



Law Council  
OF AUSTRALIA

*Business Law Section*

**4 December 2020**

Department of Industry, Science, Energy and Resources  
Industry House, 10 Binara Street  
CANBERRA ACT 2600

By email: [SmallBusinessFranchising@industry.gov.au](mailto:SmallBusinessFranchising@industry.gov.au)

Dear Sir/Madam,

### **Exposure Draft of proposed changes to the Franchising Code of Conduct**

1. The Competition and Consumer Committee of the Business Law Section of the Law Council of Australia (the **Committee**) is pleased to make the following submissions on the proposed changes to the Franchising Code of Conduct (**Franchising Code or Code**) in response to the Fairness in Franchising Report March 2019.
2. The Committee welcomes the government's review of the Franchising Code, and the implementation of many of the recommendations made in the Exposure Draft. However, there are some issues that the Committee wishes to raise in relation to specific changes proposed.
3. The Committee notes that comments are sought only on the technical aspects of implementing the law, and that there is no intention for this process to reconsider the policy underpinning these reforms. Accordingly, we have not sought to revisit the broader policy concerns raised by the Committee in its submissions of 11 May 2018 and 20 September 2019. However, to the extent that certain concerns have not been addressed in the Code, the Committee continues to hold the concerns expressed in those submissions.
4. In preparing this submission, the Committee has also had regard to the Supporting Guide - Changes to the Franchising Code November 2020 (**Supporting Guide**)<sup>1</sup> and the Parliamentary Joint Committee on Corporations and Financial Services Report March 2019 (**Report**).<sup>2</sup>

### **Executive Summary**

5. This submission comments on the following issues, with reference to the clauses in the Exposure Draft where relevant:
  - (a) The proposed mock-ups of a "Key Facts Sheet", which summarise critical information in the franchisor's disclosure document.

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<sup>1</sup> Supporting Guide - Changes to the Franchising Code November 2020.

<sup>2</sup> Fairness in Franchising Report March 2019.

- (b) The provision of accurate earnings information, which is not specifically addressed in the Exposure Draft.
  - (c) The proposed extension to the cooling off period in clause 26A(2).
  - (d) New clauses 30A(3) and (4), which would require franchisors to discuss proposed capital expenditure with franchisees.
  - (e) The introduction of conciliation, mediation and arbitration as dispute resolution options in clauses 40A(3) and 43A.
  - (f) The detail of clause 26B(1) and its effects on ss (2) and (3), which outline the process for when franchisees wish to terminate the franchising agreement.
  - (g) A proposed new clause 31A(1) which prohibits franchisors from varying franchise agreements retrospectively and unilaterally.
6. Where appropriate, the Committee has recommended solutions to address these issues.

### **Ensuring franchisees are sufficiently well-informed**

#### **Key Facts Sheet**

7. The Department has provided three mock-ups of a "Key Facts Sheet" being an additional document to be provided to prospective franchisees to assist with understanding of the franchise documentation.
8. Committee questions, however, whether disclosure of this document will cause, at least some, prospective franchisees to rely on the Key Facts Sheet with the consequence that the disclosure document remains unread or only partially read. In this regard, the Committee refers to the findings in the Report including that: *"franchisees are unlikely to read disclosure documents in their entirety, and may not have a full understanding of the terms in the disclosure document and franchise agreement."*<sup>3</sup> While the intention of the document is to remedy that issue and simplify the process of the review of the disclosure document by identifying key clauses, there is, in the Committee's view, a risk that prospective franchisees will substitute review of the Key Facts Sheet for review of the disclosure document itself. This risk arises due to the volume of information provided to a prospective franchisee and because the Key Facts Sheet is said to summarise the most critical information in the franchisor's disclosure document.
9. In that respect, the Key Facts Sheet appears to set out information in the order the Department considers most critical (ie. litigation) to least critical (ie. earnings and financial information - this is discussed further below). However, the Committee's view is that a prospective franchisee should be notified early and well about the prospective earnings from a franchise, and such information is likely to be critical in the decision making process as to whether any agreement should be signed. For that reason, the Committee respectfully suggests that, if a Key Fact Sheet is to be provided to prospective franchisees it is arranged so that information essential to the

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<sup>3</sup> Fairness in Franchising Report March 2019, p 82.

decision making processes of a prospective franchisee is located at the start of the document (refer to section 0 below for further comments on this issue).

