously questioned, particularly where they introduce the real and present danger of anti-competitive behaviour and potential for an abuse of market power by non-franchised competitors.
- Additional red tape which is unnecessary to support that objective. The Explanatory Statement states that the Register will not impose "undue burden upon the sector". A number of the features of the Register run counter to the Federal Government's overall stated ambitions to reduce red tape.
- Unintended consequences of anti-competitive outcomes of the Franchise Register in requiring the provision of information on rebates, supplier details, marketing fund expense details, earning information and franchisor financial reports, etc when non-franchised competitors are not required to publicly do so.
- The objective to give information to prospective franchisees and "assist prospective franchisees to make an informed decision before entering a franchise agreement" is not met by providing the disclosure document and would be better serviced by using the Key Fact Sheet (which was intended to simplify information for franchisees) or a registration form with key high-level comparisons.

- A franchisor should be entitled to redact confidential and commercially sensitive information beyond just the personal information of franchisees and details of rebate percentage.

There are reoccurring concerns that have been raised with the FCA by both franchisees and franchisors seeking clarification from the Government, which include:

- i) What other information might be included on the register – there is significant concern about non-franchised competitors using commercially sensitive information to gain a competitive advantage over a franchised business.
- ii) Is the information to be redacted from the disclosure document appropriate – franchisees are particularly concerned about their personal information being published.
- iii) Complications using the MyGovID portal, or practicality of it in terms of use by franchisors.
- iv) The implication that because the Government is auspicing the Register, there is an inferred endorsement of a franchise brand featured on the Register.
- v) Cyber Security threats, including from foreign agent hacking attacks.

Response to key issues arising from the Exposure Draft

Item	Information	Reasoning
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8.1	<p>Details of the franchisor's intellectual property, registration status, and details of any agreement that impacts the franchisor's right to use or give others the right to use IP.</p>	<p>For some franchise systems this information could be highly confidential. In the hands of competitors, the information would be open to abuse, to the detriment of a franchise system. This unfairly prejudices franchise systems that compete against no-franchised systems, which are often large corporations. Ultimately, this would diminish the shareholder wealth of existing franchisees in that system by devaluing their business. Prospective franchisees are not disadvantaged by redaction as they can access the redacted information separately as part of normal Code disclosure, provided in a confidential and secure environment.</p> <p>A common theme throughout the 2018 Joint Parliamentary Inquiry into the Franchising Code of Conduct was that large volumes of information was often not read by prospective franchisees. In this vein, the Key Fact Sheet would actually be of more assistance in providing clearer, better information that would be more likely to be read properly by a prospective franchisee than a lengthier and more cumbersome document like a disclosure document.</p> <p>The FCA has been assisting many franchisees who applied for state government COVID hardship grants and were unsuccessful because they did not meet the relevant ANZIC code requirements. Based on their financial data and the sector they were operating in (such as food retail), these franchisees should have been unequivocally eligible, but for outdated ANZIC codes. The same concern applies in this instance about the need to review and update ANZIC codes to ensure they reflect contemporary industry and business developments.</p>
10.1(k)	<p>Nature of rebates or financial benefits received from every supplier and the name of every supplier. (Proposed Code amendments already allow redaction of the % rebate calculation under 10.1(k)(iii).)</p>	<p>Highly confidential information that places franchise systems at a substantial competitive disadvantage to competing nonfranchised networks. Franchisees and prospective franchisees are not disadvantaged by redaction as they can access the redacted information separately as part of normal Code disclosure, provided in a confidential and secure environment. Of key concern to the FCA are:</p> <ul style="list-style-type: none"> • Supplier details/ details with a third party supplier should remain confidential. • The fact of rebates being disclosed at all seriously put at risk a fair and open market • Anti-competitive and commercial disadvantage are major concerns across these areas