10. The Committee is of the view that mock-up 1 is to be preferred due to the inclusion of helpful tips for prospective franchisees which serve to assist franchisees in interpreting the disclosure documents and identify any legal and financial risks, subject to further comments on this topic as set out below. By way of one specific comment, the tip in mock-up 1 encouraging prospective franchisees to reach out to previous franchisees may result in those ex-franchisees becoming exposed to legal liability for misrepresentation or omission, albeit unintentional, which they have gratuitously provided to the prospective franchisee. A similar issue was raised in a previous submission by the Business Law Section.<sup>4</sup>
11. In the Committee's view, mock-up 1 and mock-up 2 are preferable to mock-up 3. This is because mock-up 3 relies on the franchisor summarising information in the disclosure document, which may be more burdensome on franchisors and lead to inconsistencies between the disclosure document and Key Facts Sheet. Given the reliance on the franchisor's discretion on how they summarise these issues and an incentive for franchisors to "paint" the franchise in any appealing manner, there is also a risk that a Key Fact Sheet which requires summarisation in the way contemplated in mock-up 3 will not highlight the most critical information from the disclosure document, as desired.<sup>5</sup>
12. Further, we recognise the Supporting Guide states that the Key Facts Sheet will only include information that is in the disclosure document. However, on its face, mock-up 3 is unclear as to whether the franchisor is to summarise material only from the disclosure document or whether additional information is required to be provided. Absent instructions for franchisors, the format of mock-up 3 may lead to confusion for franchisors about the information they are required to include. The Committee encourages consideration of drafting notes for franchisors in the Key Facts Sheet if mock-up 3 becomes the preferred option following consultation and review of the submissions.

### **Earnings information**

13. The Report notes the provision of accurate earnings information is particularly problematic and recommends that franchisors provide prospective franchisees with the prior two years' Business Activity Statements.<sup>6</sup> The Committee suggests that reference to the location of earnings information in the disclosure document appear towards the beginning of the Key Facts Sheet, rather than towards the end, see comments in paragraph 10 above.

### **Extension of cooling off period**

14. The Committee notes it has previously submitted that the existing cooling off periods are adequate - the real problem is that franchisees do not use the cooling off period for its intended purpose – namely to reflect on the wisdom of entering into the

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<sup>4</sup> Submission on the operation and effectiveness of the Franchising Code of Conduct, 11 May 2018.

<sup>5</sup> Supporting Guide - Changes to the Franchising Code November 2020, p 4.

<sup>6</sup> Fairness in Franchising Report March 2019, p 83.

franchise.<sup>7</sup> While the Committee supports the use of cooling off periods the Committee queries whether, as a matter of balance between the parties, the proposed extension of the cooling off period in clause 26A(2) properly addresses this issue or whether the issue is adequately addressed through the provision of an adequately framed Key Facts Sheet to prospective franchisees. On balance, the Committee respectfully proposes the view that the introduction of the Key Facts Sheet is sufficient to address the stated issue.

15. The extension of the cooling off period for franchise transfers creates practical difficulties if a franchisee exercises its cooling off right after the completion of a sale of business transaction between two franchisees. The proposed clause will require the exiting franchisee to step back into the business and the sale of business transaction (including payment of the sale price) to be unwound. The proposed clause will increase legal fees for vendor and purchaser franchisees and create complications in connection with third parties such as the franchisor, lessor and suppliers. The Committee proposes that the existing exception continues so that the cooling off rights do not apply in connection with franchise transfers.

### **Capital Expenditure**

16. The Committee agrees with the overarching objective of introducing appropriate constraints on the franchisor's ability to impose capital expenditure noted in the Report.<sup>8</sup> The Committee also notes clauses 30 and 30A in the Exposure Draft are intended to ensure greater transparency for franchisees in relation to their potential capital expenditure obligations, to assist them to assess their commercial and legal options.
17. However, the Committee questions whether the current drafting of new clauses 30A(3) and (4), which requires the franchisor and franchisee to "discuss the expenditure", is required if a franchisor is already obliged to disclose "as much information as practicable" about the expenditure in the disclosure document per s 30A(2).
18. The Committee is concerned that undocumented discussions between the franchisor and franchisee about matters of real significance to the franchisee may not give franchisees greater transparency about capital expenditure and could risk franchisors, advertently or inadvertently, providing misleading information to franchisees.
19. The Committee is of the view that it is preferable that the capital expenditure information in the disclosure document is brought to the prospective franchisee's attention in a documentary manner, such as via a specific section of the proposed Key Facts Sheet.
20. Moreover, we note the proposed deletion of clause 30(2)(e) from the Code, which currently allows franchisors to compel franchisees to provide capital expenditure that it considers to be necessary as capital investment, provided the franchisor gives a written statement to affected franchisees of:
  - (a) the rationale for making the investment;

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<sup>7</sup> Submission to develop the Government's response to the Fairness in Franchising Report of the Parliamentary Joint Committee on Corporations and Financial Services, 20 September 2019.

<sup>8</sup> Fairness in Franchising Report March 2019, p 297.

- (b) the amount of capital expenditure required;
  - (c) the anticipated outcomes and benefits; and
  - (d) the expected risks associated with making the investment.
21. The Committee is concerned that the removal of this clause will overly restrict the ability of franchisors to make important decisions which require capital expenditure by franchisees. This level of constraint on franchisor discretion will impact on franchisors' ability to manage and improve their systems, particularly where they have long term franchise agreements. This is likely to result in shorter term agreements (which is of detriment to franchisees), and make it harder for franchise systems to adapt as needed to remain competitive.

### **Rebates**

22. The Committee recognises the policy reason for proposing changes to the current obligations on franchisors to disclose rebates received from suppliers. However, there are many different franchise models operating in Australia, and some franchisors rely on the payment of rebates to reimburse the franchisor for the work undertaken in managing the supply chain.
23. The proposed changes to Item 10 of the Disclosure Document will have a significant financial impact on some businesses, increased compliance costs for franchisors and requires the disclosure of confidential, commercially sensitive supplier rebates which are likely to be otherwise subject to confidentiality obligations.
24. The Committee is of the view that this clause should be removed. In the alternative, if this additional disclosure obligation is retained, it should be revised to include a materiality threshold and also to include clarity in relation to the information to be disclosed. The current drafting does not make it clear whether exact amounts or percentages need to be shown by franchisors.

### **Providing fair, accessible and timely redress for franchisees**

#### **Dispute Resolution**

25. Clause 40A(3) of the Exposure Draft provides that if parties cannot agree how to resolve the dispute within 21 days, any party may refer the matter to an ADR practitioner for an ADR process under (a) a franchise agreement or (b) this Code. By definition, an ADR process is confined to conciliation or mediation.
26. Clause 43A of the Exposure Draft provides that the dispute between the parties may, by written agreement, be resolved in whole or part by arbitration.
27. While these provisions arguably evidence the Government's efforts, as noted in the Supporting Guide, to strengthen dispute resolution options in the Franchising Code by introducing conciliation and voluntary binding arbitration and in doing so, create more affordable dispute resolution options for the franchising sector, there is no provision under which a franchisee can compel a franchisor to participate in arbitration so as to generate a binding outcome for the parties.

28. Moreover, the Committee is of the view that the proposed dispute resolution amendments arguably do not go far enough to address a key concern outlined in the Report, despite the general good faith obligation in the Franchising Code<sup>9</sup>:

*Evidence to the inquiry included a litany of instances where the franchisee alleged the franchisor failed to engage in good faith in the mediation process, knowing that the only alternative was court action which was prohibitively expensive for the franchisee. Absent good faith, the mediation process fails by design. If all the issues are unable to be resolved satisfactorily through mediation, a determinative procedure such as arbitration is required.*

29. While the Committee appreciates that arbitration is more expensive than mediation because of the time and expertise required, it can deliver finality to parties who wish to resolve a matter. Arbitration is cheaper and more flexible than court action and this is important in any attempt to deliver a just outcome for both parties in a timely fashion.
30. Franchisors who could be compelled to engage in arbitration are more likely to be incentivised to avoid the costs and risks of arbitration, leading to a more open and constructive participation in conciliation and mediation processes. Absent compulsion, there is a risk that franchisors may continue to rely on franchisees withdrawing their concerns as they cannot afford to resolve them by way of court proceedings.
31. The Committee therefore recommends the inclusion of a mechanism for franchisees to request a binding arbitration process that does not require the consent from the franchisor. By way of example, the Food and Grocery Code of Conduct (**Grocery Code**) permits suppliers to seek either mediation or arbitration of a complaint or dispute relating to a matter covered by that code<sup>10</sup> and mandates that retailers and wholesalers must take part in these processes in good faith.<sup>11</sup> The Committee encourages consideration of the inclusion of a similar provision in the Code.