		<ul style="list-style-type: none"> • How is this information of benefit to a prospective franchisee at this stage of their business research? • Has the ACCC been asked for its view on the potential for anti-competitive behaviour by nonfranchised competitors?
10.1(m)	The method for working out how rebates are shared amongst members of a franchise network, and a description of each direct or indirect benefit received by the franchisee.	Competitors will have access to this information, which they can use to the disadvantage of franchise systems in negotiations with suppliers. Franchisees and prospective franchisees are not disadvantaged by redaction as they can access the redacted information separately as part of normal Code disclosure, provided in a confidential and secure environment.
11	Restrictions on the goods or services franchisee may supply, to whom and whether they must supply the whole range.	This information is clearly relevant to a franchisee or prospective franchisee, but is available to a franchisee or prospective franchisee in un-redacted form as part of normal franchise disclosure. However, for some franchise systems the information could easily be used to the detriment of a franchisee by its competitors. It could also be used by competitors of the franchise system itself. For example a competitor of a real estate franchisee could conduct a marketing campaign that focused on the limitations of a franchisee's rights, unfairly prejudicing that franchisee.
12	Details of online sales, including profit sharing with franchisees.	Non-franchised networks do not have to publicly disclose their online strategy, or the details of the arrangements that apply to those involved in online sales. Although this information is relevant to a franchisee or prospective franchisee, it is available to a franchisee or prospective franchisee in un-redacted form as part of normal franchise disclosure.
14.3 – 14.10	Details of all establishment and operating costs, including real estate, equipment, inventory, security deposit and working capital in extensive detail.	This important information for prospective franchisees is highly confidential and market sensitive for most franchise systems. If redaction of sensitive information is not permitted, franchisors may reduce the quality of information provided to prospective franchisees, knowing it is likely to end up in the hands of competitors or others who can use it to the detriment of the franchise system. This cuts across the fundamental purpose of disclosure. It is much better to encourage franchisors to make detailed and specific disclosure, but allow it to be redacted in publicly available information. A prime example is supermarkets, which already copy retail concepts in areas such as bakery, delicatessen, food retail and coffee. In this instance they will have specific confidential information available to them in a way that gives them additional unfair advantage.

15	Marketing fund information.	<p>In most cases franchisors can provide this information without major concern. However, a small number of franchise systems would regard this information as highly confidential. For example, some cooperatives and buying funds. Key points to this are:</p> <ul style="list-style-type: none"> • Anti-competitive – expense detail that shouldn't be public. • Franchisees should know whether they would be making a contribution and where applicable the amount.
20	Earnings information.	<p>There seems no justification for providing earnings information publicly. Noting the proposed amendments already allow some redaction, the right to redact should be extended to any earnings information that is confidential and commercially sensitive.</p> <p>This should be removed, with the exclusion only about existing sites or existing franchisees.</p>
21.1	Solvency statement to be provided.	<p>Providing an assurance of solvency in the context of the signing of a franchise agreement is one thing. However, it is quite another to require this to be done in a publicly available document, that can then potentially be misused by third parties or others who might claim to have relied upon it. This is an unreasonable extension of potential third party liability.</p>
21.2	Financial reports for the franchisor for the past 2 years.	<p>This cuts across reporting obligations of exempt proprietary companies under the Corporations Act, and provides highly sensitive information to the general public. Again, this disadvantages small businesses trying to compete against larger or non-franchised businesses. The FCA has major concerns about the anti-competitive nature of this proposed requirement.</p>

Clause 53 – specific recommendations

- Clause 53B(2)(a) appears to be narrow, and indeed the actual scenario provided is unrealistic. Presumably, the Secretary would need broader discretion to remove information, and should not have to rely on an unlikely request from a franchisor that has ceased to exist.
- Clause 53B(3) gives the Secretary the power to remove a disclosure document from the Register. The better option may be to require the Secretary to issue a notice to the franchisor requiring the franchisor to show cause within say 14 days as to why the disclosure document should not be removed. In most cases this will prompt the franchisor to either upload an updated disclosure document or provide the

information under section 53F. There also ought to be a fetter on the power of the Secretary, such that it will only be exercised where the show cause notice was not addressed.

- Clause 53C(1) - The unintended consequence is that a franchisor who is marketing franchises but may not have yet given a copy of its disclosure document to a franchisee or prospective franchisee, will not have to comply with section 53C. This would be easily rectified by adding the words “, or proposes to give,” after “the franchisor has given” in paragraph (a) of subsection 53C(1).
- Clauses 53C(4) and 53D(4) require that the franchisor must redact “any personal information that relates to an individual that is included in the document”. It would be useful if this section specified exactly what needed to be redacted, so there can be no ambiguity.
- Clause 53C(5)(b) should be amended to read “given to a franchisee under subclause 17(3)”. Otherwise the Secretary has the power to require a franchisor to include things on the Register that go well beyond the intended purpose of the Register such as:
 - a copy of a franchise agreement (as required under clause 9(1A)(a) of the Code)
 - a copy of the Code (as required under clause 9(1A)(d) of the Code)
 - specific leasing information (as required under clause 9(1A)(e) of the Code)
 - the information statement (as required under clause 11 of the Code)
 - leasing documents (as required under clause 13 of the Code)
 - other agreements (as required under clause 14 of the Code)
 - financial statements for marketing funds or other cooperative funds (as required under clause 15 of the Code)
 - end of term notifications (as required under clauses 18 and 47 of the Code)