#### **Franchisee may propose termination at any time**

32. The Committee welcomes the inclusion of provisions that grant franchisees the right to exit franchise agreements under certain conditions. However, the Committee considers there is a risk that these provisions do not adequately balance the rights and obligations of franchisees and franchisors.
33. Clause 26B(1) of the Exposure Draft provides that a franchisee may give the franchisor a written proposal for termination of their franchising agreement on the terms specified in the proposal, **despite the agreement**. Clauses 26B(2) and (3) require that the franchisor must then provide a substantive written response within 28 days and provide reasons if they refuse the termination outright or on the proposed terms.
34. The Committee is concerned that the provision does not set out any requirements or guidelines for the franchisee's written proposal for termination. In particular, there is

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<sup>9</sup> Clause 6 of the Franchising Code of Conduct provides that "(1) Each party to a franchise agreement must act towards another party with good faith, within the meaning of the unwritten law from time to time, in respect of any matter arising under or in relation to: (a) the agreement; and (b) this code"

<sup>10</sup> Clause 38(1) of Schedule 1, Food and Grocery Code of Conduct.

<sup>11</sup> Clause 38(3) of Schedule 1, Food and Grocery Code of Conduct.

no minimum requirement for the level of detail, clarity or standard of reasonableness of the proposal. If the franchisee is not sufficiently clear in their proposal as to the grounds on which they seek to terminate the franchise agreement, it is not possible, and therefore unfair to expect, the franchisor to adequately fulfil their obligations under clauses 26B(2) and (3). Moreover, if the franchisee's proposal to terminate gives rise to a dispute, any dispute resolution process will likely be much more efficient and effective if both parties' positions are in a clear and written form from the outset.

35. The Committee is also concerned that this clause gives franchisees the right to circumvent the terms of the franchising agreement to which they agreed. A solution to this concern is to restrict the application of clause 26B to circumstances where a franchising agreement does not otherwise give franchisees the right to terminate for cause.
36. Another concern with this clause is that it does not take into account the interests of third parties such as landlords, financiers and suppliers. In a retail franchise, where the franchisor holds the head lease, the franchisor would be left holding the lease.
37. So as to strike an adequate balance between the parties, the Committee therefore recommends further details are included in this clause 26B to clarify the information the franchisee must include in their written proposal before providing it to the franchisor (including the impact of the proposed termination on third parties) and make it clear that the 28 days in which the franchisor must respond is only triggered once all the relevant information is provided by the franchisee. There should also be a limitation on the number of times this clause can be exercised by individual franchisees.

### **Doubling penalties**

38. The Committee notes that the ACCC's level of activity in investigating and taking enforcement action in relation to breaches of the Franchising Code is low. Since 2010, only 16 enforcement actions have been taken by the ACCC.<sup>12</sup>
39. The Committee recognises that doubling penalties goes some way to ensuring general deterrence. However, without a real and visible threat of enforcement, increased penalties alone may not go far enough to achieve the Government's goal of strengthening the enforcement framework.

### **Preventing unfair practices**

#### **Franchisors are not to vary franchise agreement retrospectively and unilaterally**

40. Clause 31A(1) provides that a franchisor must not vary a franchise agreement with retrospective effect without the consent of the franchisee. Subclause (2) states that (1) does not apply to a variation if: (a) 3 or more franchise agreements, including the agreement, each allow the franchisor to make the variation as described in subclause (1); and (b) a majority of the franchisees under those agreements consent to the making of the variation.
41. While the Supporting guide states that this provision is similar to an existing provision in the Food and Grocery Code,<sup>13</sup> in the Committee's view, there are some important

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<sup>12</sup> ACCC Franchising Investigations webpage, available at <https://www.accc.gov.au/business/industry-codes/franchising-code-of-conduct/franchising-investigations>.

<sup>13</sup> Supporting Guide - Changes to the Franchising Code November 2020, p 6.

distinctions between the two codes. Clauses 9 and 10 of the Grocery Code are more comprehensive in the protections offered to suppliers in relation to exceptions for unilateral variation with consent, including the need to consider:

- (a) the reasonableness of the variation in the circumstances;
- (b) that suppliers are given reasonable written notice of the variation, its terms and reasons for it; and
- (c) the benefits, costs and risks (if any) for both parties when determining the reasonableness of the variation in the circumstances.

42. The Committee considers that the inclusion of similar terms in the Franchising Code would afford greater protection for franchisees and more certainty to franchisors that some unilateral variations are permissible.

43. The Committee would be pleased to discuss this submission, if that would be helpful. Please contact Deputy Chair Lisa Huett at [Lisa.Huett@au.kwm.com](mailto:Lisa.Huett@au.kwm.com) or 03 9643 4163, in the first instance if you require further information or clarification.

Yours faithfully



**Greg Rodgers**  
**Chair, Business Law Section**