Whilst one would expect that the Secretary will not request these types of documents to be included on the Register, the risk of this occurring can be alleviated by making the amendment suggested above.

Broader observations

1. Substantial funding needs to be made available to promote awareness. Otherwise the Register will be invisible and irrelevant. The Government needs to carefully consider how it engages with prospective franchisees. This means engaging with organisations and existing initiatives that play a constructive and meaningful role in assisting and supporting franchisees. As the only not for profit organisation in the franchise sector that provides prospective and current franchisees with information, education and training advice and support, the FCA has a key role to play here. There are other existing initiatives, such as the Franchising and Business Opportunities Expos, which run yearly across Australia and are endorsed by the FCA. These events showcase information as well as interactive demonstrations on training and operating a range of franchise brands. Most importantly, they engage with a large number of actively interested prospective franchisees that are the target audience for the Franchise Disclosure Register.
2. A franchisor should be entitled to redact confidential information beyond just the personal information of franchisees and details of rebate percentages under Item 10.1(k)(iii). As the register will be publicly available at no charge, there are other sensitive items that

could be considered confidential. Franchisees are able to get access to the un-redacted information from the franchisor, so there is no prejudice to a prospective franchisee or franchisee. The FCA recommends that the franchisor should be able to redact information if it is confidential and commercially sensitive, provided the franchisor notes what has been redacted and provides reasoning for the redaction.

3. The disclosure obligation should make clear that other documents required to be provided with the disclosure document, such as a copy of the franchise agreement, any leases and other agreements, do not need to be provided.
4. Some requirement should exist for the Government to monitor use and access. This will hold the Government accountable for ensuring the Register is actually used by prospective franchisees, and not just by competitors and other third parties for commercial purposes. Registering a user's email address may be sufficient enough to monitor any potential market or competitive abuses of the Register.
5. Concerns have been raised about the searchability function; specifically that it would be better achieved by a more detailed collection of information that can be taken on the profile page at the start so that information can be compared across systems easily.

Penalties

It seems overly harsh and unreasonable to apply a pecuniary penalty of 600 penalty units to a breach of clauses 53C(2), 53D(2) and 53E(2) in circumstances where a franchisor is reliant on technology and systems outside the franchisor's control.

There is similar concern at the application of a pecuniary penalty of 600 penalty units for breach of clause 53F. These amounts are far in excess of the penalties applying to failure to lodge company documents under other legislation, such as the Corporations Act.

The Code already provides for substantial pecuniary penalties for failure to prepare or update a disclosure document, being what many would consider to be substantive breaches of the Code. The penalties under clauses 53C, 53D, 53E and 53F are more analogous to penalties for failure to lodge documents, and arguably a duplication of the substantive penalties.

Transitional provisions

There appears to be no transitional provisions. The way the exposure draft presents is that every franchise business needs to appear on the Register, even if they are not actively granting franchises at that current time.

In the exposure draft, the current requirement is that franchisors must upload their documents by 31 October each year ('the Period'). This does not make practical sense given that franchisors

have up to 31 October to amend their disclosure. The date for uploading should actually be after that Period has expired not the last day of the Period.

There may be a situation where franchisors are uploading at the last minute for a variety of reasons, for example they get their financial statement on 31 October.

There is no cogent reason to make it 31 October given that prospective franchisees (that wish to enter into an franchise agreement soon after the expiry of that period) will receive the new disclosure regardless. For these reasons we recommend that the timing be shifted to 14 days after the expiry of the Period.

The FCA provides similar feedback around updating for “material changes”. Fourteen days is inconsistent with other similar government requirements. For example, ASIC documents are required to be uploaded to government portals within a month.

The FCA trusts that its feedback and recommendations on the points above are taken in the spirit of ensuring the Register is most accurately able to meet its stated aims and objectives. The FCA would be pleased to provide additional details on any of the points above.